# TAJIKISTAN ECONOMIC UPDATE

## Focusing on Boosting Private Sector Dynamism in Tajikistan.

WORLD BANK GROUP

Summer 2023

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# ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| ACH | Automated Clearing House |
| ADB | Asian Development Bank |
| AML/CFT | Anti-Money Laundering/Combating the Financing of Terrorism |
| AMS | Antimonopoly Service under the Government |
| BIT | Bilateral Investment Treaty |
| BTI | Bertelsmann 'Stiftung's transformation index |
| CEM | World Bank Country Economic Memorandum |
| CIS | Commonwealth of Independent States |
| CPI | Consumer Price Index |
| DSA | Debt Sustainability Analysis |
| EBA-Lite | External Balance Assessment Lite |
| ECA | Europe and Central Asia |
| ECI | Economic Complexity Index |
| EIU | Economist Intelligence Unit |
| FCI GP | Finance, Competitiveness, and Innovation |
| FDI | Foreign Direct Investment |
| FEZ | Free Economic Zone |
| GDP | Gross Domestic Product |
| GNI | Gross National Income |
| GVC | Global Value Chains |
| HBS | Household Budget Survey |
| HPP | Hydro Power Plant |
| IDIF | Individuals' Deposit Insurance Fund |
| IFI | International Financial Institution |
| IIA | International Investment Agreement |
| ILO | International Labor Organization |
| IMF | International Monetary Fund |
| ISDS | Investor-State Dispute Settlement |
| L2T | Listening to Tajikistan |
| LMIC | Lower-Middle-Income Countries |
| MTI GP | Macroeconomic, Trade, and Investment Global Practice |
| NBT | National Bank of Tajikistan |
| NFIS | National Financial Inclusion Strategy |
| NPL | Nonperforming Loan |
| NTM | Non-tariff Measure |
| OECD | Organization for Economic Co-operation and Development |
| PMT | Proxy-Means Test |
| PPA | Power Purchasing Agreements |
| PPG | Public and Publicly Guaranteed |

| | |
|---|---|
| PPP | Purchasing Power Parity |
| REER | Real Effective Exchange Rate |
| RTGS | Real-Time Gross Settlement System |
| SCISPM | State Committee on Investment and State Property Management |
| SMEs | Small and Medium-sized Enterprises |
| SOE | State Owned Enterprises |
| SPS | Sanitary and Phytosanitary |
| SW | Single Window |
| TALCO | Tajik Aluminum Company |
| TBT | Technical Barriers to Trade |
| TEU | Tajikistan Economic Update |
| TIP | Treaties with Investment Provision |
| TSA | Targeted Social Assistance |
| UCTC | Unified Communication Transit Center |
| WBBPS | The World Bank Business Pulse Survey |
| WBES | The World Bank Enterprise Survey |
| WBG | World Bank Group |

# Acknowledgment

Tajikistan Economic Update (TEU) periodically analyzes economic developments, policies, and prospects. The team that prepared this edition was led by Bakhrom Ziyaev (Economist, MTI GP), Ilyas Sarsenov (Senior Economist, MTI GP), and consisted of Pietro Calice (Senior Financial Sector Economist, FCI GP), Alisher Rajabov (Senior Economist, POV GP), Chiyu Niu (Economist, POV GP), Anna Sukhova (Social Protection Specialist, SPJ GP), Julia Renee Roseman Norfleet (Consultant, ECA CE Office), Zuhro Qurbonova (World Bank Consultant), and Rashad Hasanov (World Bank Consultant).

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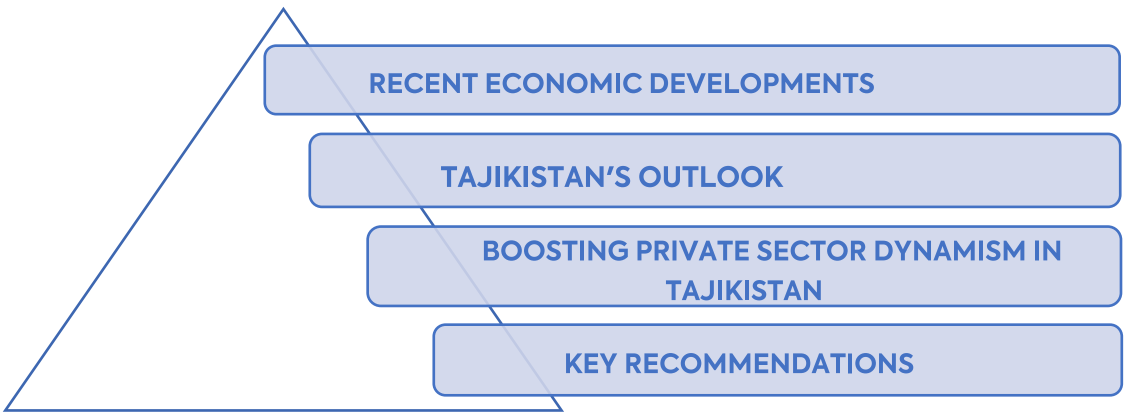
# EXECUTIVE SUMMARY




## RECENT ECONOMIC DEVELOPMENTS

In the midst of regional instability and global inflation, Tajikistan experienced remarkable economic growth and achieved a record low inflation rate in 2022. The country's economic activity flourished, thanks to the influx of remittances and the expansion of both services and industrial production. Real GDP expanded by 8 percent in 2022, following a recovery from the previous year. Tajikistan boasted the lowest inflation rate in the region, which was made possible by the implementation of a prudent monetary policy and a strengthened exchange rate. By the end of 2022, the consumer price inflation rate registered at 4.2 percent and continued to decline throughout the first half of 2023.

Tajikistan has successfully maintained a current account surplus for the third year in a row, achieving a historically high surplus of 15.6 percent of GDP in 2022. However, the trade deficit widened due to increased imports, while exports decreased as the government chose to retain more gold domestically. Fortunately, the country offset this deficit with remittance inflows, which amounted to approximately 50 percent of GDP. The mining industry attracted the majority of foreign direct investment. Additionally, international reserves have sharply increased and now provide coverage for over 9 months of imports.

While the financial sector significantly benefitted from strong financial flows and cross-border transfer operations, the sector remains vulnerable due to poor asset quality, high credit concentration, and elevated levels of dollarization. Nonperforming loans declined but still at elevated levels, and large exposures to state-owned enterprises pose risks. Access to finance, particularly for small and medium-sized enterprises, is hindered by an inefficient banking sector with limited competition and high collateral requirements.

Tajikistan has managed to reduce its overall fiscal deficit from over 3 percent in 2020 to around 1.2 percent in 2021-2022. This was achieved through a combination of measures such as expenditure restraint policies, increased development partner grants, and non-tax revenues. On the other hand, the adoption of a new tax code had a negative impact on tax revenues, which fell by 1.5 percent of GDP compared to pre-pandemic levels. Despite this setback, the government raised public sector wages and social payments, with a focus on capital investment in energy and transport sectors, particularly the Rogun hydropower plant (HPP). The volume of public debt declined from 46.5 percent of GDP in 2020 to 34.8 percent in 2022, thanks to robust economic growth and the appreciation of the Tajik somoni. However, Tajikistan is still at high risk of debt distress due to the repayment of Eurobond in 2025-2027.

In 2022, the poverty rate in Tajikistan decreased and many vulnerable households relied on labor migration as a significant source of income. The poverty rate fell to 13.4 percent under the international poverty line of US$ 3.65 (2017 PPP). Despite earlier forecasts, labor migration increased significantly with reports of one-third to one-half of households having at least one member working as a migrant abroad. Remittances have played a crucial role in reducing poverty in Tajikistan, with over 80 percent of remittances being used for food consumption and around 10 percent for other basic needs like healthcare, housing, and education.

Tajikistan's social assistance program is the smallest in the Europe and Central Asia region and reaches only about 15 percent of population. The authorities have recently launched the social assistance reform aimed at increasing benefit amounts and improving equity among the beneficiaries of social transfers, and better identification of poor households.

## TAJIKISTAN'S OUTLOOK

Tajikistan's growth prospects are not as strong as its recent performance record. The outlook for 2023 and the medium term is largely affected by uncertainty in the regional geopolitical environment, tightening global financial conditions, and continued weakness in accelerating structural reforms. Economic growth is forecast at 6.5 percent in 2023 and 4.5-5 percent over the medium term. The inflow of remittances is expected to normalize after the positive shock of 2022, and weakening global manufacturing is forecast to reduce demand for Tajikistan's major export commodities - metals and minerals. Inflation is expected to gradually rise toward the target band of National Bank's inflation targeting framework. Diminishing remittance flows and global monetary tightening may increase pressure on the exchange rate.

Tajikistan's external position is expected to remain in surplus in the coming years, with remittances normalizing from $5.2 billion in 2022 to around $3.6 billion in 2023. The trade balance will continue to record a large deficit, and imports are projected to decline due to lower consumption and declining global prices for food and fuel. The financing of the current account will be sourced through FDI inflows and development partners, though with limited prospects for FDI. Relatively high magnitude of international reserves provides a buffer to cope with external shocks.

Tajikistan's high risk of debt distress also requires medium-term fiscal discipline, thus constraining any significant hike in public investment programs. Absent significant shocks, the fiscal deficit is expected to be capped at 2.5 percent of GDP. The budgetary gap and financing of large-scale infrastructure projects including for Rogun HPP are expected to be sourced through grants and concessional loans. Public debt is projected to hover around 38-41 percent of GDP in the medium term.

The poverty rate is expected to decline in line with the GDP growth forecast and continued remittances flows from labor migrants. The baseline projections suggest that poverty in Tajikistan will further decline to 12.6 percent in 2023 under the international poverty line of US$ 3.65 (2017 PPP).

Risks to the outlook and structural weaknesses expose Tajikistan to external and internal shocks. If the Russia-Ukraine war lasts through 2023 and sanctions further intensify, a sharp decline in remittance inflows could weaken the banks' earnings, raise non-performing loans, and create currency depreciation pressure. Tajikistan may need to escalate social assistance transfers should migrants with dual Tajik-Russian citizenships decide to return due to pressures for military mobilization. High quasi-fiscal deficits of the state-owned enterprises and pressure to build the Rogun HPP create fiscal vulnerability. Tajikistan also remains highly sensitive to climate change and natural disaster shocks.

## BOOSTING PRIVATE SECTOR DYNAMISM IN TAJIKISTAN

Private sector participation in the Tajik economy is relatively large, but dynamism is very low. Analysis with micro-level data points to multiple weaknesses: low entry rate, low productivity, limited integration to trade, low incidence of innovation, and limited capabilities. Also revealing is that private firms struggle to grow as they age. All these aspects reflect a business environment that does not reward the more efficient firms or those with the highest growth potential. The Covid-19 effects brought additional challenges to this low-level equilibrium scenario with shocks in sales and financial distress. The silver line aspect stems from the increasing use of digital technologies. Still, the apparent digital divide regarding firm size poses questions on the real implications for future productivity performance. Against this backdrop, and to tackle the long-term weaknesses of the private sector in Tajikistan, it is crucial to remove barriers that prevent the reallocation of resources towards more productive firms so that the private sector becomes more efficient and able to generate more and better jobs. In this case, and to prioritize measures that maximize effects on aggregate demand in the short-medium-run, it is crucial to give precedence to structural policies that remove impediments to firm entry and expansion of the private sector. Three sets of barriers deserve particular attention: (i) barriers to competition, (ii) barriers to foreign direct investment, and (iii) trade barriers. These barriers must be tackled together because they all reinforce each other regarding firms' competitiveness.

**The state of market competition is weak in Tajikistan**. Most prominent challenges are due to limited enforcement of the competition law to curb anti competitive practices, excessive use of price controls, and incomplete mandate of state aid framework.

- The Competition Law has suboptimal rules and insufficient tools to identify and deter anticompetitive practices. Cartels are not considered unlawful per se, and the recent amendments in the Competition Law did not address this issue, potentially undermining competition in the market. The Antimonopoly Service (AMS) lacks the necessary tools to detect, sanction, and deter cartels due to constraints in conducting unannounced inspections. The definition and control of market dominance are restrictive, burdening private sector growth, and the merger control regime is lengthy and costly. Antitrust fines are insufficient to deter anti-competitive behavior, as they are poorly calibrated and not proportionate to the size and negative effects of the misconduct. Additionally, there are gaps in the institutional setup for independent enforcement, and limited human resources are allocated to addressing anti-competitive practices, with a significant focus on monitoring rather than enforcement actions.

- Tajikistan excessively uses price control mechanisms which poses risks to market competition. Dominant firms are prohibited from setting low prices without clear guidance on when high or low prices could be anti-competitive, potentially discouraging pro-competitive pricing behavior. While price controls are sometimes used to achieve policy objectives like social welfare or inflation control, artificially defined prices can distort market dynamics and discourage market entry and investment. Price controls are most effective in addressing specific market failures related to market power and lack of competition, such as natural monopolies or temporary market power due to external shocks.
- The incomplete mandate of state-aid control and insufficient enforcement in Tajikistan can have negative consequences for market functioning and competition. State aid, which includes various forms of support like tax exemptions, grants, and subsidies, is often intended to promote development goals but can lead to distortions in the market if not framed appropriately. In Tajikistan, significant state aid is provided through various instruments, favoring specific investors and sectors without transparent criteria. However, the enforcement of state aid control is weak due to unclear rules and procedures, resulting in no rejections of state aid proposals by the AMS.
- Barriers to competition in backbone sectors, such as telecommunications (telecom) and air transportation pose significant challenges for private sector development in Tajikistan. Development of the telecom sector is hindered by the absence of competitive neutrality and the existence of monopolistic practices. Sectoral regulations are insufficient (e.g., important regulations supporting the Electronic Communication Law are missing or not enforced) and opaque (e.g., regulatory mechanisms for the allocation of sparse resources, such as spectrum, or for accessing essential facilities, such as the fiber optic backbone). The sector governance is burdened by the lack of independence between the regulator and policymaker – Communications Service – that is de-facto in charge of the state-owned telecom company. Moreover, there are monopolistic tendencies in the national fixed connectivity segment and in the international connectivity segment, where all operators are obliged to "pass their incoming and originating traffics of the international services of electric communication and internet through a single switching center of electric communication of the state operator" referred to as the Unified Communication Transit Center (UCTC). In the air transportation sector, regulatory barriers like bilateral service agreements and the "Cost-Plus" pricing model for infrastructure services limit market access and efficiency.

**Tajikistan attracts low volume of foreign investments**. Most prominent challenges are due to limited capacity of investment promotion agency, burdensome investment entry and establishment procedures, incomplete investment protection framework, and insufficient design, administration, and transparency of incentives.

- Tajikistan's Investment Promotion Agency, TajInvest, faces limitations in its capacity and role as an investment promotion agency. While the country's institutional framework for investment policy is solid, TajInvest is just one of several contact points for foreign investors, leading to competing interests among different agencies. To strengthen TajInvest's role, it should be designated as the main contact point for all foreign investors and improve coordination with various government bodies. Additionally, TajInvest lacks a clear strategy for investment promotion that identifies target sectors and activities based on the state policy for attraction and protection of investment. The agency also needs to enhance its targeting efforts by identifying potential investors and creating a database.

- The entry and establishment procedures for foreign investment in Tajikistan are burdensome and require improvement. While Tajikistan is relatively open to foreign investment, certain sectors such as agriculture, forestry, media, and legal services have more stringent restrictions compared to OECD countries. The lack of a centralized source for information on entry restrictions and reserved sectors makes it difficult for potential investors to obtain reliable information. Business establishment procedures have undergone some reforms to reduce time, cost, and procedures, but challenges persist, including high costs, inadequate enforcement of licensing and inspections, and complex processes for business registration and closure. Tajikistan maintains a screening mechanism for FDI, which can be lengthy, non-transparent, and subject to personal connections, creating uncertainty for potential investors.

- The investment protection framework is incomplete and needs improvement. The country's legislation provides guarantees against expropriation and requisition, with protections for direct and indirect expropriation and the ability to convert payments related to investments into freely convertible currency. However, Tajikistan's international investment agreements (IIAs) are not aligned with good international practices and put the country at risk of costly investor-state dispute settlement (ISDS) cases. Dispute settlement issues exist in both domestic and international contexts, with challenges in contract enforcement and resolution in domestic courts. The lack of transparency, independence, and consistency in Tajikistan's judicial system hampers effective dispute resolution and raises the cost of doing business. Foreign investors also face difficulties in enforcing decisions of international tribunals, especially against state-owned enterprises. Establishing a formalized mechanism to address investor grievances could alleviate the burden on the court system and prevent investor-state disputes, benefiting both existing and potential investors.

- Tajikistan's incentive regime lacks design, administration, and transparency. The country has numerous incentives that need to be rationalized and aligned with national development priorities, with estimates ranging from 97 to over 200 incentives, many of which are not available in practice. Efforts are being made to clarify sectors eligible for incentives but it's important to ensure that all incentives, including non-tax incentives, are tailored to priority sectors. Procedural and legal reforms are needed to ensure that incentives are granted based on clear and transparent criteria and do not harm competition. Transparency can be improved by publishing up-to-date information on the types of incentives offered and creating a centralized registry of firms enjoying incentives. While investment agreements may be necessary in the short term to attract strategic investors, in the long run, a general regime applying to all investors should be considered to avoid complexities and potential claims of arbitrariness.

**Trade in Tajikistan faces many constraints imposed by geography as the country is landlocked and has a difficult topography that complicates shipments across borders and through neighbouring countries.** Most prominent challenges include pervasiveness of non-tariff measures (NTMs), underdeveloped logistics and transit supporting systems and burdensome regulations and procedures.

- Tajikistan's trade policies prioritize import substitution for the domestic market over exports, with low tariffs but high tariff escalation that protects domestic industries and creates an anti-export bias. NTMs are prevalent, particularly in the agricultural and natural resource sectors, imposing higher regulations compared to global and regional averages. Exporters face NTM requirements to foreign markets, affecting a significant portion of exports and potentially limiting the participation of smaller firms due to compliance costs. Additionally, the reliance on imported inputs by domestic firms is hindered by high input tariffs and NTMs, restricting productive and technological decisions.
- The underdeveloped logistics and transit supporting systems in Tajikistan pose challenges to trade and transportation. Customs escorts are still required for goods shipped within the country, increasing costs and causing delays. Access to international road transport permits is limited, favoring larger firms and creating obstacles for smaller ones. The lack of international status for certain border crossing points, such as Karamyk BCP, adds to travel time and distance for trade with China. The air logistics infrastructure, although equipped with a cargo terminal, remains underutilized due to the small domestic market and competition from neighboring countries like Uzbekistan. Efforts are needed to improve transparency in permit allocation, negotiate international status for border crossing points, and enhance the competitiveness of the Dushanbe air cargo terminal.
- Trade procedures in Tajikistan are burdensome, resulting in delays and high trading costs. The country lacks quality information technology infrastructure and relies on manual processes, leading to lengthy border crossing procedures and delays. For instance, exporting fresh fruits and vegetables requires numerous steps, the submission of multiple documents to different agencies, and costly permits. While some trade facilitation measures have been implemented, there is still room for improvement. Areas that require attention include information availability, border agency cooperation, simplification of documents, and automation of procedures. Efforts should also focus on reducing duplication of functions and improving collaboration among border control agencies. Streamlining licenses and permits, as well as expanding the reach of the Electronic Single Window, are necessary steps before further digitalization can take place.

## KEY RECOMMENDATIONS

The Tajik authorities could consider the recommendations summarized below to enhance the frameworks of macroeconomic management, the competitive environment, investment regulations and trade policies, and trade facilitation. However, given the narrow focus of the current exercise, the policy suggestions outlined below should not be seen as a comprehensive set of recommendations but rather regarded as a complement to other thematic reports of the World Bank, which also provide a specific list of recommendations.

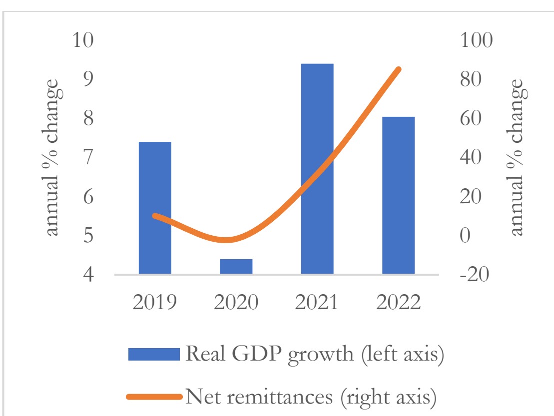
| | |
|---|---|
| 1. | Macroeconomic Management |
| 1.1. | Strengthen the macro- fiscal sustainability |
| 1.2. | Strengthen the monetary and exchange rate policies |
| 1.3. | Strengthen the financial stability and financial sector development |
| 1.4. | Invest in human capital development and encourage domestic labor mobility |
| 2. | Competition Framework |
| 2.1. | Strengthen the antitrust regime |
| 2.2. | Phase out pervasive price controls |
| 2.3. | Streamline the state aid control framework and its implementation |
| 2.4. | Remove competition barriers in the telecom sector |
| 2.5. | Remove competition barriers in the air transportation sector and improve safety oversight |
| 3. | Investment Framework |
| 3.1. | Strengthen the role and capacity of TajInvest |
| 3.2. | Streamline business entry and establishment procedures |
| 3.3. | Strengthen investment protection |
| 3.4. | Improve the design, administration, and transparency of incentives |
| 4. | Trade Policy and Trade Facilitation |
| 4.1. | Reduce trade policy barriers |
| 4.2. | Improve trade and transit-supporting services |
| 4.3. | Implement trade facilitation measures |

# RECENT ECONOMIC DEVELOPMENTS

## 1.1. Economic Growth

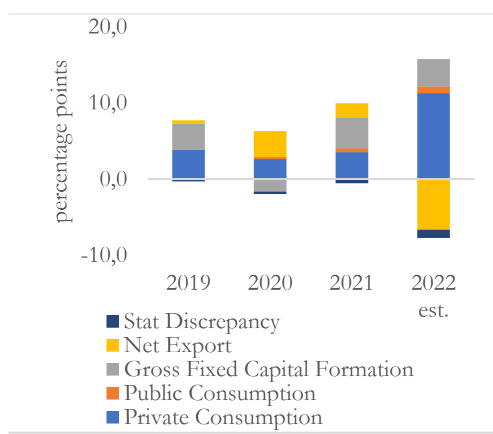
- **The Tajik economy grew by 8.0 percent in 2022, more than expected.** Strong GDP performance contrasted with earlier expectations shaped by regional instability and a high base effect from the post-COVID rebound of 2021. The adverse spillover effects from Russia's invasion of Ukraine did not materialize or were mitigated by offsetting positive impacts, as Tajikistan saw strong financial inflows that fueled household income growth and economy-wide liquidity. The economy benefited from Russia's strong labor demand[1] and appreciation of the Russian ruble – the main earning and transfer currency of labor migrants (fig. 1.1). An additional contribution to GDP growth came from investment. While externally co-financed development projects drove the growth of public investments in sectors such as energy, education, and transport, private investments concentrated primarily on the mining industry. The export volume normalized in 2022 after substantial inventory sales of precious metals in the preceding two years. Higher household incomes bolstered consumer imports, resulting in a net export decline (fig. 1.2).
- **According to preliminary estimates by Tajikistan's Statistical Agency (TajStat), economic activity has remained strong in the first quarter of 2023.** The economic activity index expanded by 8.2 percent year-on-year, supported by household consumption and investment growth.

Figure 1. 1. Remittances and GDP growth




Source: TajStat, NBT, and WB Staff estimates

Figure 1. 2. Composition of GDP growth by Expenditures




Source: TajStat and WB Staff estimates

- **Tajikistan reported a broad-based expansion of output across different sectors of the economy.** The services sector's contribution to GDP was the largest at 2.5 percentage points,

[1] Russia's invasion of Ukraine and military mobilization resulted in a massive exodus of Russian citizens causing labor supply shortages.

followed by industry at 2.4 percentage points and agriculture at 2.1 percentage points. The least contribution came from the construction sector at 1.0 percentage point (fig. 1.3).

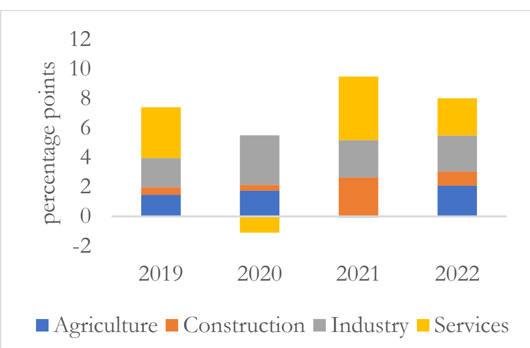
- **Following a significant rebound in 2021, the services sector continued to give a strong growth performance at 4.3 percent.** The relaxation of movement restrictions and opening of cross-country borders significantly[2] precipitated rapid growth in ground transportation of goods by 26,1 percent[3]. Related to this, wholesale and retail trade expanded by 11,2 percent. The growing demand from increased inflows of tourists, temporary military mobilization of immigrants, and household consumption also stimulated service activity. The number of foreign citizens that visited Tajikistan increased twofold, from 634.3 thousand in 2021 to 1151.9 thousand in 2022 (fig. 1.4).

- **Industry continued to grow rapidly, expanding by 15,4 percent in 2022.** New investments in mining and metallurgy, energy, food processing, and textiles drove the expansion. 2022 also saw significant growth in industrial enterprises, from 2,385 in 2021 to 2,795. Most operate in the manufacturing industry, accounting for 62 percent of total industrial output. This is followed by the extractives that account for 11 percent of industrial firms and 21 percent of total industrial output. Most other enterprises are engaged in energy and water.

- **After a slight decline in 2021, agricultural production rebounded by 8 percent in 2022, supported by favorable climatic conditions and expansion of the early sowing of spring crops.** The area allocated for the early sowing of spring crops increased by 5.8 percent to 19,538 hectares in 2022.

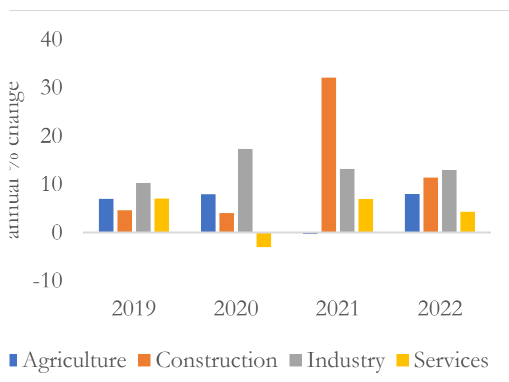
- **Continuing the construction boom that began in 2021, the sector grew by 11.4 percent in 2022**. This is driven by a hot real estate market, with housing market sales up 19 percent in real terms in 2022, as the fast-growing population, urbanization, and investment into property spur the development of both residential and commercial buildings, especially in Dushanbe.

Figure 1. 3. Composition of GDP growth by Production




Source: TajStat and WB Staff estimates

Figure 1. 4. Growth by Sectors




Source: TajStat and WB Staff estimates

[2] The border with China fully re-opened at the end of 2022.
[3] Because Tajikistan is landlocked and the aviation sector is undeveloped, roads and railways play an dominant role in trade. Out of total cargo transportation in 2022, road vehicles accounted for 94.1 percent, rail vehicles for 5.9 percent, and aircraft for 0.001 percent.

## 1.2. Balance of Payments

- **Tajikistan maintained a current account surplus for the third year.** The current account balance recorded a historically high surplus of 15.6 percent of GDP in 2022 compared with 8.2 percent in 2021. The primary and secondary income accounts typically compensate for the large trade deficits in Tajikistan. This tendency was observed in 2022 as well (fig. 1.5). The trade deficit has expanded over the past two years, particularly as imports have grown. Conversely, the surplus on the primary and secondary income accounts had increased substantially to US$ 5.2 billion by the end of 2022. Net remittance inflows remained a key factor in driving this increase, peaking at a historic 49 percent of the GDP[4].

- **Exports fell as the government retained more gold domestically.** Exports fell from 24.2 percent of GDP in 2021 to 16.7 percent in 2022. The drop was attributed primarily to a 41 percent reduction in the export of precious metals, specifically gold (fig. 1.6), as the government chose to retain more gold in the country to bolster external reserves during heightened uncertainty[5]. Precious metals and stones accounted for one-third of total goods exported in 2022. Exports of other goods have remained robust, largely reflecting growing domestic mineral production.

- **Higher agricultural exports partially offset the decline in precious metal exports.** The price for Tajikistan's key agricultural products, such as onions, dried fruits, and grapes, surged to 60 percent for most of 2022 due to both international price spikes amid shortages caused by the war in Ukraine and higher demand from Russia to compensate for fewer shipments from Europe. Textile prices increased by 20 percent in the first half of 2022 compared to 2021. However, the sharp drop in textile demand in the year's second half offset the initial price increase, resulting in a value of textile exports similar to the previous year's. Consumers had to undercut garment purchases as energy and grocery bills spiked globally. Tajikistan also increased electricity exports to neighboring countries by 10.6 percent in 2022, driven by strong external demand. The export of primary aluminum increased by 3.5 percent, benefitting from higher aluminum prices which, on average, rose by 13 percent in 2022.

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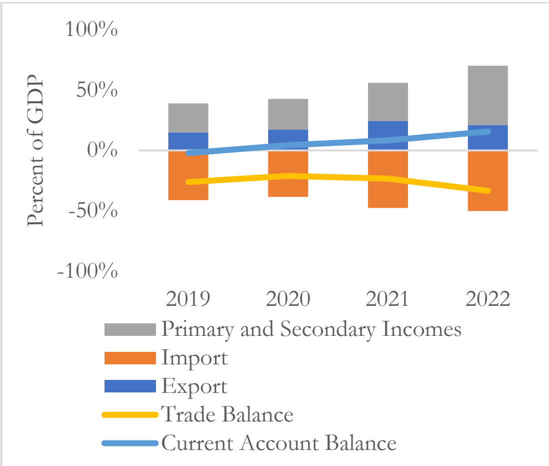
[4] If accounted for short-term outflows in the financial account, net remittances comprised around 38 percent of GDP. These outflows are related to money transited through Tajikistan over the sanctions panic and Russian military mobilization.

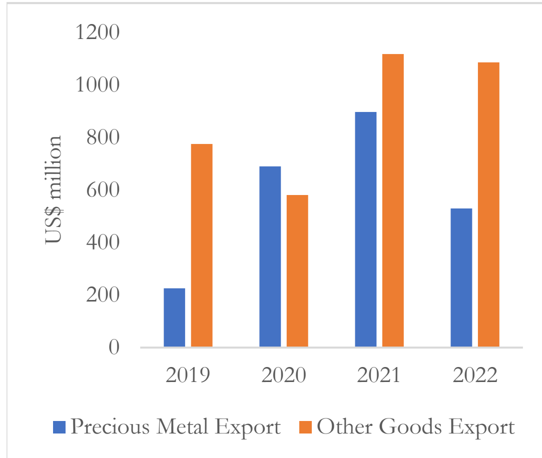
[5] Prior to 2022, the country had been aggressively increasing gold exports from inventories, with Switzerland being the primary destination. Following the government's plan to maintain and further build up external reserve buffers, the export of gold declined from nearly US$ 900 million in 2021 (equivalent to around 14-15 tons at world prices) to US$ 529 million in 2022.

Figure 1. 5. Current Account Balances




Source: TajStat and NBT

Figure 1. 6. Export of Precious Metals and Other Goods



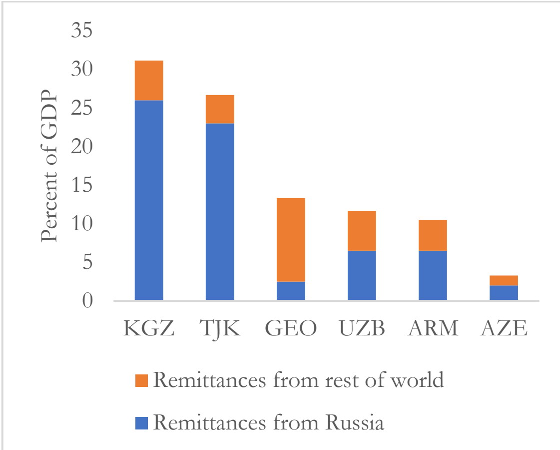

Source: TajStat and NBT

- **Imports continued an upward trajectory supported by higher domestic consumption.** Imports increased from 47.6 percent of GDP in 2021 to over 50 percent in 2022. Tajikistan's import basket mainly comprises food, wheat, wheat flour, petroleum, and construction materials. These products are largely imported from Russia, Kazakhstan, and other CIS countries, which together account for 60 percent of the goods imports. China is the third largest country, delivering, mainly, low, and mid-tech machinery and equipment as well as various household appliances and apparel, which comprise 16 percent of the total imports. In 2022, Tajikistan imported US$ 4.6 billion worth of goods, recording a 23 percent annual increase. The major driver of this result was the increase in food and oil prices in the first half of 2022 and higher household consumption. In general, all subcategories of imports, except for machinery and equipment, which decreased by 6.4 percent, have shown more than a 20 percent increase in value[6].

- **Remittances increased substantially in 2022, despite the geopolitical instability in the region.** Tajikistan remains one of the most remittance-dependent countries in the world. There are about 1 million Tajik migrants in Russia[7], working mainly in the construction and retail sectors. Remittances from Russia account for over 85 percent of total remittances to Tajikistan – among the largest in the region (fig. 1.7). The outbreak of the war and the departure of many western companies and their staff increased Russia's employment opportunities for migrants from Central Asia and South Caucuses. The ruble's appreciation over local currencies further drove the attractiveness of employability in Russia. As a result, migration from Central Asia increased significantly in 2022 before showing some decline after Russia announced mobilization in September (fig. 1.8).

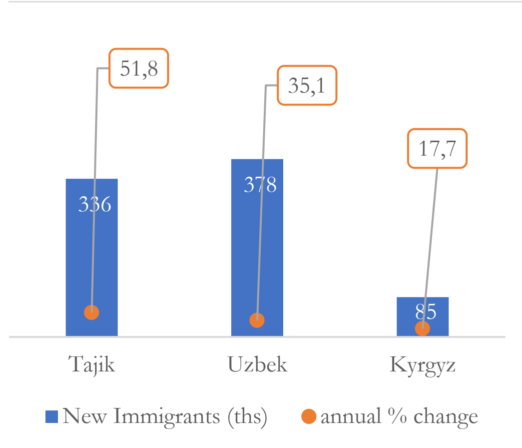
[6] See a more detailed analysis of Tajikistan's trade performance in Special Topic: "Boosting Private Sector Dynamism in Tajikistan".
[7] https://tass.ru/ekonomika/17090753

Figure 1. 7. Country Origins of Remittances, 2021




Source: IMF

Figure 1. 8. Incoming migrants to Russia from Central Asia, 2022




Source: Finexpertiza.ru

- **Net foreign direct investment (FDI) increased significantly in 2022.** While in 2020-2021, the annual amount of net FDI was about US$ 36 million (0.4 percent of GDP), in 2022, the total value of net FDI rose 4.5 times to US$ 162 million (1.5 percent of GDP). The mining sector was the main attractor of foreign investment. The total volume of foreign investment inflows into the economy of Tajikistan over the past 15 years has amounted to about US$ 11 billion: almost US$ 5 billion came through equity investments, with more than US$ 500 million of portfolio investments into the Eurobond, and about US$ 5.7 billion in the form of loans and grants. Despite Chinese investors only beginning to invest in the Tajik economy in the latter half of the 2000s, they surpassed Russia, the country's primary investor, in just ten years[8].

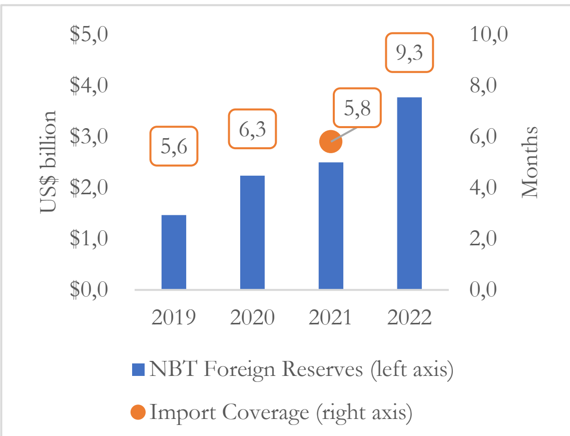
- **Ample foreign exchange inflows increased international reserves.** Tajikistan recorded 37 percent growth in international reserves in 2022, to around US$ 3.8 billion (fig.1.9). Considerable remittance and FDI inflows, grants provided by international institutions, and a net increase in debt issuance helped build new reserves. The current level of 9 months of import coverage of reserves lies well above the reserve adequacy (ARA) metric of 5.5 to 6.3 months[9]. However, the financial sector's balance sheet suggests that exposure to foreign exchange risk remains high. The net foreign assets of deposit-taking corporations, mainly commercial banks, and other sectors, are negative. The FX-denominated liabilities of the financial sector surpassed FX-denominated assets by US$3.7 billion at the end of 2022, almost equivalent to the NBT's international reserves.

- **Tajikistan's price competitiveness improved in 2022.** The real effective exchange rate (REER) – a measure of international price competitiveness - closed the year with a notable depreciation of 5.2 percent (fig. 1.10). The nominal exchange rate essentially tracks the Russian ruble pattern, given Tajikistan's high dependence on ruble-denominated remittances

[8] See a more detailed analysis of FDI in Special Topic: "Boosting Private Sector Dynamism in Tajikistan".
[9] https://www.imf.org/en/Publications/CR/Issues/2023/03/28/Republic-of-Tajikistan-2022-Article-IV-Consultation-Press-Release-Staff-Report-and-531499

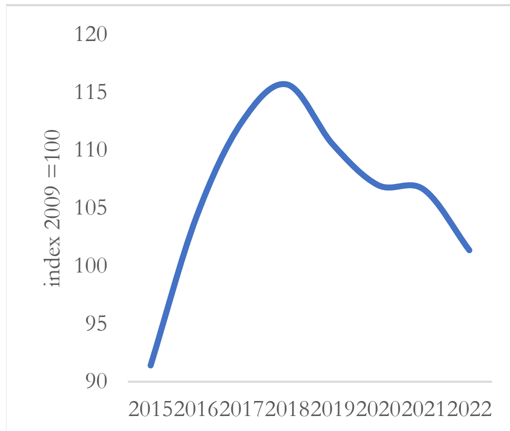
and intensive trade flows with Russia. Switching the currency of settlement from the US dollar to the ruble in most trade with Russia further strengthened this tie. Although the Tajik somoni showed nominal appreciation, inflation in Tajikistan fell considerably behind trading partners who saw double-digit price hikes. The IMF's EBA-Lite methodology indicates that the Tajik somoni remains undervalued by about 15-19 percent[10]. While significant undervaluation of the national currency helps promote exports, it also makes imports more expensive.

Figure 1. 9. Foreign Reserves




Source: NBT and WB Staff Estimates

Figure 1. 10. Real Effective Exchange Rate (up = appreciation)




Source: NBT

- **Tajikistan's external debt substantially declined in 2022.** The volume of total external debt fell from 63.5 percent of GDP in 2021 to 49 percent in 2022, supported by strong economic growth and repayments. At 18.5 percent of GDP, the private sector's share in external debt stood at about 40 percent of total external debt in 2022.

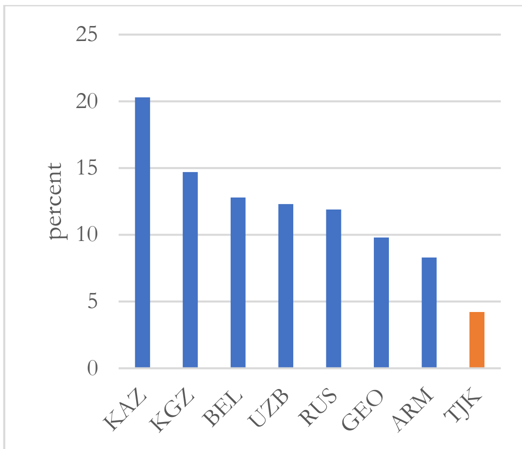
## 1.3. Monetary Policy and Prices

- **Despite the rise in commodity prices, Tajikistan has effectively managed inflation and kept it under control throughout 2022, registering the lowest inflation rate in the region.** The inflation rate in Central Asian and South Caucasus countries exceeded inflation targets and rose above 10 percent (fig.1.11), while in Tajikistan, at 4.2 percent, it was within the target band of (+6 to -2 percent). Inflation has been on a downward trend from a peak of 9.4 percent at the end of 2020. With Russia's invasion of Ukraine and the ensuing global and regional risks, especially on food and energy products, the government promptly adopted an anti-crisis plan, including a decision to postpone the scheduled utility tariff price adjustments, support to farmers, and the release of strategic food reserves. Inflation remained high, reaching 8.3 percent by June 2022. But supported by strong agricultural output, tighter monetary policy and appreciation of the somoni, domestic and imported price pressure relaxed as the year progressed. The downward trend in core inflation started in August 2022 and continued declining through the first quarter of 2023. The exchange rate is important in

[10] https://www.imf.org/en/Publications/CR/Issues/2023/03/28/Republic-of-Tajikistan-2022-Article-IV-Consultation-Press-Release-Staff-Report-and-531499

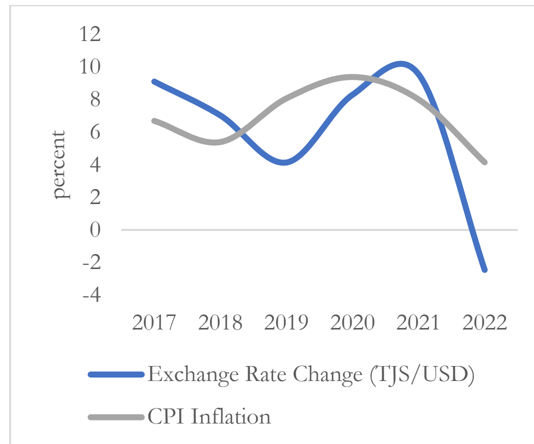
controlling inflation in Tajikistan because imported items account for about 60 percent of the consumption basket (fig. 1.12). Inflation subsided further in the first half of 2023, registering at 2.4 percent by May.

Figure 1. 11. Inflation Rate in the Region




Source: NBT

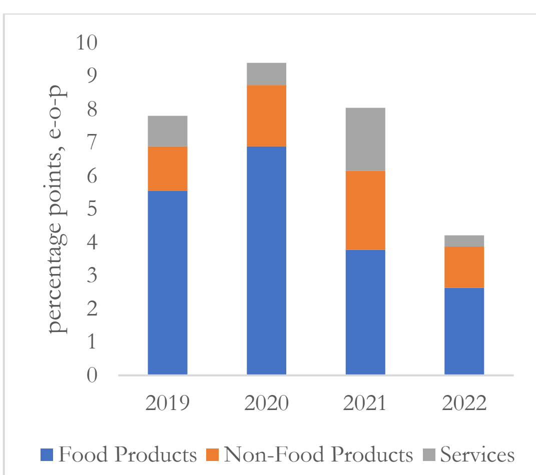
Figure 1. 12. Relationship between inflation and exchange rate in Tajikistan




Source: NBT and WB Staff Estimates

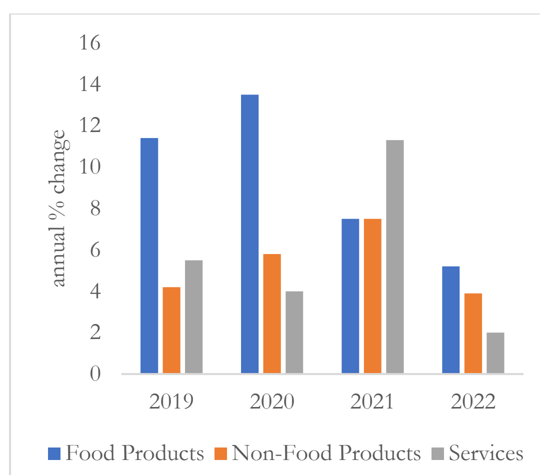
- **Food prices have been the major driver behind inflation over recent years.** Tajikistan imports 75 percent of its food needs, and food prices have tended to be the main driver of inflation (fig.1.13 and fig. 1.14). In October 2022, however, electricity prices were increased by 17 percent based on the government's tariff recovery plan, which applied to both residential and industrial consumers, except for TALCO[11]. Oil and gas prices significantly decreased after a long period of surges since 2021, registering a more than 20 percent drop compared to the previous year.

Figure 1. 13. Inflation Components




Source: NBT

Figure 1. 14. Inflation by Category




Source: NBT and WB Staff Estimates

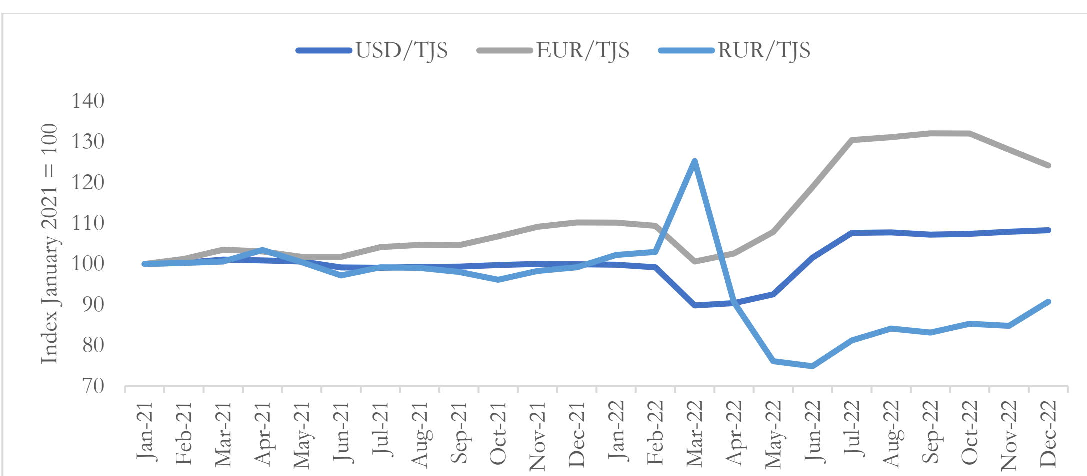
[11] Higher tariffs for TALCO were introduced in January 2023.

- **The National Bank of Tajikistan (NBT) kept monetary policy relatively tight for most of the year in response to the war in Ukraine and the deteriorating inflationary environment worldwide.** The Monetary Policy Committee raised the policy rate from 13.25 percent in 2021 to 13.5 percent in August 2022. By late 2022, however, when inflation fell within the target range (6+/- 2 percent) and the outlook became more benign, the NBT shifted towards a dovish stance. Accordingly, the NBT cut the policy rate by 50 basis points to 13 percent in November, 11 percent in early 2023, and further to 10 percent in May 2023. The real interest rate – measured as the difference between the nominal interest rate and inflation rate – increased from 4.9 percent in 2021 to 8.4 percent by the end of 2022.

- **With weak monetary policy transmission mechanisms, the exchange rate is the main anchor for controlling inflation.** The NBT intends to adopt inflation targeting gradually, which requires modernization of the monetary system. Monetary policy transmission remains weak, mainly due to the insufficient development of money markets and a cash-based economy. Cash in circulation accounts for three-quarters of the total money supply in the economy. Due to the high impact of remittances and commodity prices on domestic prices, many households and businesses prefer to keep their savings in foreign currencies.

- **After relative stability in 2021, the nominal exchange rate depicted some volatility in 2022.** The performance of the Tajik somoni against key currencies was largely stationary until the start of the war in Ukraine, after which there was a sharp but temporary spike in the somoni relative to the Russian ruble in March. This was followed by a much larger depreciation of the somoni against the ruble until mid-2022. However, starting from the year's second half, the domestic currency recorded gradual appreciation against the US dollar and the euro, following the course of the ruble. Overall, the somoni ended the year as one of the best-performing currencies in the region (fig. 1.15).

Figure 1. 15 Nominal Exchange Rate of TJS against USD, EUR, and RUR
(up = appreciation)

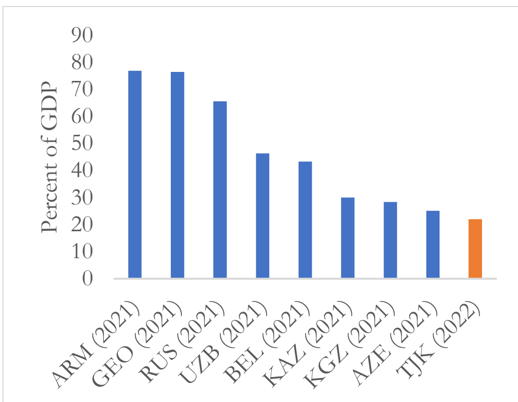



Source: NBT

## 1.4. Financial Sector Developments

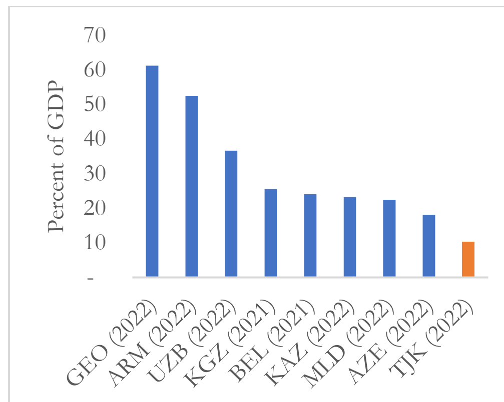
- **The financial sector in Tajikistan remains small compared with other regional economies, bank-dominated, and relatively concentrated.** At the end of 2022, bank assets stood at 21.9 percent of GDP, and credit to the private sector comprised just 10 percent of GDP (fig. 1.16 and fig. 1.17). As of December 2022, the banking system accounted for 78 percent of total financial sector assets, spread across 64 institutions, with assets at 22 percent of GDP and loans at around 9 percent of GDP. Three large banks[12] control half of the market. Nonbank financial institutions, especially microcredit organizations, have been growing rapidly in recent years and, by 2022, held assets equivalent to 14 percent of total financial sector assets.

Figure 1. 16. Bank Assets by Country




Source: IMF and NBT

Figure 1. 17. Credit to Private Sector by Country



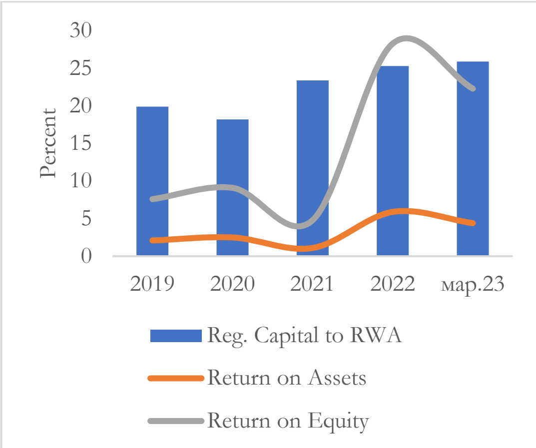

Source: IMF and NBT

- **Despite recent improvements, the financial sector remains vulnerable.** Financial soundness indicators improved with the liquidation of two large banks (Agroinvestbank and Tajiksodirotbank) in 2021. The reported capital adequacy ratio had strengthened to 25.9 percent by the first quarter of 2023 from 23.4 percent in 2021, while strong fee and commission income supported profitability, especially on services related to heightened remittance flows. The return on assets surged from 1.1 percent to 4.4 percent, and the return on equity from 4.8 percent to 22.3 percent between December 2021 and March 2023 (fig. 1.18). The banking system is highly liquid, with liquid assets almost entirely covering short-term liabilities. However, the system remains fragile due to the relatively poor quality of assets, high credit concentration, and elevated levels of dollarization. Reported nonperforming loans (NPLs), though on a declining trend from a peak of 47.6 percent of total loans in 2016, remain elevated at 11.5 percent (fig. 1.19). Large exposures, especially to state-owned enterprises[13], accounted for about half of the total regulatory capital at the end of 2022; loans denominated in foreign currency represent less than a third of total loans, while deposit dollarization remains stubbornly high at 46 percent.

[12] Amonatbank, Orienbank, and Bank Eskhata

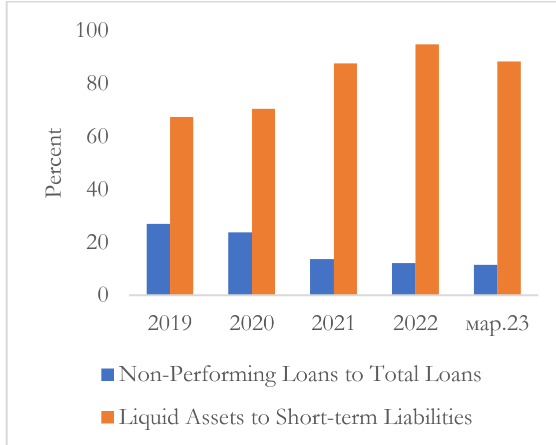
[13] See Boxes 2.1 and 3.2 for more information on the SOE sector in Tajikistan

Figure 1. 18. Capital and Earnings




Source: NBT

Figure 1. 19. NPLs and Liquidity




Source: NBT

- **Access to finance, especially by small and medium-sized enterprises (SMEs), is hampered by a very inefficient banking sector.** According to the latest World Bank Enterprise Survey in 2019, only 18 percent of private firms had a bank loan or line of credit, compared with an average of 41 percent in Europe and Central Asia (ECA). Amongst SMEs that wanted to apply for credit in 2019 but did not, most cited high-interest rates and high collateral as the main reasons. The cost of borrowing in domestic currency has remained static at about 23 percent over the past three years, regardless of the policy rate, signaling significant inefficiency. This reflects limited competition in the financial sector, further evidenced by large cost inefficiencies across banks. The level of collateral needed to obtain a loan stood at 126 percent in 2019. Consequently, only about 3 percent of private firms reported using banks to finance investment, compared with 16 percent in ECA.

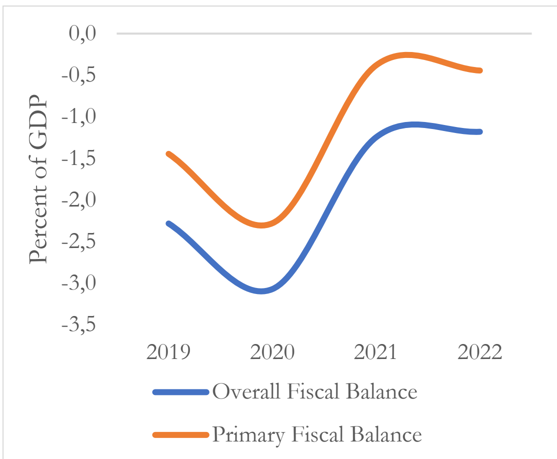
- **There is a strong case for breaking the current high-financial vulnerability, low-financial development equilibrium.** The low levels of financial development and financial stability in Tajikistan are holding back the country's development. Not only does the underdeveloped banking sector fail to finance growth through sound lending policies, but its high vulnerability and instability stifle depositor confidence and hinder its capacity to mobilize savings. Breaking out of this suboptimal equilibrium requires a strong commitment from the authorities to advance reforms in several areas.

- **The authorities are making progress in strengthening the financial system.** Most recent reforms in the financial sector are aimed at the following: i) raising the governance standards for banks, ii) improving banking supervision by aligning with Basel Core Principles, iii) strengthening the financial stability framework, bank resolution and crisis management framework, iv) improving depositor protection through successive increases in the limit of deposits covered by the Individuals' Deposit Insurance Fund (IDIF), v) establishing an emergency backup funding mechanism and information sharing and cooperation framework, vi) the approval of a National Financial Inclusion Strategy (NFIS), and vii) enactment of an updated Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) law, which brought the national system in line with international standards.

## 1.5. Fiscal Policy

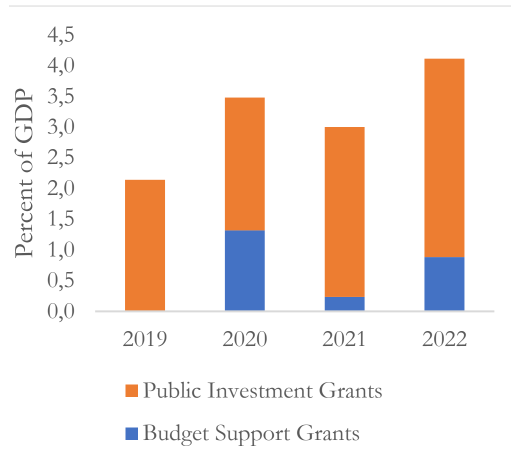
- **Tajikistan has tightened fiscal policy over the past two years.** The authorities reduced the overall fiscal deficit from over 3 percent in 2020 to around 1.2 percent in 2021-2022. The primary deficit declined from over 2 percent during the 2020 pandemic to 0.4 percent in 2021-2022 (fig. 1.20). While in 2021 the authorities achieved fiscal consolidation primarily by cutting expenditures, in 2022, development partner grants and non-tax revenues helped boost state budget revenues (fig. 1.21).

Figure 1. 20. Overall Fiscal Balance and Primary Balance




Source: MOF and WB Staff estimates

Figure 1. 21. Grants for Budget Support and Investments




Source: MOF and WB Staff estimates

- **The adoption of a new Tax Code negatively affected tax revenues.** As of 2022, Tajikistan adopted a new tax code to streamline taxes, simplify administrative procedures, and increase transparency in tax policy and administration (Box 1.1). The changes to the tax code were not revenue-neutral and implied a drop in collections in the first years of adoption by about TJS 1.8 billion (1.6 percent of GDP). The actual dent in tax collections observed in 2022 aligned with the initially estimated tax revenues as their share of GDP declined from 20.3 percent in 2017-2019 to 18.8 percent in 2022.[14] The most prominent losses occurred due to the road users' tax elimination and shortfalls in value-added tax and social contributions.
- **Conversely, state revenues from corporate income, property, and non-tax incomes showed relatively strong growth in 2022.** Higher-income tax receipts reflected the expansion of output in the manufacturing industry, whereas booming residential construction and the temporary influx of Russian residents during the military mobilization led to a surge in real estate profit margins, especially in Dushanbe City and the Sughd region. Non-tax collection recovered to 5 percent of GDP – close to the pre-pandemic average of 2017-2019 (fig. 1.22).

[14] Due to abnormalities of 2020-2021, the calculation focused on the pre-pandemic years for a more appropriate comparison.

## Box 1. 1. Key Amendments to the Tax Code

**Tajikistan enacted the new Tax Code in January 2022 aimed at easing the tax burden on businesses and simplifying tax procedures. The main changes of the new Tax Code are summarized below:**

**Number of Taxes.** The new code reduced the number of taxes from 10 to 7 by: (i) eliminating the road user's tax[15], (ii) merging corporate profit and individual income taxes into a single income tax, and (iii) merging transport tax and immovable property tax into a single property tax.

**Value Added Tax (VAT):** The new code cut the VAT rate from 18 percent to 15 percent and envisages a further reduction to 14 percent by 2024 and 13 percent by 2027. The new code also introduced a special VAT rate for hotel services at 7 percent (down from 18 percent) and for agricultural producers engaged in the processing and selling of domestic agricultural production at 5 percent (down from 18 percent).

**Income Tax on Corporates:** The corporate income tax rate for enterprises in the telecom and banking sectors was cut from 23 percent to 20 percent, and for trade, insurance, communal services, and medical activities from 23 percent to 18 percent. The new code introduced an 18 percent corporate income tax on mining sector enterprises.

**Income Tax on Individuals:** The new code removed the lower bracket rate of 8 percent for personal income tax and reduced the marginal tax rate for resident taxpayers from 13 percent to 12 percent and for non-residents from 25 percent to 20 percent but increased the rate for part-time jobs from 13 percent to 15 percent. The new code also stepped up the basic deductible income from one budgetary unit to two budgetary units.

**Social Tax:** The social tax rate for non-budget organizations was cut from 25 percent to 20 percent.

**Royalty Tax:** The royalties on natural resource extraction were revised from the range of 4 -10 percent to the range of up to 5 percent.

**Trade Tax:** The new code introduced export rent on metal concentrates at 2 percent during 2023-2024 and 4 percent from 2025 onward.

- **Higher capital investments led primarily to the expansion of total budget outlays.** As a share of GDP, total expenditures increased from 27.9 percent in 2021 to 29.1 percent in 2022. Higher expenditures were largely related to externally financed projects in the energy and transport sectors. Domestic capital spending was particularly channeled into constructing the Rogun hydropower plant (HPP), education, and healthcare facilities. Total capital expenditures increased by 1.1 percentage points to 12.7 percent of GDP. Spending on the Rogun HPP alone comprised a quarter of total capital spending.

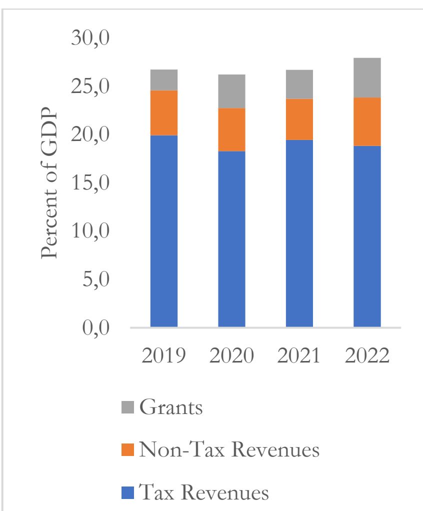
- **Owing to the expenditure restraint policy, current expenditures remained unchanged.** In 2022, the authorities implemented a public sector wage adjustment following a freeze in 2021. The authorities initially increased the wages of the military and police by 20-25 percent in January 2022. All other civil servant wage adjustments of 20 percent came in July 2022, including education, healthcare, and general government administration sectors. The minimum monthly wage was also increased by 50 percent to TJS 600. The cost of higher public sector wages amounted to 0.8 percent of GDP (or 2.75 percent of total budget expenditures). Tajikistan's public sector wage bill stood at 6 percent of GDP in 2022, which

[15] Despite the name, the tax had no relation with the road, as it was a turnover tax on business expenses paid by all enterprises and individual entrepreneurs not eligible to pay taxes under the simplified regime. The tax rate was 1 percent except for wholesale trade, retail trade sectors, and procurement activities, for which it was 0.25 percent. The abolishment of the road user tax was initially planned in 2017; however, it was postponed twice (in 2018 and 2020) since it accounted for a significant 0.5-0.6 percent of GDP.

is comparable to Azerbaijan but considerably higher than 3.4 percent in Kazakhstan. Despite the upward adjustment, Tajik public wages are significantly lower than regional peers, causing high staff turnover and emigration. At the end of 2022, the average public sector wage (including government administration, education, healthcare, etc.) stood at less than US$ 130 in Tajikistan compared with US$ 427 in Armenia , US$ 385 in Azerbaijan (2021), US$ 514 in Kazakhstan, and US$ 830 in Russia. Despite the higher wage bill, total current expenditures remained unchanged at 16.5 percent of GDP. The state budget financed higher wage and payment bills by restraining outlays on repair and maintenance, new equipment acquisition, and consuming inventories.

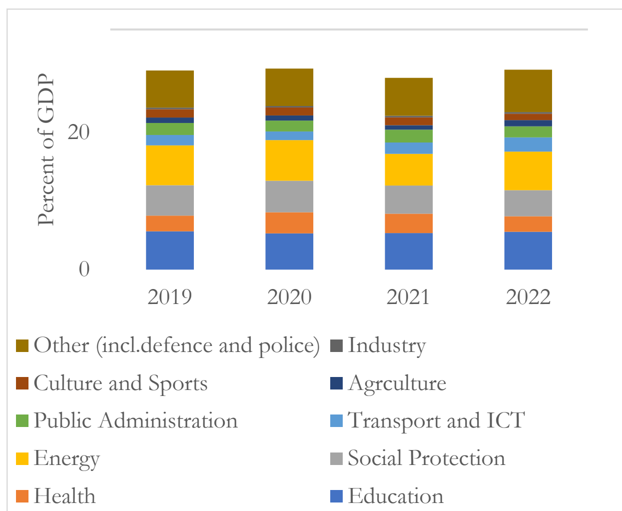
- **The public resource distribution policy did not see a major shift.** The authorities allocated 40 percent of budget outlays to social sectors as in previous years. Social assistance transfers were topped up by additional one-off cash payments to protect the most vulnerable groups from higher price pressures[16]. Energy sector outlays increased from 16 percent in 2021 to 19 percent in 2022, putting them level with the national education budget (fig. 1.23). Although the focus of infrastructure investments is aligned with the National Development Strategy (NDS) 2030, which aims to ensure energy security and end the transportation deadlock, the current allocation policy has been crowding out other important human capital investments. According to the recently published Public Expenditure Review[17], per capita allocation in education, healthcare, and social protection lags behind peer countries. Moreover, the government lacks an appropriate framework to monitor and evaluate the efficiency of public investment programs.

Figure 1. 22. Sources of Budget Revenues




Source: MOF

Figure 1. 23. Expenditures by Sector




Source: MOF

- **Tajikistan's public debt burden markedly declined.** During the 2020 pandemic, the government accumulated debt to finance countercyclical policy and support vulnerable groups. Robust growth in 2021 and 2022 helped reduce public debt, which declined from

[16] See more details in Annex 1: Social Assistance Reforms
[17] https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099205106242240623/p172237055d557050b3d502de92e8761c2

the historical peak of 46.5 percent of GDP in 2020 to 41.9 percent in 2021 and further to 34.8 percent in 2022.[18]

- **The government has been contracting new loans on concessional terms.** In 2022, the government contracted new loans with the Islamic Development Bank (US$ 2 million), International Fund for Agricultural Development (US$ 6.8 million), and European Bank for Reconstruction and Development (US$ 2 million). In line with the Medium-Term Debt Strategy 2021-2023, all new loans were contracted on concessional terms. In 2022, the government amortized US$ 181.4 million of external debt and TJS 851 million (US$ 77.4 million) of domestic debt. Interest payments amounted to US$ 73.2 million on external debt and TJS 48.2 million (US$ 4.4 million) on domestic debt, respectively. While the government has been servicing debt, it has also been borrowing to close the financing gap of the state budget and invest in public infrastructure. In 2022, disbursements amounted to US$ 183.7 million from external creditors –almost equivalent to external debt principal repayment.

- **External debt dominates the outstanding PPG debt portfolio.** About 90 percent of public and publicly guaranteed (PPG) debt is denominated in foreign currencies, corresponding to US$ 3,228 million, or 30.8 percent of GDP at the end of 2022. Most external debt is owed to China (30.7 percent of the total), the World Bank (11.1 percent of the total), and the Asian Development Bank (8.8 percent of the total). The US$ 500 million Eurobond issued for the construction of Rogun HPP comprises 15.5 percent of the total outstanding external PPG debt. Domestic public debt is about 4 percent of GDP and largely constitutes non-marketable securities, including bailout bonds to rescue the banking sector and credit from the NBT.

## 1.6. Poverty Developments

- **According to the Tajikistan Household Budget Survey (HBS), the national poverty rate fell from 34.3 percent in 2013 to 22.5 percent in 2022.** Extreme poverty, focusing only on the food component of the national poverty line, also declined from 20 percent in 2013 to about 11 percent in 2019. Supported by rebounding GDP growth and higher migrant remittances, poverty reduction resumed after a pause during the 2020 pandemic. In 2021, the national poverty rate stood at 23.2 percent per an updated HBS and re-estimated poverty line[19] (fig. 1.24). Urban and rural poverty rates have been gradually declining, with rural poverty at around 23.7 percent and urban poverty at around 21.8 percent as of 2021. The fact that over 70 percent of Tajiks reside in rural areas and mostly find employment in the low-paying agriculture sector explains the concentration of poor people in rural areas. In contrast, Sughd and Dushanbe – where industrial enterprises are concentrated – have relatively lower poverty rates (fig. 1.25). According to preliminary official estimates, the national poverty rate declined further to 22.5 percent in 2022[20]. The World Bank projects that

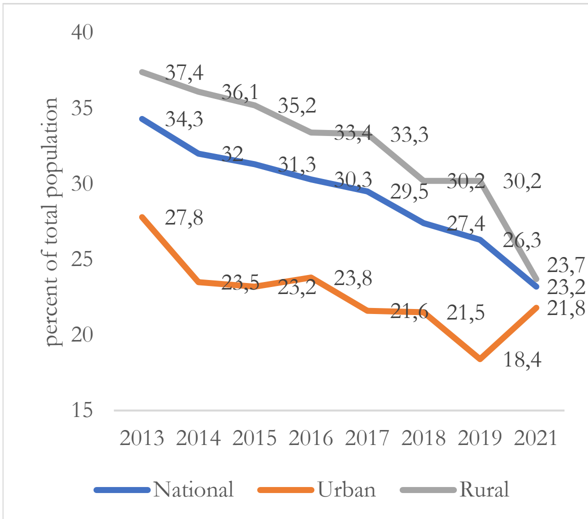
[18] Tajikistan Annual Public Debt Report 2022, Ministry of Finance, 2023.

[19] The national method for measuring poverty in Tajikistan is based on the cost-of-basic-needs approach and a minimum food basket, supplemented by a fixed percentage of expenditures for basic non-food items and services. The value of the official poverty line was TJS 146.77 per month when set in 2013 and stood at TJS 213 per month in 2019 after accounting for inflation. In 2021, the Bank and the Government re-estimated the national poverty line, which stood roughly at the level of TJS 323 per month.

[20] Annual Speech of the President of the Republic of Tajikistan, December 23, 2022, https://mfa.tj/en/main/view/11820/address-by-the-president-of-the-republic-of-tajikistan-he-emomali-rahmon-on-major-dimensions-of-tajikistans-foreign-and-domestic-policy

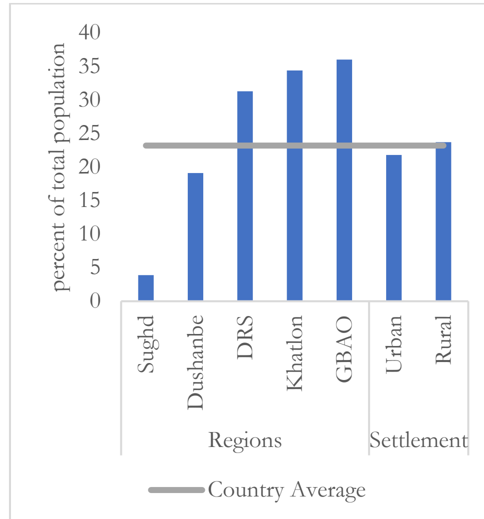
the poverty rate declined from 14.3 percent in 2021 to 13.4 percent in 2022 – using the US$ 3.65 (2017 PPP) international line for lower-middle-income countries[21].

Figure 1. 24. National Poverty Rate over Time




Source: TajStat

Figure 1. 25. National Poverty Rate by Region

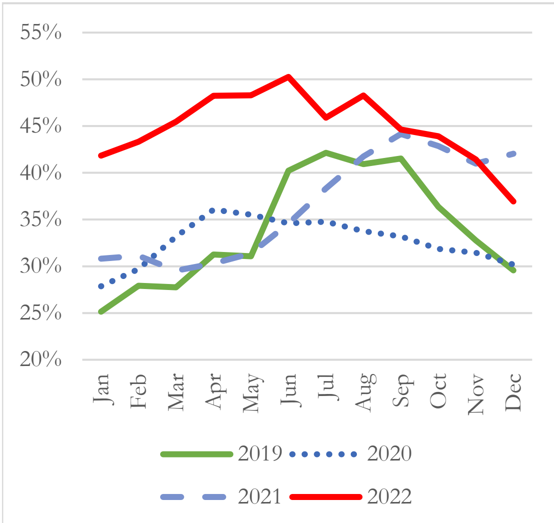



Source: TajStat

- **Despite earlier less optimistic forecasts, labor migration and remittance inflows increased in 2022.** The Listening to Tajikistan Survey (L2T)[22] shows that labor migration increased significantly in 2022, reaching levels not seen before. By January 2022, more than 40 percent of households reported at least one household member working abroad, rising to 50 percent in June 2022 and declining to 37 percent by the end of 2022 (fig. 1.26). Notwithstanding typical seasonal variation[23], the pronounced decline in the second half was likely due to the partial military mobilization in Russia. From June-October 2022, more than 80 percent of households reported being very concerned about the economic consequences of Russia's invasion of Ukraine, either for their families or the economy. The share of households receiving remittances increased in 2022 to 17 percent, compared to 13 percent in 2021 (fig. 1.27). TajStat's surveys suggest that between 22 percent and 30 percent of total household income comes from remittances, over 90 percent of which originates in Russia[24].

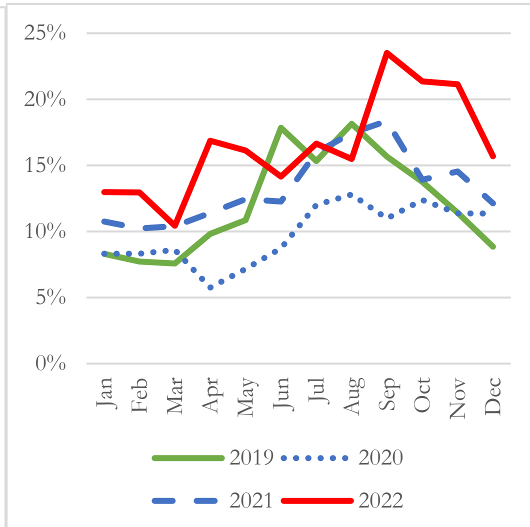
[21] In 2022, the World Bank adopted the 2017 Purchasing Power Parity (PPP) for measuring poverty numbers, versus the 2011 PPP in previous editions. The new global poverty lines of US$2.15, US$3.65, and US$6.85 reflect the typical national poverty lines of low-income, lower-middle-income, and upper-middle-income countries in 2017 prices.
[22] "Listening to Tajikistan" (L2T) is a World Bank-sponsored monthly phone survey covering over 1,400 households from all regions of Tajikistan aimed at gauging the severity of shocks for households and monitoring their well-being over time.
[23] Labor migrants typically travel abroad during the spring-summer season and return home during winter.
[24] Tajstat Household Budget Survey, 2014-2019

Figure 1. 26. Share of households with any labor migrant abroad




Source: L2T

Figure 1. 27. Share of household with remittances income




Source: L2T

- **Labor remittances are a critical source of poverty reduction in Tajikistan.** Households report that over 80 percent of remittances are used for food consumption and about 10 percent for other basic needs such as healthcare, housing, and education. The rest are used for savings, to repay debts, and for other purposes. This picture suggests that families with labor migrants are poor or vulnerable to poverty and that poverty in Tajikistan would be much higher without remittances.[25] In 2021, about 36 percent of the poorest quintile in Tajikistan received remittances each month, while in the top quintile, the figure was about 27 percent.[26]

[25] L2T Survey, July 2022.
[26] World Bank. 2022. "Social Protection for Recovery" Europe and Central Asia Economic Update (Fall). Washington, DC: World Bank. http://hdl.handle.net/10986/38098.

# OUTLOOK

*Tajikistan's growth prospects are not as strong as its recent performance record. The baseline projections are predicated on several assumptions described in earlier discussions for growth drivers in 2022. In particular, these projections are built on the assumptions of the continued war in Ukraine, the intensification of Western sanctions on Russia, and their impact on the labor demand from Tajikistan and migrant earnings. The uncertain political situation in Afghanistan constitutes another major geopolitical risk for Tajikistan, with which it has the longest geographical border. The tightening of global financial conditions is another crucial factor in driving assumptions for assessing the external environment for non-labor financial flows such as FDI and borrowing by the private sector. The policy-response assumptions are shaped by considering the limited fiscal space in Tajikistan and the slow progress in promoting structural reforms domestically. Since these assumptions are subject to the probability distribution, some may fail to hold – analogous to 2022, where the spillover effects of the war on Ukraine did not materialize, and GDP growth outturn was higher than expected, or analogous to 2020 when an unexpected pandemic shock hit the economy and GDP growth outturn was lower than expected.*

## 2.1. Global and Regional Outlook

- **Global growth is expected to slow from 3.1 percent in 2022 to 2.1 percent in 2023 due to monetary tightening before seeing recovery in 2024 and 2025 (Table 2.1).**[27] While advanced economies will experience a pronounced deceleration in growth in 2023, China will show a sizable pick-up following the removal of strict pandemic-related mobility restrictions. The peak impact of monetary tightening to rein in high inflation for many major economies, including the United States, is expected to be this year. Recent banking sector stress will further tighten credit conditions. Emerging markets and developing economies (EMDEs) with lower credit ratings are set to experience a particularly sharp slowdown in growth in 2023. Core inflation remains elevated in many countries and is accelerating again in a growing number of them. Projections suggest that inflation will remain above its pre-pandemic level beyond 2024.

Table 2. 1. Real GDP Growth in Selected Advanced Economies and EMDEs (Percent)

| | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|---|
| **World** | **-3.1** | **6.0** | **3.1** | **2.1** | **2.4** | **3.0** |
| **Major advanced economies** | **-4.3** | **5.4** | **2.6** | **0.7** | **1.2** | **2.2** |
| United States | -2.8 | 5.9 | 2.1 | 1.1 | 0.8 | 2.3 |
| Euro Area | -6.1 | 5.4 | 3.5 | 0.4 | 1.3 | 2.3 |
| Japan | -4.3 | 2.2 | 1.0 | 0.8 | 0.7 | 0.6 |
| **Selected EMDEs in Eurasia** | **-1.4** | **6.9** | **3.7** | **3.8** | **4.0** | **4.0** |
| China | 2.2 | 8.4 | 3.0 | 5.6 | 4.6 | 4.4 |
| Russian Federation | -2.7 | 5.6 | -2.1 | -0.2 | 1.2 | 0.8 |
| Turkiye | 1.9 | 11.4 | 5.6 | 3.2 | 4.3 | 4.1 |
| Kazakhstan | -2.5 | 4.3 | 3.3 | 3.5 | 4.0 | 3.6 |
| Tajikistan | 4.4 | 9.4 | 8.0 | 6.5 | 5.0 | 4.5 |

[27] Global Economic Prospects, June 2023, World Bank.

- **Economic growth in the Europe and Central Asia (ECA) region is set to remain mediocre in 2023, increasing to 1.4 percent from 1.2 percent a year prior as a contraction in the Russian Federation eases and the fall in Ukraine's output subsides**[28]. Excluding Russia and Ukraine, growth in ECA is projected to nearly halve to 2.4 percent this year from 4.7 percent a year prior, reflecting the impact of tighter financial conditions, persistent inflation, and subdued external demand. The slowdown is broad-based across the region, with nearly two-thirds of countries experiencing a deceleration in growth.

- **Growth in Central Asia is projected to be flat as the spillovers of 2022 subside.** In the ECA region, an unexpected influx of migrants, capital, and businesses and trade and investment diversion resulting from Russia's invasion of Ukraine generated positive shocks to growth in 2022 that are expected to diminish in 2023. Despite the fading of these positive growth contributions, output in Central Asia is projected to increase by 4 percent in 2023, little changed from 2022 and the fastest among the ECA subregions, amid increased public investment and hydrocarbon-related projects (mainly in Kazakhstan).

- **Growth in ECA is projected to pick up to an average of 2.7 percent over 2024-25, reflecting an easing of inflation back towards central bank targets, a recovery in domestic demand, and an improvement in the external environment.** Growth could be even weaker if there is an escalation of Russia's war in Ukraine, as well as further rises in food and energy prices, an accelerated tightening of monetary policy, or a sudden reversal of capital flows into the region. Over the medium to long term, structural constraints amid an incomplete market transition in many countries, weak productivity, lagging education outcomes, limited innovation, and a rapidly rising population need to be addressed to help expand the region's productive capacity.

## 2.2. Tajikistan's Outlook

### 2.2.1. Growth and Prices

- **Tajikistan's economic growth is projected to decelerate from 8.0 percent in 2022 to 6.5 percent in 2023**. The deceleration in growth this year reflects a combination of factors, including diminishing remittance inflows and household consumption following a high base effect from 2022, normalization of FDI inflows after strong growth in 2022, and weak global demand for metals and minerals – Tajikistan's major export commodities. Without strong structural reforms, especially in areas such as the business environment, public sector management, and social and environmental resilience, the potential for GDP growth is estimated to be around 4.5-5 percent over the medium term[29]. Similar to the past few years, it is expected that services, the mining industry, consumer product manufacturing, and the construction of development projects will drive growth in the near future[30].

[28] Izvorski, I., M. Lokshin, J.R.R. Norfleet, D. Singer, and I. Torre. 2023. Europe and Central Asia Economic Update, Spring 2023: Weak Growth, High Inflation, and a Cost-of-Living Crisis. Washington, DC: World Bank.

[29] This is much lower than the Government's target of 7-8 percent GDP growth rate that is needed to accelerate poverty reduction and achieving NDS 2030 objectives.

[30] Since 2020, the Government has embarked on the Medium-Term Development Program for 2021-2025 and Accelerated Industrialization Program for 2020-2025 to promote growth in the medium term. These and other sub-

- **In the short and medium terms, inflation is expected to hover within the NBT's inflation target band.** The baseline scenario projects that inflation will start rising gradually from the lows of 2022-2023 and reach 6 percent in 2024-2025. The main driver of inflation in 2023 is expected to be the lower harvest in Central Asia and potential food supply shortages related to the war in Ukraine[31]. The expected slowdown in the growth of the Russian economy could translate into weaker Russian ruble and remittance flows. In turn, this is projected to amplify the upside pressure on exchange rate depreciation and lead to higher inflation of imported goods in Tajikistan. In line with the medium-term inflation target and price stability objectives, the forecast assumes that the NBT will continue pursuing tight monetary policy when inflationary and exchange rate pressures emerge by effectively utilizing available policy tools.

- **External conditions may increase pressure on the exchange rate.** The NBT maintains a managed float exchange rate policy. However, should the ruble depreciate considerably, Tajikistan's dependence on the Russian ruble regarding remittance and trade flows may depress the current account and foreign exchange reserves. Although the Tajik somoni was among the best-performing developing country currencies in 2022, it may see greater pressure from tightening monetary policy in the US, EU, and elsewhere. In 2022, this tightening was offset by higher remittances, a stronger ruble, and higher prices for Tajikistan's exports but, in 2023, a negative outlook in both remittances and commodity prices may materialize into a more adverse impact on the US$/TJS rate. The authorities could seek greater exchange rate flexibility to avoid the emergence of a parallel market and gradually allow the exchange rate to move in line with economic fundamentals.

- **External risks are dominated by the unstable geopolitical environment, globally tightening financial conditions, and elevated disaster risk.** Notwithstanding some upside risks, such as ending the war or activating the Chinese Grandiose Plan for Central Asia,[32] downside risks generally prevail in the outlook for Tajikistan. The escalation of the war in Ukraine and the lagged impact of sanctions on Russia could result in substantial spillover effects on the remittance flows to Tajikistan. While a substantial dent in the Russian economy could significantly impact migrant earnings, military mobilization risk could lead to the return of migrants and their families with dual Tajik and Russian citizenship. This scenario could start materializing in 2023 and flow into the medium term, with disproportionately negative implications for poor and vulnerable households. This scenario would require greater social assistance and an enhanced social protection system capable of responding to sudden shocks should they occur. Over the medium term, it will be critical to significantly scale up social protection reforms by ensuring sufficient investment into human capital development and better protection for poor and vulnerable Tajik households (Table 2.2).

- **Trade flows with Russia and the region could decline, and there is a risk of re-emerging export bans on trading socially important items, including staple food.** This

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sectoral programs aim to improve institutional capacity and human capital development, enhance the competition framework for better private investments, and increase the diversification and export orientation of the economy.

[31] https://eurasianet.org/uzbekistan-kazakhstan-ban-food-exports-amid-wild-winter-inflation?fbclid=IwAR3SsiQ47fHaxOUci_MLXIxpqo9_oSewPkTy-nNW9Jm0DlDAjfgAFDDyjGk, https://eurasianet.org/central-asian-river-levels-poised-for-dramatic-plunge-forcing-urgent-measures

[32] https://jamestown.org/program/china-unveils-grandiose-plan-for-central-asia/

could translate into higher food prices and a significant erosion of the purchasing power of the socially vulnerable population. The uncertain political situation in Afghanistan and unresolved border delineation with the Kyrgyz Republic constitute another major geopolitical risk for Tajikistan. The geographical location, mountainous terrain, and high role of agriculture in the economy expose the country to adverse natural hazards and climate change risks[33], including earthquakes, floods, landslides, and extreme weather events. Such weather events may affect production in the agricultural sector, which is the largest employer and a critical source of income for vulnerable population groups[34].

- **Domestic challenges and risks are primarily related to fiscal sustainability, inefficient SOEs, financial stability, and private sector development.** The slowdown in economic activity and implementation of the new tax code creates a risk of lower fiscal revenues, which are critical for safeguarding social expenditures. The materialization of SOE contingent liabilities, including failing to service directly or indirectly contracted commercial loans, payment to suppliers, and accumulation of arrears to the state budget, comprise a crucial fiscal risk to the state budget. Lower remittance flows and extensive exchange rate depreciation could destabilize the balance sheet of the financial and real sectors and increase the share of non-performing loans in the system. Slow progress in structural and institutional reforms in the protection of property rights, enforcement of contracts, competition environment, investment regulations, and trade facilitation create significant challenges and risks for private sector development.

Table 2. 2. Major External and Domestic Risks the Outlook

| | Real Sector | Financial Sector | External Accounts | Fiscal Accounts |
|---|---|---|---|---|
| **External Risks** | | | | |
| Spillover effects from the war in Ukraine | High | High | High | High |
| Global financial tightening | Medium | High | High | Medium |
| Slowdown in global/regional growth | Medium | Low | Medium | Low |
| Climate change and natural disasters | Medium | Low | Low | Medium |
| **Domestic Risks** | | | | |
| Slow implementation of structural reforms | High | High | High | High |
| Materialization of SOE contingent liabilities | Low | High | Low | High |
| Political uncertainty with Afghanistan | Medium | Low | Medium | High |
| Border dispute with the Kyrgyz Republic | Low | Low | Low | Medium |

[33] The Notre Dame Global Adaptation Index indicates that Tajikistan ranks as the 74th least vulnerable and 139th most prepared country in regard to climate change.
[34] Earthquakes and floods pose the greatest risks at the national and regional levels, with annual average losses of 4.3 percent and 1.4 percent of GDP, respectively. With 93 percent of the country covered by mountains, much of it is unsuitable for agriculture and inaccessible during winter. Furthermore, soil erosion affects about 70 percent of arable land, and at least 10 percent of the population lives on degraded lands.

### 2.2.2. Balance of Payments

- **Tajikistan's external position is expected to record a surplus over the medium term.** The current account is projected at over 4 percent of GDP in 2023 and then decline to 3-3.5 percent , primarily affected by lower remittance inflows. Lower household incomes will dampen consumer imports, but the trade deficit will remain large overall. Due to the tightening of global financial conditions and challenges in the business environment, FDI inflows are expected to remain muted. Tourism presents a significant opportunity for Tajikistan, given the country's attractive natural landscapes and rich history, and has the potential to become an important driver of higher services exports.

- **Remittances are expected to normalize at about US$3.6 billion (around 30 percent of GDP) from 2023 onwards, reflecting economic uncertainties driven by the war in Ukraine.** They will be lower than the US$5.2 billion (49 percent of GDP) of 2022 when many Russians used Tajikistan as a transit destination for their exodus from the war. In the past, there has been a strong link between Russia's economic performance and remittance inflows, with higher GDP in Russia leading to higher levels of inward remittances. However, recently, statistics show that this correlation has been broken. Despite the economic contraction in Russia in 2022, labor demand for the foreign workforce remained resilient. This phenomenon is expected to prevail in 2023 without one-off flows observed in 2022. In 2024-2025, remittance inflows are expected to resume their correlation with the GDP growth of Russia.

- **The trade balance will continue recording a large deficit over the medium term**. Tajikistan has a low domestic production base, and the country relies heavily on imports to meet the population's consumption and investment needs. The goods trade deficit is expected to narrow to 23 percent of GDP in 2023, driven largely by import contraction. The medium-term outlook foresees no significant changes to the trade patterns of Tajikistan.

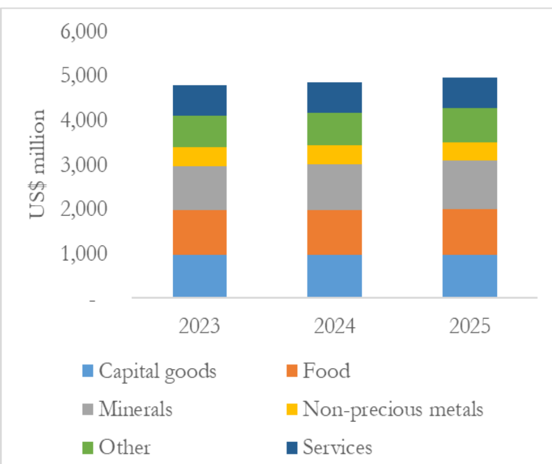
- **Imports are projected to decline as households reduce consumption and global prices for food and fuel decline by 8 and 26 percent, respectively**.[35] Food accounts for about 22 percent of the total goods import basket, whereby food prices significantly impact the import bill. On the other hand, due to the failure to fulfill a planting plan, the expected food supply shortage in Central Asia may intensify pressure on the trade balance if harvest yields decline. According to the latest country report by the Food and Agriculture Organization of the United Nations, exceptionally high rainfall has hampered the late planting operations of 2023 winter crops.[36] In 2022, fuel products constituted around 15 percent of Tajikistan's total goods import basket. Although a major focus on renewable energy can further drive prices down over the medium and long term, energy prices may still fluctuate because of the geopolitical climate and risks to the economic outlook. Another major pressure point on the import side will come from the Rogun HPP. The project has a high import content related to hydro-turbines, construction materials, machinery, and auxiliary engineering equipment and services. The import content is estimated at 60 percent of the total remaining project's cost of US$5.2 billion[37]. Over the medium term, the project's schedule will focus on achieving key

[35] Commodity Markets Outlook, World Bank, April 2023
[36] https://www.fao.org/giews/countrybrief/country.jsp?code=TJK&lang=fr
[37] The cost of completing the construction of Rogun HPP is under re-estimation.

milestones related to the dam's construction, building the right bank structures, and impoundment of the reservoir (fig. 2.1).

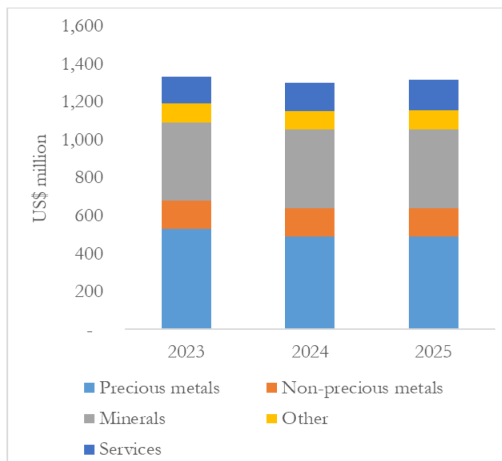
- **Demand for Tajikistan's minerals and base metals is expected moderate due to weakening global manufacturing production and China's service-oriented recovery.** Prices for minerals and metals are expected to fall by 8-9 percent in 2023 and a further 3-4 percent in 2024.[38] Projected higher prices for precious metals in 2023– up by 5-6 percent – could partially offset the decline of export of minerals and metals (fig. 2.2). Over the longer horizon, however, Tajikistan is expected to benefit from the green energy transition as the region intensifies efforts of de-carbonization and the country ramps up electricity generation. Considering the regional demand and tariffs, about 60 percent of electricity generated by Rogun HPP is expected to be exported in the amount of 10 billion kWh per year. As a sustainable base load, Tajikistan's hydroelectricity energy capacity may become a major source of clean energy for the Central Asia region.

Figure 2. 1. Import Projections




Source: World Bank staff projections

Figure 2. 2. Export Projections




Source: World Bank staff projections

- **The financing of the current account is expected be sourced through FDI inflows and development partners. Net FDI is projected to be below 2 percent in 2023 and slightly picking up over the medium term.** The prospects for FDI remain limited, afflicted by the global economic slowdown and a difficult business environment. Challenges in the regulatory and operational business environments have been cited among the main barriers to attracting foreign investments, building investor confidence, and diversifying the investor profile. Therefore, accelerating reform in the private sector is critical for financing the government's ambitious plan to implement more than 200 public investment projects and attract US$7.5 billion by 2025[39]. The IFI budget support and investments into development projects will constitute another major source of financing to close the external financing gap, including repayment of the Eurobond in 2025-2027. Subject to the government's reform commitment, the World Bank, Asian Development Bank, Eurasian Fund for Stabilization and

[38] Commodity Markets Outlook, World Bank, April 2023
[39] https://asiaplustj.info/en/news/tajikistan/economic/20221223/over-tjs152-billion-of-foreign-investment-mobilized-by-tajikistan-over-the-past-20-years-says-rahmon

Development, European Union, and other development partners will continue supporting the country's reform agenda to achieve the National Development Strategy 2030 objectives. Portfolio investment and other investment types are expected to contribute marginally to financing the current account deficit.

- **Tajikistan's international reserves provide a buffer to cope with external shocks.** The current level of reserves is above the IMF's reserve adequacy metrics[40] and provides 8-9 months of next year's import cover. Nonetheless, while external buffers have become stronger over the past few years, Tajikistan's vulnerability to external shocks remains high, especially in the context of elevated geopolitical uncertainty. Over the medium term, it will be important to continue building foreign reserves and gradually seeking greater exchange rate flexibility – the latter should be combined with an improved monetary policy transmission mechanism.

### 2.2.3. Financial Stability

- **Despite a positive outcome in 2022, short-term risks in the financial sector remain elevated.** The financial sector in Tajikistan is exposed to the war in Ukraine and tightening global financial conditions through direct and indirect channels. The provision of cross-border payment services for remittance flows constitutes a significant source of income for Tajik banks. If the war lasts through 2023 and sanctions further intensify, a sharp decline in remittance inflows could weaken earnings on cross-border transfers, create pressure on currency depreciation, and raise non-performing loans. The banking sector experienced a similar episode in 2016 when the global energy price collapse led to a sharp decline in remittances and large currency depreciation in Tajikistan. These events, compounded by corporate governance and risk management weaknesses, precipitated a banking crisis in 2016. Furthermore, excluding several Russian banks from the SWIFT payment system can hurt Tajik banks that rely on correspondent accounts with them for cross-border payments.

### 2.2.4. Public Finances

- **The 2023 state budget envisages a widening fiscal deficit.** The government's medium-term budgeting framework assumes a GDP growth rate of 7.8 percent in 2023 and about 8 percent in 2024-2025. Inflation is projected at 7percent in 2023 and 6+/-2 percent in the medium term. The fiscal deficit has been envisaged at 2.3 percent of GDP in 2023 – up from 1.2 percent in 2022. This deficit level is aligned with debt sustainability considerations, given the country's high risk of debt distress.

- **Despite projected robust economic growth, the authorities have been cautious in tax and non-tax revenue forecasts to account for uncertainty in the external environment**. Tax and non-tax revenues to GDP are projected to decline to 18.1 percent (from 18.8 percent in 2022) and 3.2 percent (from 5 percent in 2022), respectively, in 2023 (fig. 2.3). Historically, actual outturns have systematically and markedly deviated from the adopted State Budget Law. While in 2019-2020, the deviation occurred mostly on expenditures ranging between

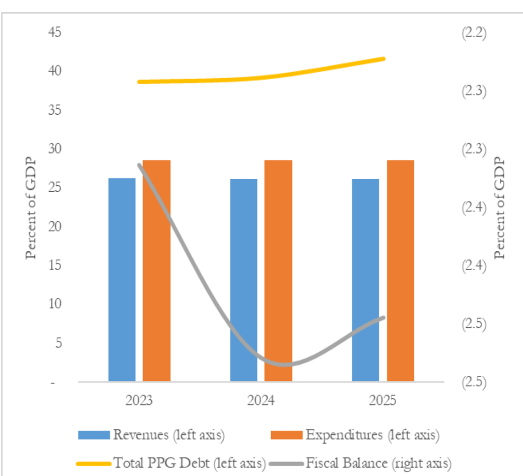
[40] https://www.imf.org/en/Publications/CR/Issues/2023/03/28/Republic-of-Tajikistan-2022-Article-IV-Consultation-Press-Release-Staff-Report-and-531499

2.2 -7.3 percent, in 2021-2022, deviations were large both on the revenue and expenditures sides, ranging between 7-9 percent, and 5 percent, respectively (fig. 2.4). In 2023, grants from development partners are expected to increase to over 5 percent of GDP. In addition to the World Bank budget support of US$ 50 million (disbursed in early 2023), the European Union and Eurasian Fund for Stabilization and Development are also expected to activate their budget support programs in 2023-2025 – subject to a successful structural reform program. In 2023, total grants are expected in the amount of TJS 6,630 million – TJS 587 million for general budget support and TJS 6,043 million for public investment programs.

- **State expenditures will remain broadly unchanged.** Total expenditures are envisaged at 28.9 percent of GDP compared with 29.1 percent in 2022. The authorities plan to increase wages and payments by about 20-25 percent across all public sectors, including pensions and student stipends[41], and finance a higher wage bill by constraining the government's consumption of goods and services.. The budget has also increased allocations to education and healthcare by 13 percent and 27 percent, respectively. The budget for social protection is planned to be increased by 11.6 percent, and the targeted social assistance program by 33 percent to TJS 154.3 million[42]. State expenditure on the Rogun HPP are expected to be limited to US$ 300-400 million annually over the medium term[43].

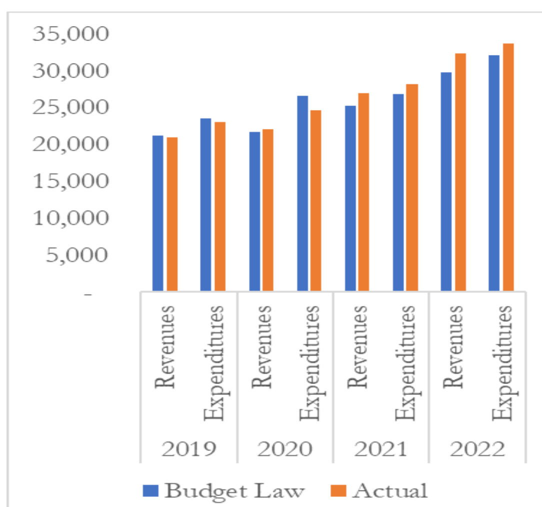
- **The fiscal deficit will be primarily financed through new external loans, SOE loan repayments, and domestic debt issuance.** The public debt burden is expected to increase to 38-41 percent of GDP over the medium term. According to the recently published DSA, Tajikistan remains at high risk of debt distress, and the country's external debt is most vulnerable to export shocks and SOE contingent liabilities. Debt is assessed to be sustainable based on the authorities' commitment to fiscal discipline over the medium term and avoidance of non-concessional borrowing.

Figure 2. 3. Fiscal Projections




Source: WB staff estimates and projections

Figure 2. 4. Actual vs State Budget Law




Source: MOF and WB staff estimates

41 Presidential Decree No 526. "On measures to strengthen the social protection of the population and increasing the pensions, stipends, and salaries of employees of budgetary institutions and organizations" February 06, 2023.

42 See Annex 1 for Social Assistance Reforms

43 The cost of completing the construction of Rogun HPP is under re-estimation and may require adjustments to annual spending plans.

- **Many risk factors threaten the fiscal outlook.** Challenges and risks are led by elevated uncertainty in regional geopolitics, spending pressures to build the Rogun HPP, SOE contingent liabilities (Box 2.1.), and weak structural reforms to foster private sector development. A significant slowdown of economic activity in Russia could reduce migrant remittances and household consumption, thus negatively affecting indirect tax collections. Spending pressures to complete the construction of the Rogun HPP without securing power purchasing agreements (PPA) could derail fiscal and debt sustainability efforts. The materialization of SOE fiscal risks related to the repayment of their loans and accumulation of arrears to the state budget and suppliers presents another critical risk from fiscal and debt sustainability perspectives[44]. The fiscal performance may also suffer from unsatisfactory reforms to create an environment conducive to attracting private investments and ensuring a fair competition framework by phasing out inefficient tax exemptions. During 2025-2027, Tajikistan also needs to secure resources to repay the Eurobond. While external risks are beyond the authorities' control, domestic risks could be mitigated by improving the efficiency of public resource management and accelerating structural reforms.

## Box 2. 1. Fiscal Risks Emanating from the SOE Sector

Tajikistan's SOE sector poses a serious fiscal risk to an already challenging fiscal position. While the 2022 Debt Sustainability Analysis by the World Bank-IMF deemed the public debt to be sustainable, it highlighted the vulnerability of debt sustainability to potential fiscal liabilities from SOEs.

SOE fiscal risks are primarily caused by their quasi-fiscal deficits (QFDs). These QFDs have led to a significant accumulation of liabilities by SOEs, resulting in inadequate investment in the maintenance and upgrading of fixed capital assets. As a consequence, the reliability of supply has been negatively affected. The electricity sector has the largest QFDs, estimated to be around 4 percent of GDP in 2020. This is mostly due to the fact that end-user tariffs are set at levels that barely cover half of the cost of supply. To address this issue, the Government has been implementing the Program for the Financial Recovery of Barqi Tojik for 2022-2031. This program aims to gradually raise the average domestic tariffs to full-cost recovery levels. Implementing this electricity tariff reform could significantly reduce fiscal risks from the sector.

The total liabilities of 25 major SOEs accounted for approximately 50 percent of the GDP on average during 2020-2021. Over half of these liabilities are owed to the Government, resulting from past lending of external finance mobilized by the state budget. Additionally, over a quarter of the debt comprises debts to suppliers. Most of these debt liabilities are held by SOEs that do not have adequate financial resources to repay suppliers in full, marking almost all SOEs' debt liabilities as fiscal liabilities of the Government. The high capital investment requirements of SOEs, such as the completion of Rogun HPP, the rehabilitation and upgrading of electricity generation, transmission, and distribution infrastructure, and any expansion of TALCO, will incur additional fiscal liabilities since the Government will need to borrow to fund these projects.

Note: See Box 3.2 for SOE Presence and Risk to Competition

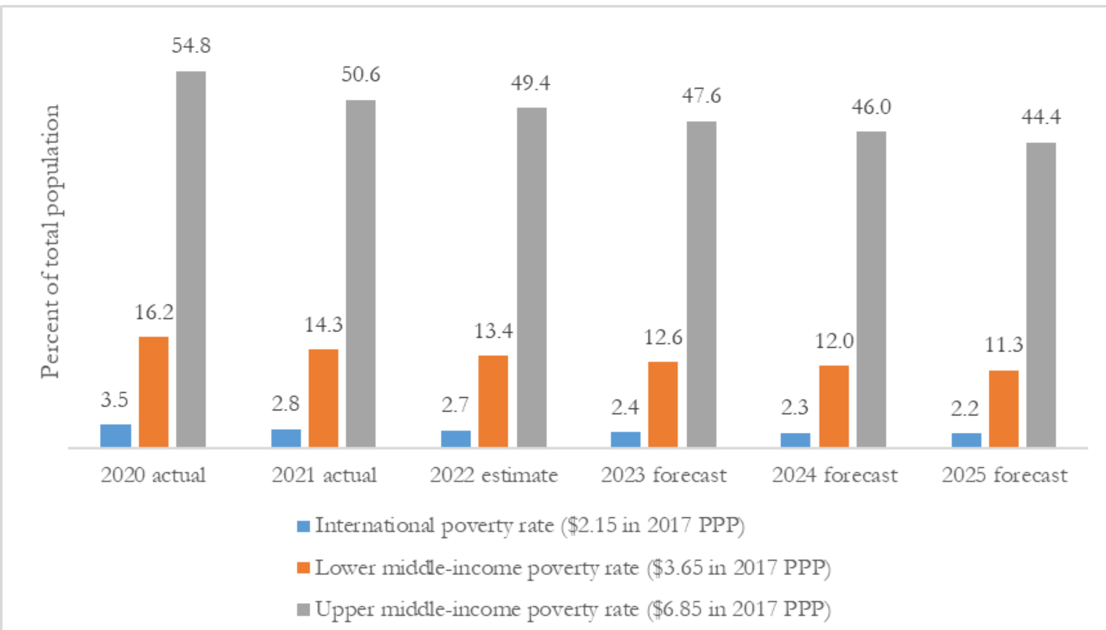
Source: Tajikistan Integrated SOE Framework (iSOEF) Assessment, World Bank 2023 (upcoming)

[44] In 2020, the write-off of liabilities of SOEs to the state budget amounted to 6 percent of GDP.

### 2.2.5. Poverty Projections

- **Assuming further income growth, the share of poor people in Tajikistan is forecast to decline in 2023.** Our baseline projections suggest that poverty in Tajikistan will further decline from 13.4 percent in 2022 to 12.6 percent in 2023 under the international poverty line of US$ 3.65 (2017 PPP), in line with forecast GDP growth. Remittance flows are expected to gradually normalize after the positive shock in 2022 and continue constituting one of the major sources of income for poor households, further reducing poverty levels (fig. 2.5).

Figure 2. 5. Poverty Projections




Source: World Bank staff projections

### 2.2.6. Selected proposals to improve macroeconomic management and social protection

- **To strengthen the effectiveness of macroeconomic management, the Tajik authorities could consider the recommendations summarized in Table 2.3.** These recommendations are not exhaustive and were formed based on the findings and insights shared in chapters 1 and 2 of the report.

Table 2. 3. Selected recommendations to address macroeconomic and social vulnerabilities

| Reform Action | Implementation Period | Implementation Agencies |
|---|---|---|
| **1. Strengthening the macro-fiscal sustainability** | | |
| Cap the fiscal deficit below 2.5 percent of GDP as an operational anchor for fiscal and debt sustainability | Short and Medium term | MOF |
| Temper spending on large-scale infrastructure projects, including the Rogun HPP | Short and Medium-term | MOF |
| Avoid non-concessional borrowing until the country's risk profile improves | Short and Medium-term | MOF |
| Improve debt management practices, including increasing the transparency of public debt and SOE contingent liabilities | Short and Medium-term | MOF |
| | | |
| Improve the efficiency of public investment programs | Medium term | MOF |
| **2. Strengthening the monetary and exchange rate policies** | | |
| Continue improving the transmission mechanism of the monetary policy | Medium term | NBT |
| Seek greater exchange rate flexibility | Medium term | NBT |
| Continue measures to de-dollarize the economy | Medium term | NBT |
| **3. Strengthening financial stability and financial sector development** | | |
| Enhance macro and micro-prudential supervision | Short and Medium term | NBT |
| Enhance the financial safety net by recapitalizing the deposit insurance fund and strengthening the bank resolution framework | Short and Medium term | NBT |
| Develop a savings mobilization strategy | Short and Medium term | MOF, NBT |
| Continue implementing the National Financial Inclusion Strategy 2022-2026 | Medium term | MOF, NBT |
| **4. Investing in human capital development and encouraging domestic labor mobility** | | |
| Continue implementing the TSA reform based on the newly adopted PMT formula and per capita approach | Short and Medium term | MOF, Ministry of Health and Social Protections of Population |
| Increase allocations to education, healthcare, and social programs | Medium term | MOF |
| Encourage domestic labor mobility | Medium term | GOT |
| Note: Short-term refers to a period of 6 months – 1 year, medium-term to a period of 1-2 years, and long-term 3-5 years | | |

# SPECIAL TOPIC: BOOSTING PRIVATE SECTOR DYNAMISM IN TAJIKISTAN

## 3.1. Private Sector Landscape in Tajikistan: A Brief Analysis with a Micro-Lens

- **A vibrant private sector can diversify exports, strengthen resilience to shocks and create more and better jobs.** This is much needed in Tajikistan, given the country's young population with limited domestic job opportunities, resulting in large out-migration and heavy economic dependence on remittances.

- **Private sector participation in the Tajik economy is officially high. However, a closer analysis reveals that its composition is primarily made up of individual entrepreneurs and farmers.** Tajikistan's Statistical Agency estimates that private sector firms account for 60 percent of GDP and provide 70-80 percent of jobs in the economy. The value added generated by private sector is concentrated in agriculture, followed by trade and hotels, and manufacturing. Notwithstanding, a closer analysis reveals that individual entrepreneurs account for the vast majority of registered companies and most of individual entrepreneurs are registered as farmers.[45] Moreover, according to the Statistical Agency, the official definition of a private sector firm in Tajikistan includes enterprises with less than 50 percent state participation. This means that a proportion of firms officially classified as privately owned might be SOEs with minority state shareholdings.[46]

### Box 3. 1. The private sector landscape in Tajikistan before Covid-19

The World Bank Enterprise Survey (WBES) data provides a representative sample of the non-extractive, non-agricultural, formal private economy, comparable across 144 countries. To be included in the survey, firms must have at least five employees, be formally registered, and have a minimum of 1% private ownership. Sector coverage includes the manufacturing, construction, and most services sectors47 but excludes public utilities, government services, health care, and financial services. The WBES interview takes place with top managers and business owners. In Tajikistan, business owners and top managers in 352 firms were interviewed between January and September 2019.

[45] According to EBRD (2020), of over 300,000 active SMEs registered in Tajikistan, only 10 per cent (around 30,000) SMEs are legal business entities, of which only 363 are foreign-owned. The vast majority, 90 per cent of all SMEs, are individual entrepreneurs classified as patent-holders (a form of business registration allowing owners to operate under a simplified tax arrangement), certificate holders and dekhan farmers (privately owned farms that were established after 1997 through the dissolution of Soviet-era state and collective farms). Dekhan farmers account for 61 per cent of all individual entrepreneurs

[46] World Bank (2023) shows that as of end-2021, the portfolio of companies with state equity comprised 1,036 enterprises, out of which 405 are SOEs with minority state equity (below 50 percent).

[47] Retail, wholesale, automotive repair, hotels and restaurants, transportation, storage, communications, construction, and IT.

WBES data for Tajikistan in 2019 show that, on average, 63% of firms are small (5–19 employees), 31% are medium-sized (20–99 employees), and only 6% are large (100 or more employees). Firms in retail and other services account for almost 60 percent of firms, with the remaining share in manufacturing. Almost half of firms were less than ten years old. Only 7% reported having a top female manager, which is well below the ECA average (20%).

Figure B3. 1. Size composition (# of employees) of the private sector in Tajikistan, 2019

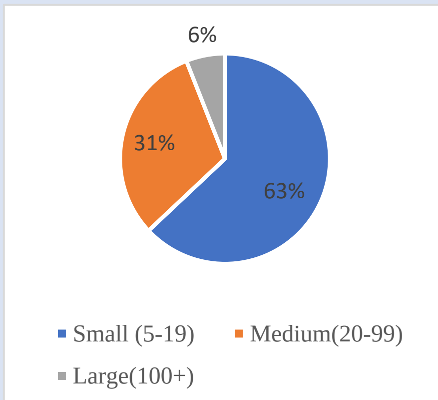
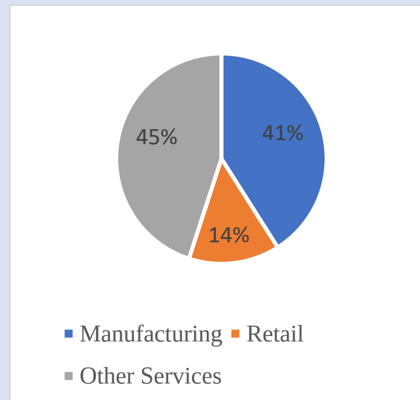



Figure B3. 2. Sector composition of the private sector in Tajikistan, 2019

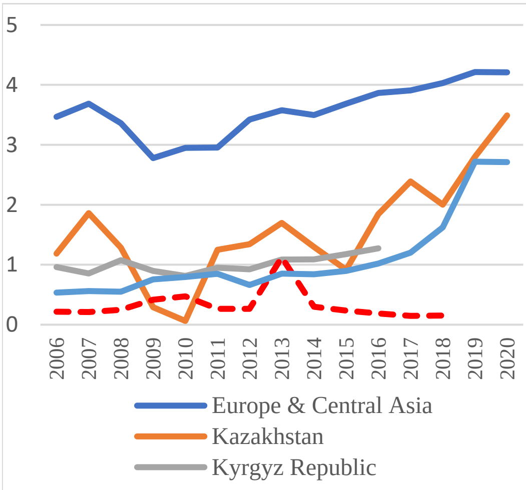



Source: World Bank staff elaboration based on WBES

- **Tajikistan's private sector lacks dynamism, with the entry of new firms well below the regional average, indicating limited market contestability.** A good proxy of entrepreneurial activity and private sector vitality is the entry rate into the formal private sector. New entrants are the agent of the "creative destruction" process and help to drive productivity growth. Figure 3.1 illustrates that this entry density rate is extremely low for Tajikistan and, other than a temporary blip, shows no sign of improvement over time[48]. The latest data available for Tajikistan is from 2018. Tajikistan fares worse than the ECA average and peer countries in Central Asia. Worryingly, while formal business registration does increase as the level of economic development grows, evidence shows that the registration of new private firms in Tajikistan is lower than in other countries of similar income level (fig. 3.2).

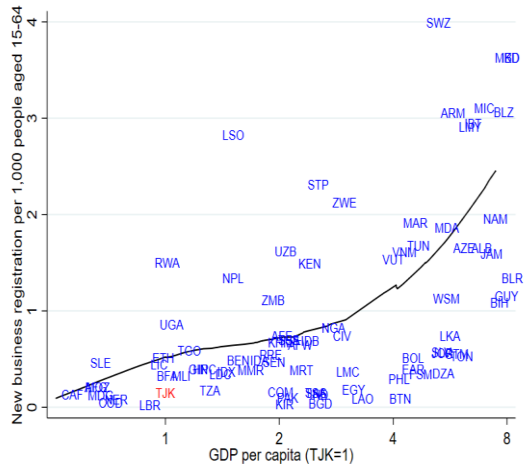
[48] It is worth acknowledging that these numbers only capture entry through the Limited Liability Company (LLC) modality. They do not include entry of firms as sole traders, corporations, non-profit, etc. Therefore, it captures a lower bound figure of entry rate into the formal private sector.

Figure 3. 1. New business density (new formal registrations per 1,000 people ages 15-64): Tajikistan vs. regional peers




Source: World Bank staff elaboration based on World Bank Entrepreneurship Dataset.
Note: New business entry density is defined as the number of newly registered formal, private limited-liability firms per 1,000 working-age people (ages 15-64).

Figure 3. 2. New business density and GDP per capita (2018)




Source: World Bank staff elaboration based on World Bank Entrepreneurship Dataset and WDI.

- **Once they enter the market, private sector firms struggle to grow.** A crucial driver for economic development is the speed with which the average business grows over its lifecycle.[49] WBES data shows that post-entry performance in the Tajik formal private sector was also poor compared to regional peers.[50] In Tajikistan, the average firm between 0-10 years of age has 25 employees, and the average firm of 21 or more years of age has 50 employees. But firms of 21 or more years of age are larger in ECA low- and middle-income countries (LMIC), especially Kazakhstan and the Kyrgyz Republic (fig 3.3).[51] Overall, these results suggest that private firms in Tajikistan struggle more to grow as they age, hinting at constraints to private sector expansion.

[49] Hsieh and Klenow (2014); Eslava, Haltiwanger, and Pinzón (2019).
[50] Ideally, one would like to trace firms over time to observe the size (measured in employment) variation across birth cohorts. Unfortunately, access to such long panels of firms in Tajikistan is not easily available. In this context, the analysis of firm dynamics across different birth cohorts is proxied through WBES data. In this regard, although WBES is representative of a cross- section of Tajikistan's firms at one point in time, they contain a key question that makes the analysis possible. Managers of the firms are asked, "How many permanent full-time employees did this establishment employ when it started operations?" This question allows their 2019 size to be compared with the size at the time of setting up the business.
[51] Another way to interpret the same results is to compare the median size gap relative to Tajikistan across age cohorts. In this case, data shows that differences in median (employment) size in relation to Tajik firms widen as firms age. For example, the median Tajik formal private firm of up to 10 years old employs 25 workers, compared with 16 workers in Kazakhstan; this (positive) difference of 9 workers in favor of Tajikistan is reverted to a negative gap of 48 employees for firms that are 21 or more years old. Compared to the Kyrgyz Republic, the initial median gap of 7 employees in favor of Kyrgyz firms grows even wider to 27 employees for 21+ older firms.

Figure 3. 3. Average firm size (# of employees) of private firms by age group: Tajikistan vs. regional peers

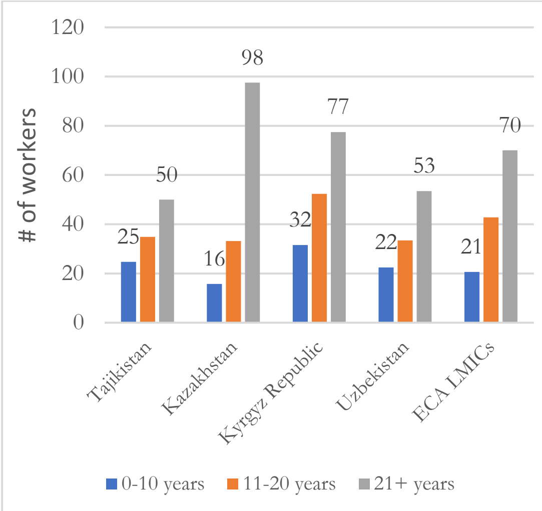
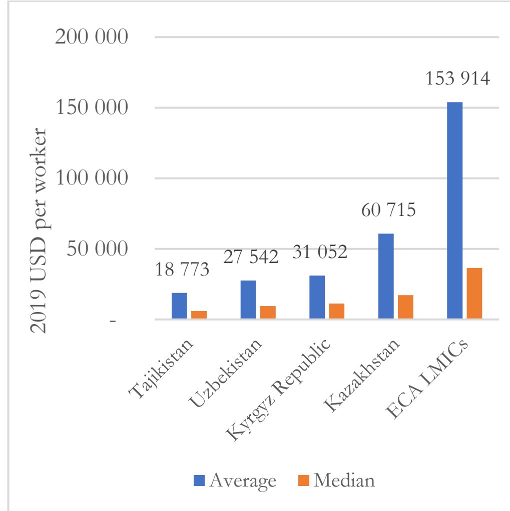



Figure 3. 4. Average and median labor productivity of private firms (2019 USD per worker): Tajikistan vs. regional peers




Source: World Bank staff elaboration based on WBES

- **Tajikistan's private firms are less productive than those of regional peers.** Labor productivity—defined as sales revenue per worker— of the formal private sector in Tajikistan is lower than that of ECA LMIC and regional peers. Average annual sales per worker are US$18,733 at a firm in Tajikistan but are US$27,542 in Uzbekistan and US$31,052 in the Kyrgyz Republic (fig. 3.4). Comparisons of median values, less likely to be influenced by outliers, also reveal worse performance for Tajikistan private firms. Comparing the distribution of productivity across countries can provide insights into private sector firms' overall composition and productivity levels. The data reveals that in Central Asian economies, including Tajikistan, the productivity distribution is skewed to the left when compared to Germany, a high-income economy with a vibrant private sector. This suggests that Central Asian countries, including Tajikistan, share a common issue of a concentration of low-productivity firms in their economies. However, when specifically examining Tajikistan, its productivity distribution's left tail appears slightly thicker than its Central Asian peers. This indicates that the survival of inefficient firms in Tajikistan may pose a relatively more significant challenge than other countries in the region. In addition, this suggests that specific factors or barriers in Tajikistan may contribute to the persistence of inefficient firms and hinder their exit from the market (fig. 3.5).

Figure 3. 5. Labor productivity distributions of private firms, 2019: Tajikistan vs. regional peers

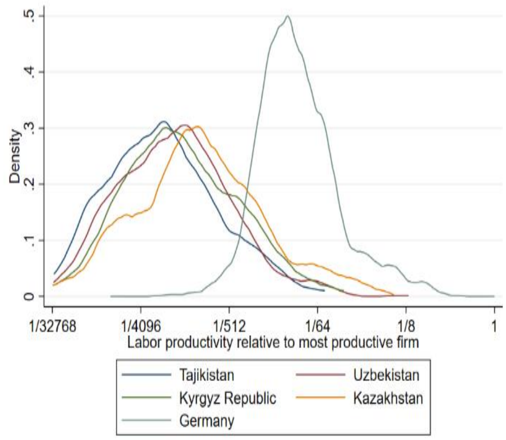
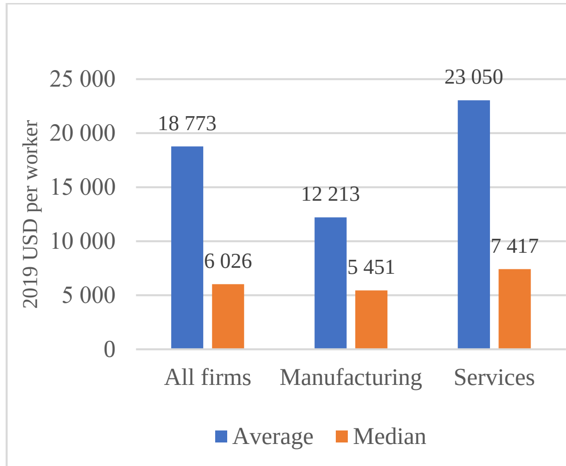



Figure 3. 6. Average and median labor productivity of private firms in Tajikistan (2019 USD per worker): services vs. manufacturing

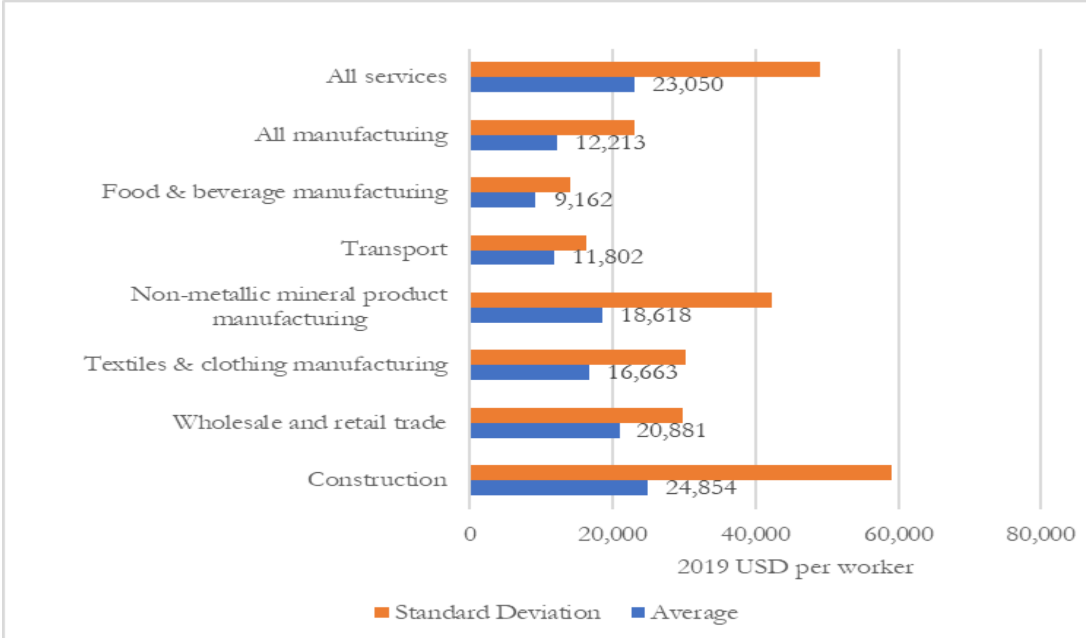



Source: World Bank staff elaboration based on WBES

- **Within the country, weak productivity is most apparent in the manufacturing rather than the services sector. However, when zooming in within sectors, there are large differences in labor productivity performance across firms both in manufacturing and services, suggesting opportunities for upgrading in the whole economy.** The manufacturing sector's average labor productivity is about half that of the services sector (fig 3.6). Another interesting aspect is revealed when zooming in on the labor productivity performance of private sector firms within sectors, where firms are supposed to operate under similar constraints regarding technologies and production processes. In this case, fig 3.7 compares the average and dispersion (measured by the standard deviation) of productivity performance across firms within sectors. High dispersion in labor productivity within a sector indicates opportunities for upgrading in which labor reallocates from less productive firms to more productive firms. This is an important finding from a policy perspective as it suggests significant scope to reduce disparities and improve aggregate productivity. Data for Tajikistan reveals that despite having a higher average, services – which comprises non-tradable activities - has higher dispersion than manufacturing. Also, data shows that sectors like construction and non-metallic mineral product manufacturing (e.g., glass, cement) have the largest dispersion in productivity. These results indicate a need and scope to improve productivity in these sectors, which will require the design of interventions tailored to the particularities of these activities to remove the distortions that create the existing wedges across firms' performance. [52]

[52] It is worth acknowledging the limitations of this analysis which is based on a survey rather than a census, and so forth it does not capture the entire economy. As a result, the analysis does not fully capture the dispersion and characteristics of sectors or firms that were not included in the sample. Therefore, there is a possibility that there are sectors or firms not covered in the survey where dispersions of productivity could be even higher.

Figure 3. 7. Average and standard deviation of labor productivity of private firms in Tajikistan (2019 USD per worker).




- **Overall, the unresponsive productivity performance has resulted in limited integration to trade.** There is vast empirical literature showing a positive association between export activity and productivity premia. The two main mechanisms underlying this relationship are self-selection into the export market and 'learning by exporting'.[53] WBES data suggests that the private sector in Tajikistan may fail to realize trade gains: only 3.1 percent of (manufacturing) firms in Tajikistan export directly more than 10 percent of sales, three times less than in the Kyrgyz Republic and more than five times less than the average for ECA LMIC (fig. 3.8). Importing inputs offers another potential channel through which firms can explore productivity gains. By accessing a wider variety and higher quality of inputs, firms have additional possibilities for production and opportunities to save on costs or upgrade their final product quality.[54] In Hungary, for instance, one-quarter of productivity growth during the liberalization period of 1993-2002 was attributed to imported inputs.[55] But Tajik private firms are not fully tapping into these opportunities and the proportion of private manufacturing firms that rely on imported inputs is among the lowest in ECA region (fig. 3.9).

[53] There are two alternatives, but not mutually exclusive, hypotheses on why exporters are expected to be more productive than non-exporters. The first hypothesis points to self-selection of the more productive firms into export markets: firms need to reach a minimum productivity threshold to enter the more competitive foreign markets (Melitz, 2003); thus, only the ex-ante most productive firms can sell abroad. For empirical evidence of this first hypothesis, see Alvarez and Lopez (2005); Kraay (2002); and Blalock and Gertler (2004). The second hypothesis suggests that once firms enter export markets they can experience further productivity gains: the potential gains arise from because exporter firms can benefit from economies of scale, knowledge flows from international customers and from increased competition in export markets that forces firms to improve their efficiency. For empirical evidence of this second hypothesis, see Van Biesebroeck (2005); De Loecker (2010); and De Loecker (2013).

[54] A large literature shows that productivity gains extend to firms that directly import inputs. See, for instance Halpern et al. (2015).

[55] See Halpern et al (2015). Evidence from India also suggests imported inputs can have positive effects on firm profitability, providing more resources for investment and expansion. De Loecker et al. (2016).

Figure 3. 8. Percentage of private firms that export at least 10% of sales directly in 2019: Tajikistan vs. regional peers

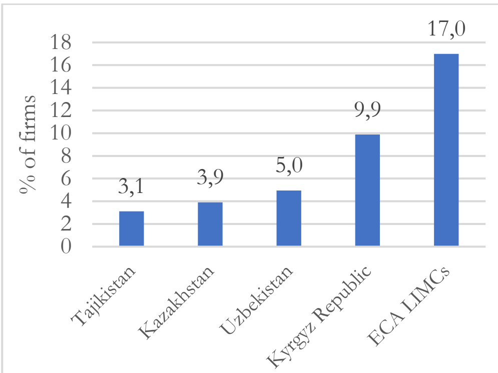
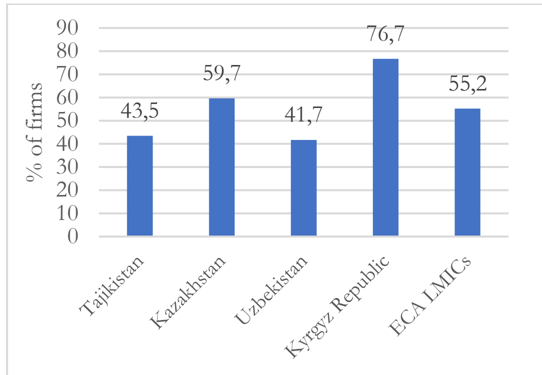



Figure 3. 9. Percentage of private manufacturing firms using inputs and/or supplies of foreign origin in 2019: Tajikistan vs. regional peers




Source: World Bank staff elaboration based on WBES

- **Moreover, innovation intensity among private sector firms is also low, suggesting underdeveloped firm capabilities.** By introducing process and product innovation, firms can improve the goods and services they offer while increasing demand and reducing production costs. All these outcomes affect productivity. In this regard, the WBES data suggest that the innovation performance among formal private firms in Tajikistan was underdeveloped before the pandemic: only 18.6 percent of private firms report introducing a new product or process between 2016-2019, below the average for ECA region (fig. 3.10). Low innovation performance owes to underdeveloped firm capabilities. Cirera and Maloney (2017) highlight that firms' ability to identify opportunities, manage the associated risks, formulate growth strategies, and then introduce innovative products or processes depends on their capabilities. Multiple capabilities are necessary: basic human capital, managerial capabilities, technological capabilities, and actuarial capabilities. In this regard, WBES data shows that Tajikistan's private formal firms underperform in several measures of firms' capabilities. For instance, Figure 3.11 shows that only 2.2 percent of formal private firms have internationally recognized quality certification, considerably below regional peers and the average for the ECA region (around 20 percent).

Figure 3. 10. Percentage of private firms introducing a new product or process in 2016-2019: Tajikistan vs. regional peers

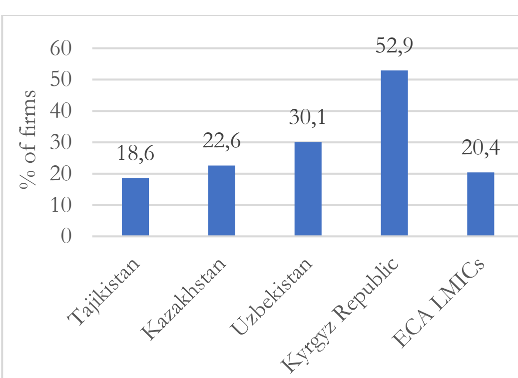
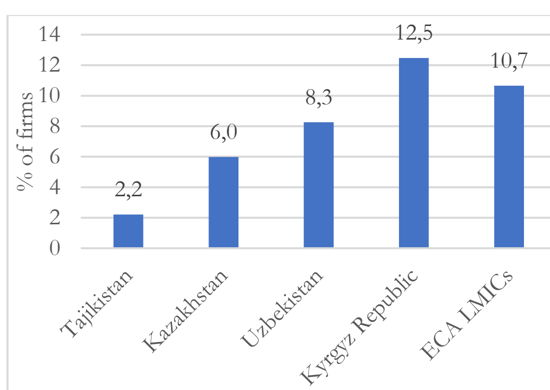



Figure 3. 11. Percentage of private firms with internationally recognized quality certification in 2019: Tajikistan vs. regional peers




Source: World Bank staff elaboration based on WBES

### 3.1.1. How did private firms weather the Covid-19 crisis?

- **Against this backdrop of poor comparative performance, the formal private sector in Tajikistan was hit hard by the Covid-19 shock, with a persistent negative effect on sales, especially among micro and small firms.** The World Bank Business Pulse Survey (WBBPS) provides a representative picture of how private firms – across agriculture, manufacturing, and services sectors - fared throughout the Covid-19 pandemic. Three survey rounds were conducted: August-September 2020, May-July 2021, and March-May 2022[56]. In August 2020, WBBPS data shows that sales declined at private sector firms of all sizes relative to the previous year (fig. 3.12). In June 2021 and April 2022, the latter already capturing the initial effects of the Russian invasion of Ukraine, sales continued to decline year on year. However, proportional declines were less pronounced among large firms. From this perspective, the pandemic hit micro and small firms hardest. While private sales performance remained consistently in the negative range, there are a few signs of recovery given the decreasing magnitude of sales drop over time; the latent recovery has been more pronounced for medium-large firms.

- **Surprisingly, the economic shock has not resulted in a strong employment adjustment.** From an employment perspective, private firms of all sizes maintained roughly the same number of full-time and part-time workers in 2020 (fig. 3.13). Furthermore, employment net variation (i.e., hiring minus firing of workers) has experienced a slightly positive performance in 2021 and 2022, with hiring concentrated among medium-large firms. This is a positive sign that illustrates the capacity of the private sector to preserve productive worker-firm links and worker skills, which are likely to help private firms to recover their activities when demand picks up.

Figure 3. 12. Average percent change in sales of private firms relative to the previous year

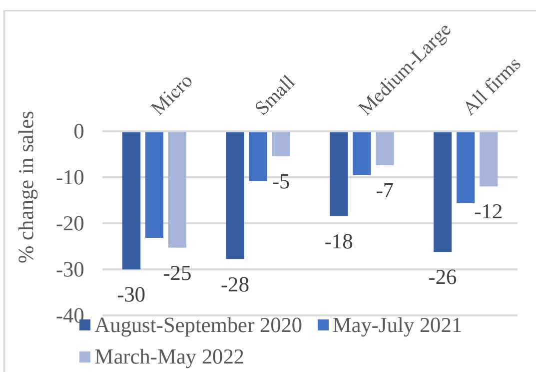
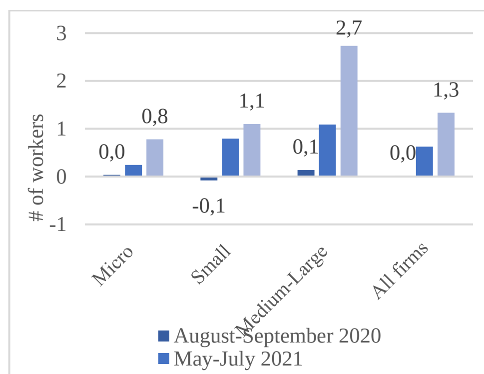



Figure 3 13. Average change in the number of workers of private firms in the last 30 days[57]




[56] The WBBPS is a novel dataset that tracks the potential impact of the pandemic on the private sector about critical dimensions of business performance, such as operations of the business, sales revenue, liquidity and insolvency, labor adjustments, adoption of technology, expectations and uncertainty about the future, and access to public support. The data include micro, small, medium, and large businesses across all main sectors (i.e., agriculture, manufacturing, retail, and other services, including construction). In Tajikistan, the sampling frame was based on censuses from Statistics Agency and business listings from Business Associations and only included registered businesses. Three survey rounds were conducted in Tajikistan: August-September 2020, May-July 2021, and March-May 2022. Interviews were conducted over the phone. In the August-September 2020 survey had 1,690 respondents; the May-July 2021 survey had 1,032 respondents; the March-May 2022 survey had 1,029 respondents.

[57] The surveys occur during different seasons, with the 2020 and 2021 surveys occurring in the summer, and the 2022 survey occurring in the spring. In principle, since the survey asks about hiring over the past 30 days, if seasonal factors leading hiring to be higher in the spring relative to summer, employment growth in 2022 could be overstated. However, trends are not different in agriculture and retail, which are expected to be more seasonal than manufacturing, so there is no evidence of seasonality effects driving the results.

Source: World Bank staff elaboration based on WBBPS
Note 1: Micro firms have 0-4 employees; small 5-19; medium-large firms have 20 and above. Medium and large firms are aggregated into a single category because there are very few large firms in the sample, which undermines the point estimate for large firms.
Note 2: Sampling weights are used so that averages are representative of the private sector.

- **Private firms have also been experiencing persistent financial fragility.** With COVID-19, liquidity pressures can escalate and may lead to solvency issues. WBBPS data shows that many firms have been expecting to fall into arrears. Figure 3.14 shows that by August-September 2020, 27 percent of firms were already in arrears or expecting to fall into arrears in the following six-month period. This probability has been declining over time for all size groups, though at a slower pace for micro firms. In March-May 2022, firms reporting that they expect to fall into arrears also said they had enough cash to continue paying all costs and payments (such as payroll, suppliers, taxes, or loan repayment) with the cash available for 11.5 weeks, on average. In 2020, this average was 29 weeks. This result points to a puzzling picture because the decrease in the probability of falling into arrears has not been accompanied by an increase in the number of weeks firms can cover their expenditures with their cash. Two potential explanations emerge: firms were too optimistic by August-September 2020, or else some have benefited from deferred payments.[58]

Figure 3. 14. Percentage of private firms expecting to fall into arrears in the next six months.

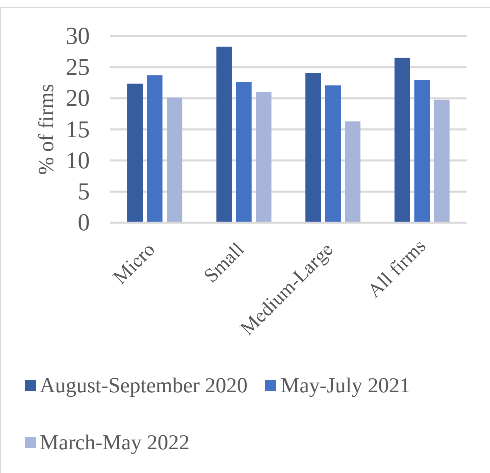
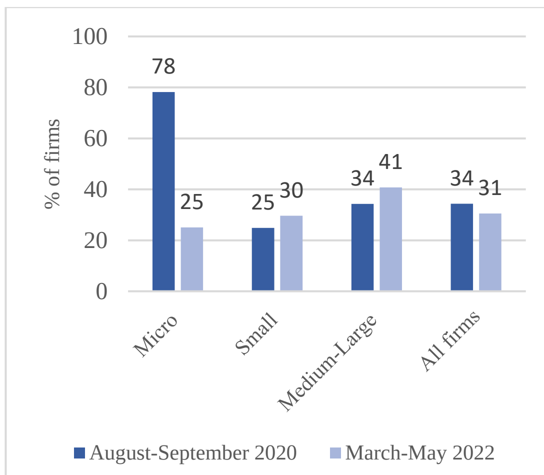



Figure 3. 15. Percentage of private firms that started using or increased the use of digital platforms




Source: World Bank staff elaboration based on WBBPS
Note 1: Micro firms have 0-4 employees; small 5-19; medium-large firms have 20 and above.

[58] Another alternative explanation is that firms, in response to falling sales in 2020, prioritized liquidation of existing inventories instead of investing in machinery and equipment or incurring any expenses with input purchases for new production, which could have led to extra cash holdings.

### 3.1.2. Building back better: tackling the structural weakness of the private sector

- **While the short-term effects of the crisis on sales are undoubtedly negative, and financial fragility is persistently high, it is still unclear how the crisis will affect Tajikistan's private sector's long-term trajectory of productivity growth.** The long-term effects of this economic shock on Tajikistan's long-term private sector performance are still unknown. On the one hand, the economic shocks caused by the pandemic can trigger a cleansing effect by encouraging the exit of low-productivity firms and reallocating resources toward higher-productivity firms or growth[59] sectors[60]. On the other hand, economic shocks can lead to persistent low-growth episodes and damage long-term drivers of productivity growth by negatively impacting firms' capabilities through irreversible effects on intangible assets - like buyer-supplier trust, lender-borrower relationships, and employee-firm relations - that would require additional and newly sunk cost investments to replicate.

- **The pandemic may have spurred the productivity-enhancing use of digital solutions.** WBBPS data points to a large and persistent increase – at least among micro firms - in using digital platforms to respond to the crisis (fig. 3.15) and points to potential gains in long-term productivity by allowing firms to access more (and eventually more sophisticated) consumer markets and to increase the efficiency with which they organize their production process. This is consistent with worldwide trends of accelerated digitalization among firms in response to the pandemic in the short term.[61]

- **Likewise, the limited impact on employment might indicate that private firms managed to preserve employment-productive links, which can help boost future productivity growth.** The evidence provided by the WBBPS data of small net variation in the number of full-time employees points to potential employment resilience among private sector firms in Tajikistan. Private firms have retained employees' skills and associated links with productivity activities by keeping on their employees. This is a desirable outcome, at least when looking at short-term resilience. On the other hand, if these employment links are preserved in inefficient firms that continue to operate, there is a risk of negative reallocation that might result in a negative aggregate impact on the economy.

- **Business support policies have been playing a key role in helping to alleviate the effects of the pandemic shocks**. These policies have prioritized fiscal exemptions and medium and large firms. The WBBPS asked firms about what policy benefits they received

[59] While the shocks caused by the pandemic can indeed push inefficient firms to exit the market, it's unclear if those firms that manage to survive are necessarily more productive or if they subsist because they have other features not necessarily linked with efficiency, like market power, rent-seeking ability, etc.

[60] There is mixed evidence on reallocation of economic activity from less to more productive firms after economic shock episodes. World Bank (2021) uses Covid-19 Follow-Up WBES data for a sub set of ECA countries and shows evidence that economic activity in the region was reallocated toward more productive firms during the COVID-19 crisis, consistent with the creative destruction hypothesis. Results do not apply however to Tajikistan as data for the country was not included in the analysis. Foster, Grim, and Haltiwanger (2016) analyzed establishment-level data from the US Census Bureau for 1981 to 2010 and found evidence of increased reallocation from less productive to more productive establishments in recessions before the Great Recession, but the cleansing impact of earlier recessions attenuated during the Great Recession. Likewise, Hallward-Driemeier and Rjikers (2013) use Indonesian manufacturing census data from 1991 to 2001 to show that more productive firms were less likely to exit before the East Asian crisis, but this relationship weakened during the crisis.

[61] Apedo-Amah et al. (2020) and Cirera et al. (2021)

during the pandemic and what policies they would have preferred to receive. Figure 3.16 shows that the reach of business support policies was limited: only 21 percent of private firms in Tajikistan had received any public support right at the onset of the crisis (August-September 2020), which means that most private firms in the country have faced economic shock without any type of public support. Figure 3.16 also shows that large and medium-sized firms were most likely to receive support, with 29 percent receiving support in 2020, while only 16 percent of micro-sized firms received government support in the same year. Figure 3.17 shows that fiscal exemptions were the most preferred aid.[62] An explanation for this potential mistargeting might be the limited policy implementation capacity and the fact that many support programs in 2020 and 2021 were implemented quickly, and targeting was not the priority. In addition, barriers to accessing the support – for instance, lack of awareness about existing programs and a cumbersome application process - might be another reason to explain the low support coverage across micro and small firms. In this regard, it is worth highlighting that the likelihood of micro firms receiving government support has increased over time while decreasing for small and medium-large firms.

Figure 3. 16. Percentage of private firms that reported receiving government support (by firm size)

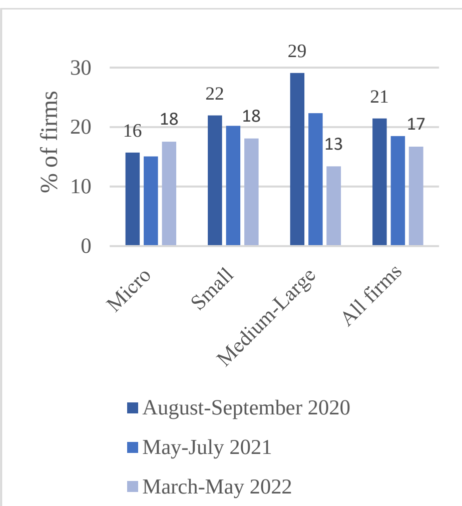
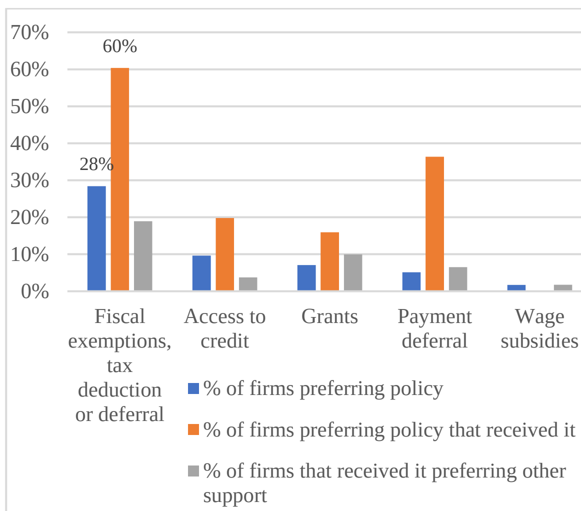



Figure 3. 17. Preferred support vs. actual support in 2020




Source: World Bank staff elaboration based on WBBPS
Note: Micro firms have 0-4 employees; small 5-19; medium-large firms have 20 and above

- **In light of limited fiscal space, business support programs must be recalibrated to streamline their objectives and scope.** Continuous shocks now and on the horizon point to the ongoing importance of business support programs. Yet with very limited fiscal space, the use of public resources for transfers to firms is highly constrained. As highlighted above, there are signs of policy support mistargeting: firms that suffered the largest impacts of the pandemic crisis – micro and small firms – were less likely to receive business support, and more productive firms were not prioritized by the government as targets of government assistance. While further and more rigorous analysis is needed to gauge additional micro

[62] A multivariate analysis that controls simultaneously for different firm characteristics confirms that larger firms were more likely to receive any type of government support than small firms. The analysis reveals that the granting of support measures has no robust correlation with firm productivity, suggesting that high productive firms were not prioritized. Even further, there is evidence that more productive firms were less likely to receive fiscal exemptions, the most common type of support granted.

evidence to confirm this potential mistargeting and to shed light on the potential underlying reasons (i.e., barriers to access support and lack of targeting capacity from the government side), there is a risk that these policies might be hampering a productive recovery. The longer firm support measures remain in place, the higher the risk that resources are locked in inefficient firms or sectors, delaying a sustainable recovery. Likewise, providing more support to larger firms risks increasing market concentration and hampering competition. In this context, as Tajikistan moves to the next stage of economic recovery, the authorities might consider recalibrating the remaining business support measures to prioritize the reallocation of factors of production towards efficient, high-potential firms and growing sectors[63]. With viable and potentially high-productive firms as targets, programs could include support to improve management skills to fortify firm capabilities, increase the adoption of digital technologies, and boost the use of green-friendly solutions. These are all effective ways to anchor productivity growth and better equip private firms to tap into new competitiveness sources.

- **More important, there is a need to tackle structural barriers to private sector expansion and productivity growth.** As important as recalibrating business support policies is having the right structural policy settings that allow for a sustainable productivity-enhancing recovery. In this regard, there is a vast economic and empirical literature showing the positive role of structural policies – such as labor market and product market regulations – in influencing the capacity of the economy to cushion the effects of economic shocks and facilitating a productivity-enhancing recovery.[64] Losses to potential output tend to be smaller and gains in productivity tend to be larger in environments that can better accommodate the reallocation of productive resources to more productive firms and sectors. The micro-level evidence presented in this section revealed the multiple weaknesses of Tajikistan's private sector: low entry rate, low productivity, limited integration to trade, low incidence of innovation, and limited capabilities. Also revealing was that private firms struggle to grow as they age. All these aspects reflect a business environment that does not reward the more efficient firms or those with the highest growth potential.[65] To tackle the long-term weaknesses of the private sector in Tajikistan, it is crucial to remove policy barriers that prevent the reallocation of resources towards more productive firms so that the private sector becomes more efficient and able to generate more and better jobs. Failure to reduce these reallocation frictions can also reduce job opportunities, stifle innovation, limiting productive career prospects and technology adoption, thus hampering productivity growth.

- **The next sections shed light on three sets of structural barriers to private sector growth in Tajikistan that should be tackled to promote a productivity-enhancing recovery: barriers to competition, foreign direct investment, and trade.** Prioritizing structural policies to remove impediments to firm entry and expansion in the private sector is paramount. While there are several barriers to private sector development: (for instance, private sector firms listed tax rates and tax administration as the top two business

[63] The recalibration of business support policies could eventually encompass support instruments introduced before the pandemic.
[64] See, for instance, Duvaland Vogel (2008); and Duval and Furceri (2018).
[65] Conceptually, if firms "learn" about their productivity over time, it would be expected that efficient firms invest and expand, while less productive ones stay small, shrink, or exit the market (Jovanovic 1982, Hopenhaynís 1992). However, resource allocation does not occur naturally when the business environment is distorted, but rather allows underperforming firms to survive and/or de-incentivizes efficient firms from growing. In fact, Hsieh and Klenow (2014) show that firm growth patterns vastly diverge across countries because of distortions that impede resource allocation toward firms with higher productivity and growth potential.

constraints in 2019)[66], the focus on barriers to competition, foreign investment, and trade stems from the interrelated forces among these policy domains. They reinforce one other in fostering firms' competitiveness. Foreign investment policy encourages the entry of new international actors, while trade policy influences the size of the output market and the range of input sources available to firms. Meanwhile, competition policy affects "behind the border" market entry and the contestability of both input and output markets while providing incentives to innovate and increase productivity.

## 3.2. Identifying Barriers to Competition

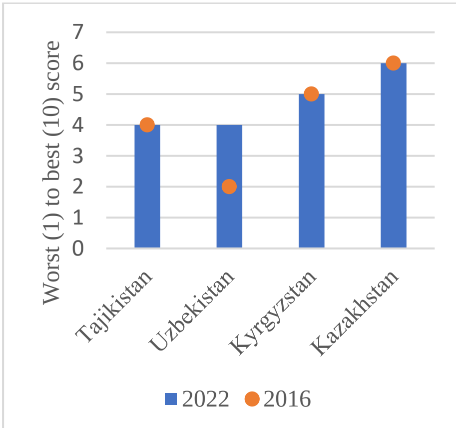
- **The state of competition is a crucial ingredient for private sector development in general and productivity growth specifically.** When competition is limited, more productive firms are prevented from growing, incumbents have fewer incentives to invest in productivity-enhancing technologies, more productive firms are less likely to enter, and less productive firms are less likely to exit the market. Governments can influence market functioning and the associated competitive pressure in different ways. For example, they provide goods and services, regulate markets, grant subsidies to firms, and collect taxes from firms. In doing so, governments can influence competition by affecting market entry or exit, the market conditions for competition among firms, and the ability of consumers to exercise consumer choice. All these government interventions are not necessarily harmful. On the contrary, they can level the playing field and boost competition when properly coordinated among multiple government bodies and calibrated to balance each policy's economic and non-economic objectives and their effects on the functioning of markets. In this context, a comprehensive competition policy framework should therefore rest on three key pillars: (1) enabling effective competition law and antitrust enforcement, (2) promoting competitive neutrality and non-distortive public aid, and (3) fostering pro-competition regulations and government interventions in markets. (Kitzmueller and Licetti, 2012).

- **The degree of competition in Tajik markets is perceived as weak compared with peer countries.** According to the latest Bertelsmann 'Stiftung's transformation index (BTI), the fundamentals of market-based competition in Tajikistan are perceived to have not improved in the past few years. As of 2022, the latest year available, it still falls behind some of its peers in Central Asia (fig. 3.18)[67] and has now been matched by fast-improving Uzbekistan. Likewise, and according to the latest data from the Economist Intelligence Unit, the overall perception of business risks related to lack of competition is high in Tajikistan, especially in relation to vested interests followed by unfair competitive practices perceive (fig. 3.19 below) .

[66] According to WBES 2019 data, tax rates and the administrative burden of paying taxes are the most common constraints listed by firms: 24 percent of firms identified tax rates as a major constraint on their business, and 78 percent of firms have been visited by a tax official, on average 3 times. This is much more frequent interaction compared to Uzbekistan and Kazakhstan, where about 30 percent of firms have been visited by a tax official, and only once per year on average.

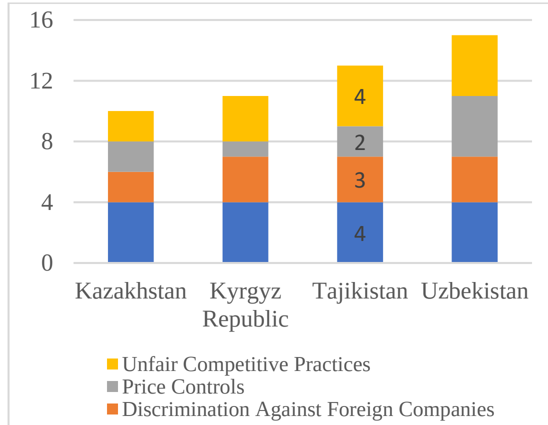
[67] The indicators of the Bertelsmann Stiftung's Transformation Index (BTI) answer the following questions based on expert judgment: (i) to what level have the fundamentals of market-based competition developed (including the low importance of administered pricing, currency convertibility, no significant entry and exit barriers in product and factor markets, freedom to launch and withdraw investments, and no discrimination based on ownership (state/private, foreign/local) and size and (ii) to what extent do safeguards exist to prevent the development of economic monopolies and cartels, and to what extent are they enforced (including the existence of antitrust or competition laws and enforcement)?

Figure 3. 18. Fundamentals of market-based competition, Tajikistan vs. regional peers, 2016 and 2022




Sources: World Bank calculations based on 2022 data of BTI (Transformation Index) (dashboard), Bertelsmann Stiftung, Gütersloh, https://bti-project.org/

Figure 3. 19. Competition-related risks for business in Tajikistan and regional peers (December 2022)




Source: World Bank staff elaboration based on the 'EIU's Risk Tracker data (December, 2022).
Note: The graph aggregates four indicators, each scored on a scale from 0 (very little risk) to 4 (very high risk).

- **The latest World Bank Country Economic Memorandum in 2019 highlighted the challenges in implementing t competition policies in Tajikistan.** The World Bank (2019) pointed to regulatory and implementation gaps that restrict the effectiveness of Tajikistan's competition policy framework to allow for efficient private investment that benefits consumers and the economy in general. These gaps are many and include limited enforcement of competition law to curb anti-competitive practices; and the use of economy-wide policies that undermine competition principles, such as excessive use of price control mechanisms, insufficient enforcement of state aid control rules, the existence of legal monopolies in potentially competitive markets, and the lack of competitive neutrality. In addition to these economy-wide restrictions, the report also highlighted specific barriers to competition in key network sectors, such as telecommunications and air transportation. The current section runs a quick update of the World Bank (2019) assessment of competition policy for Tajikistan. It does not constitute a fully-fledged, comprehensive assessment of all competition barriers in the country; instead, it offers a snapshot of key competition issues.

### *3.2.1. Limited enforcement of the Competition Law to curb anti-competitive practices.*

- **The effective enforcement of the Competition Law in Tajikistan is restricted by a combination of factors – discussed below – that persist despite the legal amendments introduced in 2022.** The Law "On the Protection of Competition" (the Competition Law)[68] sets out the basic principles and rules of the Tajik competition policy framework. With a scope covering private and public operators, including government authorities of all levels, the Law regulates abuse of dominance, anti-competitive agreement, and mergers. The Law also establishes the Antimonopoly Service (the AMS) as a

[68] Law No. 1417, dated 30.05.2017. The Law has replaced the 2006 Law "On competition and restriction of monopolistic activity in the commodity markets."

responsible body and separate authority to promote competition enforcement and advocacy (which includes participation in the privatization of SOEs, delivery of opinions on the competitive impact of introduction, change, and termination of customs tariffs or non-tariff measures, among others). Moreover, the Law empowers the AMS with tasks beyond typical antitrust frameworks, such as controlling the price behavior of dominant firms, regulating prices in the general economy, dealing with irregularities in public officials' conduct of tenders, and regulation of state-aid-related issues. On the latter, the Law states that any grant of public support, at both national and local levels, requires prior approval from the AMS. If an AMS order is violated, it can enforce its decision before judicial courts. A few minor amendments were introduced to the Law in 2022, which expands the authority of AMS in bringing a claim to the judiciary complaining about the violation of the antimonopoly legislation by individual entrepreneurs (non-corporate persons) (Article 22.1). The amendments have also authorized AMS to request the court to cancel licenses and permits of an economic entity (acting in the licensable sphere of economic activity) that has violated the requirements of the antimonopoly legislation (Article 22.1).

#### 3.2.1.1. Insufficient control of cartels

- **Unlike many jurisdictions, cartels are not considered unlawful per se according to the Competition Law in Tajikistan, which may undermine healthy competition in the market. The recent amendments introduced to the Law in 2022 have not addressed this issue.** In Tajikistan, cartels are classified as unlawful only if certain conditions are met. While the Competition Law recognizes that agreements or the implementation of concerted actions by economic entities operating on the market of the same goods[69] (or interchangeable goods) as a cartel, such agreements or actions are only prohibited if they lead to or may lead to certain adverse results such as price manipulation, market access restrictions to others, etc. (Article 7) Specifically, the Competition Law does not set per se prohibitions on 'hard-core' cartels, does not distinguish them from other agreements that can be pro-competitive, nor require assessing their effects on the markets.[70] Not prohibiting 'hard-core' cartels per se represents a potential shortcoming as it might result in the inconsistent and discretionary interpretation of what may or may not lead to such adverse results, which could undermine healthy competition in the market. The 2022 amendments to the Competition Law did not tackle these shortcomings. On a positive note, however, the AMS has reported a successful case of tackling the cartel by mobile phone operators in 2022.[71]

- **The AMS is not sufficiently equipped to detect, sanction, and deter cartels.** The mandate of the AMS to implement search and seizure procedures as part of a cartel investigation is constrained by the "Law on Inspections of Operational Activities.[72] This Law demands the AMS to inform affected entities in advance about an upcoming inspection, which can enable alteration or destruction of evidence by the investigated parties

[69] For the purpose of the Competition Law, the definition of "goods" also includes "services" and "works".
[70] The International Competition Network acknowledges the consensus on four types of conduct as constituting 'hard-core cartels': price fixing, output restrictions, market allocation, and bid rigging. Considering the negative impact of these practices, and its unlikelihood to promote either competition or welfare, most jurisdictions treat 'hard-core' cartels as objective or per se violations. For further details, see International Competition Network (ICN). 2005. "Defining Hard Core Cartel Conduct: Effective Institutions, Effective Penalties." Building Blocks for Effective Anti-Cartel Regimes, Vol. 1. Luxembourg: European Communities.
[71] By the decision of the AMS (dated July 22, 2022) the actions of these operators were recognized as coordinated, which equally affects other market participants. In this regard, an administrative case was initiated against the parties and the decision was made to impose penalties.
[72] The Law of the Republic of Tajikistan "On Inspections of Operational Activities of Business Entities" No.1269, dated 25.12.2015 (latest changes to the Law was made on 02.01.2020).

unlike an unannounced inspection, thereby constraining the AMS's powers to obtain evidence of anticompetitive agreements. The legal shortcoming identified by World Bank (2019) are still in place. In this regard, there is still a need to modify the Competition Law (Article 7) to impose per se prohibitions on 'hard core' cartels while equipping the AMS to use its powers to detect, deter, and sanction 'hard-core' cartels. The latter would require improving the AMS capacity to run economic analysis to screen for markets that might be prone to 'hard-core' cartel behavior and to build strong cartel investigations, as well as adopting regulations on the procedure for carrying out inspections on compliance with antimonopoly legislation to bring more legal certainty to the cartel investigation process. The latter, for instance, could be done by amending the "Law on Inspections of Operational Activities" to allow the AMS to conduct proper unannounced inspections as part of cartel investigations. Finally, it is important to develop a leniency framework.[73]

### 3.2.1.2. Restrictive definition and control of market dominance

- **The Law applies a structural definition of "market dominance" based solely on the market shares of a business entity at a point in time, which may unduly burden private sector growth by restricting competition based on the merits.** The Competition Law uses a structural approach to define the dominant position of a firm: any firm whose market share is higher than 35 percent at a certain point in time is considered dominant. This definition is restrictive and not in line with best practices. More importantly, as highlighted by the World Bank (2019), this is particularly problematic because, according to the Law, the AMS is mandated to keep a registry of firms classified as dominant. These firms are subject to special rules – e.g., having their prices regulated - which might affect the business's ability to compete. As a result, private companies that are classified as dominant according to the Law but that do not hold significant market power – according to economic and internationally accepted legal standards – and are not likely to abuse their market power will be prohibited by the Law from engaging in normal business conduct, such as reducing prices or bundling products to attract consumers, that would otherwise be perfectly pro-competitive if performed by non-dominant firms. The 2022 amendments to the Law have not addressed this issue. Against this backdrop, there is a need to introduce a framework that reflects economic principles to determine the abuse of dominance rather than simply relying on the market share factor. Such a framework would refocus AMS resources toward cases and investigations with a larger impact on the market and firms' incentives for growth, for instance, by focusing on investigations on abuse of dominance investigations of practices that foreclose entry instead of ex-ante control of commercial decisions of firms that are declared as dominant. This would also imply discontinuing the AMS-maintained register of dominant firms.

### 3.2.1.3. Incomplete merger control regime

- **Tajikistan's merger control framework is lengthy and costly, which might impair efficient firm growth and expansion in the domestic market. These problems persist despite the amendments introduced to the Competition Law in 2022.** An effective merger control framework helps accelerate efficient firm consolidation. It focuses on large merger transactions that can potentially lessen competition significantly, minimizes the burden of administrative procedures on businesses, and avoids market disruptions. In this context, an effective merger control regime should not obstruct the entry, growth, and exit

[73] Leniency is the total or partial reduction of fines or other penalties granted by competition authorities to companies involved in cartels in exchange for disclosing the existence of the cartel agreement or for their cooperation during the authorities' investigation by bringing forward evidence.

of businesses that result in efficiency gains. However, as the World Bank (2019) highlighted, Tajikistan's merger control framework is not fully aligned with these best practices and has several shortcomings. First, it includes corporate transactions unlikely to trigger competition impacts, such as reorganization and liquidation. Second, it imposes different and low financial thresholds for notification (starting at approximately USD 146,000 asset value for liquidation or segregation up to approximately USD 585,000 for mergers and acquisitions), which can create unnecessary confusion for firms while increasing the procedural workload for AMS staff. Third, the AMS can obstruct a merger if it leads to increased dominance, which in practice means that merging companies with at least a 35 percent market share, as well as those with lower participation but present in a market with other relatively large companies, could be forbidden to concentrate even if the merger transaction leads to efficiency gains or if competition is effective. Finally, the ten-day period for the AMS to decide on a notification and the lack of a fast-track procedure for simple mergers can also harm the framework's effectiveness by overburdening the procedural workload. The amendments to the Competition Law introduced in 2022 have not altered these issues. In this context, the recommendations outlined by the World Bank (2019) to calibrate the merger control are still valid; they include: simplifying turnover thresholds for notification (e.g., adding individual thresholds), eliminating simple corporate reorganization and liquidation from merger control, clarifying criteria for merger analysis and remedies, and streamlining procedures for review and creating fast track application for simpler cases.

#### 3.2.1.4. Insufficient fines

- **Antitrust fines are defined in absolute terms and poorly calibrated, making them insufficient to deter and punish anti-competitive behavior.** The Code of Administrative Violations in Tajikistan is the key legislative piece that sets administrative fines for administrative wrongdoings, including violations of antimonopoly rules. These fines are set at absolute terms: approximately US$18,645 for cartels (Article 543) and US$12,430 for abuse of dominance (Article 543)[74]. As stressed by the World Bank (2019), how these fines are structured is not aligned with best practices because they consider the infringing firm's size nor the negative effects of the illegal conduct. In this case, setting fines as a proportion of the turnover of infringing firms tends to be more effective in deterring and punishing anti-competitive behavior. In this context, the recommendations outlined by the World Bank (2019) – to replace absolute maximum fines with relative fines that account for the company's size and negative effects of illegal conduct – remain valid for the current context.

#### 3.2.1.5. Gaps in institutional setup for independent enforcement and limited human resources to tackle anti-competitive practices

- **AMS does not have functional or financial independence.** Challenges faced by the AMS to enforce the Competition Law, as detected by the World Bank (2019), are still present as of April 2023. For example, AMS is accountable to the Government, which does not provide functional, financial, or operational independence from the executive. The AMS has no authority to appoint and dismiss heads of agency and commissioners. Its budget is allocated through a combination of legislative assignment and direct collection (merger notification fees, for example). Also, even though the Competition Law grants the

[74] Fines are calculated based upon up to two thousand budget units in the case of abuse of dominance and up to three thousand indicators for coordinated practices. For this exercise, from 1 January 2023, one budgetary unit is valued at TJS 68 and US$ 1 equals TJS 10.91 (Official exchange rate of National Bank of Tajikistan US$, as of 11 April 2023)

right to appeal to the judiciary on violation of antimonopoly legislation, the effectiveness of such powers is yet to be tested in practice. As of April 2023, AMS had not initiated any judicial proceedings to tackle the violation of antimonopoly legislation.

- **In parallel, enforcement by the AMS has focused more on monitoring functions - of monopolies, dominant firms, and excessive prices – and less on enforcement against anticompetitive behavior.** The AMS devotes an important part of its human resources to monitoring, reviewing, and controlling excessive prices, registering and monitoring dominant firms and monopolies rather than gathering evidence of anticompetitive behavior (e.g., cartels). Having almost half of its staff occupied with these monitoring capacities may help to explain why the AMS has not prosecuted anticompetitive practices so far or sanctioned other types of misconduct covered by the Competition Law.

### 3.2.2. Excessive use of price control instruments

- **If not used to tackle specific market failures, price control mechanisms can impair competition and private sector development by hampering firm investment, entry, and expansion decisions.** Price controls are often used to achieve different policy objectives, including social policy (e.g., to guarantee low prices of key goods and services consumed by the low-income proportion of the population) or inflation control. However, because prices provide essential information for market dynamics if they are artificially defined, they can distort the efficient decision-making of firms, reducing the incentives to enter the market and invest. This scenario can also create dependence on subsidies and shortages. Price controls are effective tools only in situations of specific market failures associated with market power and lack of competition, such as natural monopolies or temporary market power arising from external shocks (e.g., wars, natural disasters, or epidemic outbreaks).

- **The Government of Tajikistan uses price control mechanisms excessively, and the AMS plays a key role in this process.**[75] There are three mechanisms through which the AMS controls prices, all of which risk hampering market competition.

- **First, the AMS prohibits dominant firms from setting low prices without specifying the circumstances in which high or low prices could be anti-competitive. This type of control can discourage pro-competitive pricing behavior.** According to the Competition Law, the AMS regulates price variations of products and services provided by dominant firms. As pointed out by World Bank (2019), the Competition Law prohibits dominant firms from practicing low prices when costs have not fallen without further guidance on what circumstances high or low prices could be anti-competitive. As stressed before (see Section 3.2.1.2), because market dominance in the Law follows a structural approach and is defined based on market share, there is a risk of firms lacking significant market power but erroneously classified as dominant being discouraged from engaging in pro-competitive price drops. The amendments introduced to the Competition Law in 2022 have not addressed this issue. In this context, the Tajik authorities should carefully consider

[75] According to the Resolution of the Government of the Republic of Tajikistan "On the Regulation on the procedure for the formation and application of free prices and tariffs for industrial and technical products, consumer goods and services" No. 257, dated 30.05.2018, there are three key methods of price regulation: i) establishing the maximum level of the trade markup; ii) establishing a limit level of retail prices; iii) establishing the marginal level of profitability.

methods to detect whether either high or low levels of prices indeed have an adverse effect on competition before sanctioning or controlling price behavior.[76]

- **Second, the AMS controls the prices of socially important products without a solid underlying framework that justifies the intervention or the scope of prices to be regulated**. The AMS regulates the profit margin prices of 19 staple and food products classified as socially important[77]: margins of locally produced products are capped at 10, while margins of imported products are capped at 8 percent. In practice, this means that the prices of these products must equal wholesale acquisition cost plus a margin defined by the government. However, how the AMS monitors compliance or verifies effective wholesale costs is unclear. Moreover, given the information asymmetry between the AMS and market players, there is a substantial risk that such a price control mechanism distorts the incentives of incumbent market players, who might inflate their costs to overcome margin restrictions or potentially collude. This would lead to higher final prices for consumers while reducing the incentives for new players to enter the market. Against this backdrop, there is still a need to define a proper framework to inform the policy for controlling the prices of socially relevant goods to find sustainable solutions to high prices while minimizing the potentially negative effects on competition. In this regard, the Tajik authorities should consider conducting in-depth market assessments to identify the root causes of potentially high prices. This assessment should include identifying potential market failures that might prevent markets from delivering competitive prices, what requires public intervention, and whether price control is a technically adequate solution to market failure. [78] Finally, it would be important to map the extent to which the regulation of prices of socially important goods aims to support specific groups of consumers; if the objective of price control of a particular good is to guarantee access to the most vulnerable, there may be more effective mechanisms than price controls to fulfill that purpose.[79]

- **Third, the AMS regulates prices of natural monopolies, but the regulatory underpinnings of such markets in Tajikistan do not account for pro-competition principles and market dynamics**. As World Bank (2019) analysis highlighted, technological progress is changing the cost structure of many formerly regulated natural monopoly industries, leading to a worldwide deregulation trend. The Law on Natural

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[76] As highlighted by the World Bank (2019), before controlling or sanctioning the pricing behavior of allegedly dominant firms, competition authorities in several jurisdictions use methods to ensure that the level of final prices would not have measurably negative effects on competition in the market, for instance, (i) pricing below average variable costs, (ii) the possibility of recouping the losses, and (ii) predatory intent. And even if these elements are present, efficiency defenses based on balancing pro- and anticompetitive effects are also considered. This is the case for competition authorities in the US, European Commission, Canada, Germany, etc.

[77] The latest list of socially significant goods is approved by Governmental Resolution No. 396, dated 25.06.2020 by introducing amendments to the original document No. 287, dated 31.05.2018. The list includes: flour (grades 1 and 2), bread made from flour of 1 and 2 grades, pasta, wheat, rice, potato, vegetables (carrots, onions, cabbage), sugar, granulated sugar, vegetable oil (cottonseed oil and sunflower oil, oil creamy), dairy products (milk, kefir, double cream, sour cream, cottage cheese), lentils, peas, buckwheat, porridge, barley, meat (beef, lamb), chicken, chicken eggs, salt, tea (green and black varieties), baby food, petroleum products (motor gasoline, diesel fuel and liquefied gas), medicines and medical products, and mineral, organic and chemical fertilizers for the agricultural industry.

[78] In most cases, high-price goods lack market failures that justify price regulation. However, if firms in this market show significant signs of market power, it would be necessary to investigate the sources of the distortions – if based on anti-competitive behavior, government regulation, or both – and then decide how to address the problem properly. In these circumstances, price controls could be used as a transitory measure while the sources of market power are dealt with. In this case, additional market reforms should be implemented to guarantee well-functioning markets, including industry restructuring regulations, removing barriers to competition (such as barriers to entry and operation restrictions), opening to trade, and enforcing the competition law. Then, as competition is restored, price controls could be removed.

[79] For instance, subsidies to vulnerable consumers for selected essential products, including a combination of targeted vouchers.

Monopolies[80] allows for the transition of firms from the state of natural monopolies to the state of a competitive market when natural monopoly conditions are no longer present.[81] However, as of April 2023, the Tajik authorities have not used this possibility nor brought their policies in line with the worldwide deregulation trend. The list of economic activities regulated as natural monopolies, whose subjects are included in the registry of natural monopoly firms, appears to span markets and market segments that could be open to competition, such as electricity generation and supply, internet data transmission, postal and communication services, and domestic air transport. Furthermore, most of the firms listed in this registry are SOEs. The Tajik authorities might consider limiting the list of economic activities regulated as natural monopolies to those that exhibit such characteristics. Accordingly, the AMS might consider excluding entities from this register based on the analysis of the relevant commodity market in cases where the absence of natural monopoly conditions is confirmed. Moreover, for regulating prices of natural monopolies per se, especially for network industries, the AMS should consider updating its methodology to incorporate pro-competition principles. First, by distinguishing between the regulation of the final price of services to consumers from prices to access essential facilities. Second, by adopting methodologies to set tariffs that incorporate aspects to incentivize cost reduction and the efficiency performance of natural monopolies.

### 3.2.3. Incomplete mandate of state-aid control and insufficient enforcement

- **Often justified to achieve development goals, state aid can negatively affect market functioning and competition.** State aid can take many forms, including tax exemptions, loan guarantees, grants, government resources (such as land, spectrum, or water) provided at prices below market level, cash transfers, accelerated depreciation allowances, and capital injections, among others. They are often well-intended and designed to promote employment growth, improve access to goods and services, and regional development. They are also presented as instruments to offset the negative consequences of economic shocks (such as the COVID-19 pandemic, the war in Ukraine, etc.). While all these are noble objectives, such interventions can cause distortions by creating obstacles for production factors to be allocated to firms of greater productivity, thus affecting the 'cross-firm reallocation' component (Restuccia and Rogerson, 2017). Likewise, they might benefit a select group of firms (e.g., firms with a particular characteristic in a given sector; firms of a specific sector; or firms in a particular location), creating an advantage over firms that do not receive those incentives[82]. More specifically, state aid can generate distortive effects on markets through various channels, including by deterring entrance or making it more difficult for new investors to enter the market, creating rents that shelter inefficient companies and allowing substandard business practices to persist, and by creating the possibility of using the granted incentives to engage in anticompetitive behavior (e.g., predatory pricing).

- **Tajikistan provides significant state aid through different instruments**, including tax exemptions, budget subsidies, preferential customs tariffs, tax write-offs, etc. The World Bank estimated that these tax incentives, including exemptions on VAT and excises on

[80] The Law on Natural Monopolies No. 235, dated 05.03.2007, Article 5.
[81] In other words, the Law on Natural Monopolies prohibits keeping natural monopolies in sectors where there is no economic justification for that (Article 11).
[82] Business support measures that are horizontal – i.e. applied to all types of firms – are not distortive.

imports, amounted to about 10 percent of GDP in 2018[83]. In particular, several investment incentives – defined under investment agreements signed by the State Investment Committee - favor particular investors and sectors without pre-determined objective, clear, and transparent criteria (see Section 3.4 for further discussion). This practice can distort competition, especially in cases where incentives are granted to specific firms that operate in sectors where other competitors have no access to the same advantage.

- **Tajikistan's framework for state aid control is currently regulated by two main legislative pieces. First, the Competition Law, among other things, empowers the AMS to grant prior approval to any state measure that can discriminate against market players and generate potentially negative effects on competition.** As per its current version (April 2023), the Competition Law contains a general prohibition on the national and local government to adopt acts or perform actions that discriminate between the activities of specific business entities (Article 14). State aid provision is subject to prior AMS approval. In practice, any state support that may potentially discriminate between business entities and harm competition requires prior AMS approval[84]. According to the Law, the AMS must review and provide its decision on the proposed state aid measure within two months. An extra month is provided in cases where the AMS requires additional information regarding the proposed measure. Finally, the Competition Law opens a few exceptions. It allows for aid associated with the public interest and emergencies and states that state aid can be granted for specific purposes such as agricultural production, labor protection, and SME promotion.

- **Second, the "Regulations on the Procedure for Providing Public and Local Assistance."** The Competition Law sets the AMS's general state aid control mandate. Yet the procedures of providing state aid from the initiation stage through to AMS approval and until actual aid provision are regulated by the "Regulation on the Procedure for Providing State and Local Assistance."[85] This regulation excludes incentives and other state support measures provided to individual firms as part of the results of auctions and public tenders from the scope of state aid definition.[86] This implies that the authorities may provide state-aid measures to individual firms selected as winners of the public procurement selection process without the analysis and approval of the AMS.

- **The state aid control framework is poorly enforced because of insufficient regulation on how the AMS's state aid control mandate should be applied.** Despite the availability of the veto power, no state aid proposal has so far been rejected by the AMS as of April 2023. The AMS has been rather soft on enforcing its state aid control mandate because of the unclear rules and procedures stated in the "Regulations on the Procedure for Providing Public and Local Assistance." In short, there is no clarity on how the state aid control procedures start and develop.

- **In addition, there is a lack of transparency and a systematic approach to providing state aid.** The shortcomings detected by tWorld Bank (2019) remain valid today. Specifically, the version of the Competition Law as of April 2023 does not address what

[83] Although Tajikistan adopted a new tax code in 2022, many tax exemptions are also issued via the annual state budget law and government decrees.
[84] As per the latest version of the Competition Law even the preferences granted through the budget law must be reviewed by the AMS and affected parties can also request a review of "unlawful" aid.
[85] Regulation No. 813, dated 30.12.2015. This Regulation is a by-law by its legal-normative value, which executes the mandate provided by the Competition Law.
[86] Regulation No. 813, Section 4.

market failures may justify providing state aid for agriculture, labor support, and SME promotion. Likewise, the AMS lacks a clear methodology to evaluate a state aid measure's positive and negative elements. Moreover, neither the Competition Law nor the "Regulations on the Procedure for Providing Public and Local Assistance" regulate how the public can access information on the benefits granted by the Government. Indeed, as of April 2023, neither the AMS nor the general Government keeps a registry of all state aid granted to firms in Tajikistan. Finally, the same Law is silent on monitoring and ex-post evaluation. In this context, the Tajik authorities might consider strengthening the current legal framework for state aid control by updating by-laws[87] to clarify the procedural steps for the authorization, granting, monitoring, and reporting on state aid while adopting guidelines with a clear methodology to assess the potential impacts of state aid on competition. Finally, creating an inventory/registry of state aid measures granted is equally important to improve transparency and facilitate monitoring.

### 3.2.4. Barriers to competition in specific sectors

- **Barriers to competition in telecom and air transportation sectors are sizeable.** According to World Bank (2019) findings, competition barriers associated with SOE footprint in Tajikistan's economy stem from the combination of lack of competitive neutrality – i.e., the absence of rules to ensure a "level playing field" in sectors where private firms compete with SOEs - and the existence of legal monopolies (exerted by SOEs) in potentially competitive markets. Box 3.2 provides a short summary of these issues. The telecom and air transport sectors provide good examples of how competition barriers stemming from SOE presence and heavy regulations can hinder private sector development.

#### Box 3. 2. SOE Presence and Risks to Competition

The SOE footprint in Tajikistan is large. As per World Bank (2023), there were 1,036 enterprises with varying degree of state ownership in 2021 ownership. Two-thirds of these enterprises are SOEs with a majority of state equity. However, their contribution to the economy is limited due to operational inefficiency. Data provided by the TajStat and the MoF for 357 SOEs (including the largest ones) shows that their aggregate gross revenue was equivalent to 16.1 percent of GDP.

SOE presence spans multiple sectors, including those with a less clear rationale for state presence. According to World Bank (2023), SOEs operate in about 19 sectors in Tajikistan, primarily infrastructure sectors such as energy, heating, water supply, and sewerage. While the presence of SOEs in infrastructure sectors is not unusual in many economies, give n the high capital outlays, Tajik SOEs also participate in markets with a less clear economic rationale for state presence, such as wholesale and retail state, mining, financial sector, and manufacturing. Moreover, SOEs have monopolies in a few sectors or sub-sectors – such as water, electricity, and international and wholesale broadband segment of the telecom sector – that can no longer justify natural monopolies.

The presence of SOEs has created an uneven playing field amongst market players because they benefit from preferential treatment, which disincentivizes private sector entry and investment. For instance, World Bank (2019) showed that some of the largest SOEs can receive financing not available to private companies and that repayment rules are lenient. Moreover, SOEs can benefit from favorable treatment not available to private firms, such as lower energy costs and write offs of tax arrears and other liabilities, allowing artificially low prices to dampen private investments. Likewise, the lack of separation between the administration of SOE and policy-making and regulation of sectors where SOE operates facilitates SOE advantages.

[87] Eliminating the loopholes in the "Regulations on the Procedure for Providing Public and Local Assistance" that allow the provision of state aid to winners of public bids without AMS approval is also key.

### 3.2.4.1. Telecom

- **The telecom sector in Tajikistan is governed by the 2022 Law of Electronic Communications[88], with the Communication Service acting as a policy maker and a regulator, de facto in charge of the state-owned incumbent operator Tajik Telecom that holds a contested monopoly over the transit of international internet and voice traffic.** The Government Decree No 252 (May 11, 2011) that established the Communication Service (CS), outlines its responsibilities, including typical functions of a telecom regulator (e.g., providing for fair competition between telecom operators, conducting tariff controls, awarding licenses, etc.), as well as a policy-maker (such as setting strategic and policy orientations of the sector). While the Law and the Decree incorporate regulatory principles aligned with international standards, the lack of sufficient separation between the CS's roles of a policy maker and a regulator, and its de-facto control of the SOE[89] has resulted in a perceived conflict of interest . This situation has arguably hindered private investment in the sector[90]. The market development is further stifled by the 2015 decision of the Government[91], requiring all operators to pass their incoming and originating traffics of the international services of electric communication and Internet through a single switching center of electric communication of the state operator Tajiktelecom" (referred to as a unified communication transit center, UCTC). The presence of this central switching center and the incremental costs of routing traffic through it is a perceived barrier to and financial disincentive for operators that wish to establish and operate their own gateways for routing international traffic into the country.[92]
- **To attract investments and foster competition in the telecom sector, it is important to develop a more transparent comprehensive policy and regulatory environment.** This can be achieved by updating and adequately enforcing Law of Electronic Communications through subsidiary policies and regulations, with a particular focus on the access to and sharing of telecom infrastructure, the establishment of adequate consultation and dispute mechanisms, the publication of transparent regulatory processes for allocation of spectrum and rights of way, etc. Moreover, establishing a clear separation between policy-making and regulatory mandates of the CS and creating a "Chinese Wall" with the Tajiktelecom operations would enhance transparency, accountability, and fairness in the sector.

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[88] The law was amended in 2006, 2008, 2013, 2015, 2016 and 2017.

[89] Annex 4 of the referenced decree includes a list of enterprises, entities, and organizations under the Communications Service, including OJSC "Tochiktelekom". Moreover, in its 2015 Program of Economic Adaptation following Tajikistan's accession to the World Trade Organization (WTO) based on Government Decree # 691 of October 31, 2014, the Government confirms that CS is "managing Tochiktelekom", hence presenting "a conflict of interest".

[90] According to the International Telecommunication Union (ITU), improved regulatory framework and performance (measured by ITU's ICT regulatory tracker indicator) is linked to a positive and significant increase in telecom investment, yielding in turn service coverage gains, price reductions, higher adoption levels and consequently, a macroeconomic impact in terms of GDP per capita. More specifically, a 10 percent increase in the score for the regulatory authority and regulatory mandate pillars is associated with an increase in investment of 8 percent and 11 percent, respectively. This means that having a separate telecom / digital regulatory agency with desired characteristics (in terms of independence, accountability, and enforcement power) rather than a ministry in charge of a wide array of regulatory topics, contributes to creating a suitable framework that significantly spurs investment. Source: The Impact of Policies, Regulation, and Institutions on ICT Sector Performance (2021).

[91] Based on Government Decree No.765, December 30, 2015. Available at: https://cis-legislation.com/document.fwx?rgn=82153.

[92] In a centralized telecom traffic model, providers face several challenges that drive up costs. These include potential routing fees to the central hub, operational inefficiencies caused by bottlenecks, significant infrastructure expenses, and regulatory costs. Combined, these factors often make this model more expensive for service providers, leading to less control compared to a decentralized system.

### 3.2.4.2. Air Transportation

- **In the mid-2000s, the Tajikistan implemented significant reforms in the air transportation sector to enhance its performance and promote connectivity.** These reforms included the unbundling of the Tajik State Air Company (TSA) and the separation of airports, airlines, and air navigation services into separate open joint stock companies (OJSCs), all of which were fully owned by the State Committee on Investment and State Property Management. Additionally, the provision of jet fuel was granted in exclusivity to a single private firm. For economic regulation, some functions were delegated to AMS, which oversees competition law enforcement across sectors.

- **Despite these reforms, there are still regulatory barriers that restrict market access and hinder competition in the aviation sector**. The World Bank (2019) identifies several key regulatory barriers that contribute to this issue. Firstly, bilateral service agreements protect key routes by limiting the entry of new players and preventing competition. Although some capacity expansion was allowed from secondary airports to Russian destinations, it was quickly limited to avoid diverting traffic away from Dushanbe. The application of "parity" concept by Tajikistan aggravates the air connectivity deficit. Secondly, the pricing methodology for airport and air navigation infrastructure services, regulated by the AMS, lacks incentives for efficiency as it uses "Cost-Plus" regulatory model. This approach does not incentivize cost efficiency and allows all costs to be transferred downstream, regardless of their economic justification.[93] Ground handling remains under the exclusive control of the airports, that also dictate pricing of those services without any regulatory control. Lastly, the decision to establish a monopoly for jet fuel provision further restricts market contestability. By granting exclusive rights to a single provider, competition in the fuel market is limited, leading to higher prices.

- **Enforcement of aviation safety standards is well below the global and regional average.** Despite successive policy reforms that entrusted oversight obligations to different bodies under the Ministry of Transport, and later to the newly created Civil Aviation Agency (CAA), the capacity to enforce civil aviation safety standards remains weak. Funding shortages and limited availability of qualified staff are structural problems to overcome. Secondary and tertiary regulations, including the State Safety Programme, are either not implemented or do not meet international standards. As reported by International Civil Aviation Organization (ICAO), Tajikistan performs poorly compared with former Soviet countries in critical areas including flight operations, licensing, aerodromes, and air navigation services. Failure to adhere to these standards jeopardizes the credibility of air transport operations in Tajikistan and poses a risk to Tajik carriers' access to international destinations.

[93] Indeed, under cost-plus regulation, where producers are reimbursed for their costs plus a margin, there can be unintended consequences that may undermine efficiency and incentivize cost escalation. Producers may have less motivation to control their costs since they can simply pass them on to consumers through higher prices. This can lead to inefficiencies and potentially result in higher prices for consumers. Furthermore, the cost-plus regulatory approach can create perverse incentives for firms. They may be inclined to inflate their costs by building larger factories or hiring more staff in order to increase their reimbursement and profit margins. This behavior can be detrimental to overall economic efficiency and may result in excess capacity or unnecessary expenses.

- **To attract private sector participation and promote market growth in the air transportation sector, adopting a more market-oriented policy is crucial.** First, it is vital to liberalize bilateral service agreements by relaxing restrictions on key/busiest routes to stimulate market growth. This would encourage more airlines to operate on busiest routes and provide better connectivity options for travellers. Second, it is important to update the regulatory model key infrastructure services. This could involve introducing more transparent and market-based mechanisms that incentivize efficiency and fair pricing, rather than relying on cost-plus models. Third, it is critical to allow competition in jet fuel provision and airport ground handling to lower operational costs for air carriers and promote a more contestable environment. Lastly, improving the capacity of the government agencies to enforce safety standards is necessary to ensure the integrity of aviation activities and to ensure that Tajik carriers are not prohibited (or limited) from operating in certain international markets.

### 3.2.5. Selected proposals to remove barriers to competition in Tajikistan

- **To strengthen the effectiveness of the competition policy framework in Tajikistan and ensure better-functioning markets, the Tajik authorities could consider the recommendations summarized in Table 3.1.** As highlighted initially, the analysis of competition distortions that informed these proposals was not comprehensive.[94] Given the narrow focus of the current exercise, the policy suggestions outlined below should not be seen as a comprehensive set of recommendations. Instead, the proposals framed in Table 1 reflect specific measures that can be taken in the short and medium term to tackle specific issues of competition policy framework in Tajikistan.

Table 3. 1. Selected recommendations to remove barriers to competition in Tajikistan

| Reform Action | Implementation Period | Implementation Agencies |
|---|---|---|
| **1. Strengthening the antitrust regime** | | |
| *1.1. Strengthening control of hard-core cartels* | | |
| Introducing amendments to the Competition Law to impose per se prohibitions on 'hard core' cartels. | High, short term | AMS |
| Improve search and seizure procedures to streamline cartel investigations (e.g., by introducing amendments to the Law "On Inspection of the Operational Activities of Business Entities" to expand the mandate of the AMS in conducting unannounced | High, short term | AMS |

[94] For instance, a comprehensive analysis of competitive neutrality, which aims to identify whether SOEs receive preferential treatment compared to private competitors (such as preferential access to loans, land, tax incentives, and subsidies) or are subject to different market rules and asymmetric policy enforcement was not conducted in this chapter of the report. While this is an important aspect to consider, it was not within the scope of the current analysis and merits a separate study.

| Reform Action | Implementation Period | Implementation Agencies |
|---|---|---|
| inspections for search and seizure while investigating cartel cases). | | |
| Strengthen the capacity of the AMS to run economic analysis to screen for cartel behavior and build strong cartel investigations. | High, medium term | AMS |
| Develop and implement a leniency program. | High, medium term | AMS |
| *1.2. Redefining market dominance to avoid discouraging firm expansion* | | |
| Introducing amendments to the Competition Law to abolish the structural definition of market dominance. | Short term | AMS |
| Discontinue the AMS-maintained register of dominant firms. | Short term | AMS |
| Refocus AMS abuse of dominance investigations on practices that foreclose entry (instead of ex-ante control of commercial decisions of firms that are declared as dominant). | Medium term | AMS |
| *1.3. Strengthening control of hard-core cartels* | | |
| Introducing amendments to the Competition Law to simplify turnover thresholds for merger notification purposes; and eliminate simple corporate reorganization and liquidation from merger control. | Short term | AMS |
| Adopt merger guidelines with clear criteria for merger review and remedies. | Medium term | AMS |
| Update regulations to clarify merger reviews and create fast-track applications for simpler merger cases. | Medium term | AMS |
| *1.4. Supporting compliance through proportionate fines* | | |
| Introducing amendments to the Code of Administrative Violations to replace absolute maximum fines for violation of competition rules with relative fines that account for the company's size and negative effects of the illegal conduct. | Short term | AMS, Ministry of Justice |
| *1.5. Strengthening Institutional set up for independent and transparent enforcement* | | |
| Expand sources of funding and technical resources, ensuring independence. | Short term | AMS |
| Refocus the use of AMS resources on fighting cartels and deterring abuse of dominance rather than controlling market strategies ex-ante (registering and monitoring companies, controlling prices). | Short term | AMS |
| **2. Phasing out pervasive price controls** | | |
| Limit the list of economic activities regulated as natural monopolies to those that exhibit such characteristics. | Short term | AMS |
| Abandon ex-ante monitoring and control of pricing strategies of firms. | Short term | AMS |

| Reform Action | Implementation Period | Implementation Agencies |
|---|---|---|
| Ensure that pro-competition principles are incorporated into the regulatory framework applied to natural monopolies, guaranteeing access to essential infrastructure on non-discriminatory conditions and at cost-oriented prices | Short term | AMS |
| **3. Streamlining the state aid control framework and its implementation** | | |
| Update the current legal framework for state aid control: e.g., update the Regulations on the Procedure for Providing Public and Local Assistance (from December 30, 2015, No. 813) to include specific provisions clarifying the procedural steps for authorization, granting, monitoring, and reporting of state aid. | Short term | AMS, Ministry of Finance |
| Adopt guidelines concerning (i) justifications for granted state aid; and (ii) assessment of the potential impacts of notified state aid on competition | Short term | AMS |
| Creating an inventory/registry of state aid measures to improve transparency and facilitate monitoring. | Short term | AMS, Ministry of Finance, State Committee on Investment and State Property Management |
| **4. Removing competition barriers in telecom sector** | | |
| Facilitate the use of essential facilities (such as core telecom network elements), while strengthening sectoral regulations, including in the areas of (i) identification of relevant markets (including wholesale segments); (ii) significant market power (SMP); (iii) management of rights of way. | Short term | CS |
| Amend the Law of Electronic Communications to establish a clear separation between policy-making and regulatory mandates of CS | Medium term | CS |
| **5. Removing competition barriers in the aviation sector and improving safety oversight** | | |
| Relax restrictions on bilateral air service agreements to allow more flights and carriers to enter the market. | Short term | GOT , CAA |
| Revise the regulatory model applied to natural monopolies in air transport infrastructure services. | Short term | AMS |
| Remove the statutory monopoly for airport ground handling services and jet fuel supply | Short term | GOT, AMS, CAA, |
| Increase funding, availing qualified staff and training to perform safety oversight obligations in line with ICAO standards | Short and Medium term | GOT, CAA |

*Note: Short-term refers to a period of 6 months – 1 year, medium-term to a period of 1-2 years, and long-term 3-5 years*

## 3.3. Barriers To Entry and Operations of Foreign Direct Investment

- **Tajikistan is not making the most of the potential benefits of FDI and has struggled to attract it.** While its FDI stock has been steadily increasing, reaching up to 40 percent of GDP in 2021 (fig. 3.20), Tajikistan has experienced a decline in FDI inflows since their peak in 2015 (of US$572 million, or almost 7 percent of GDP), particularly in the manufacturing sector (fig. 3.21). Although there was some recovery until 2019, FDI inflows declined again to US$107 million in 2020, indicating a weak rebound from the COVID-19 pandemic.

Figure 3. 20. Tajikistan's FDI inflows, 2010-2021 (US$ million in current prices and percent of GDP)

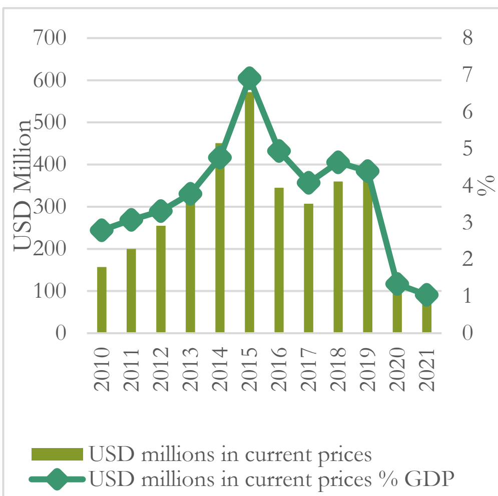
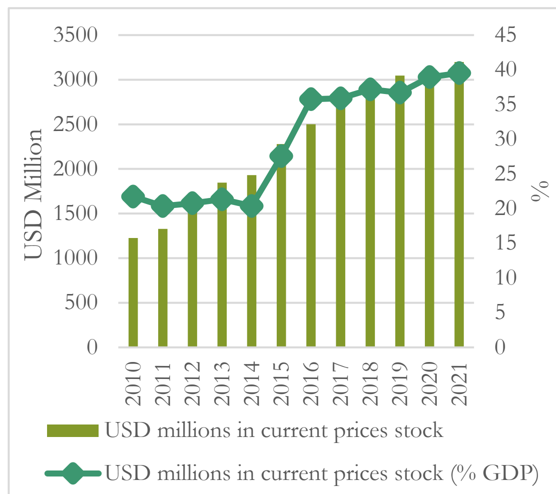


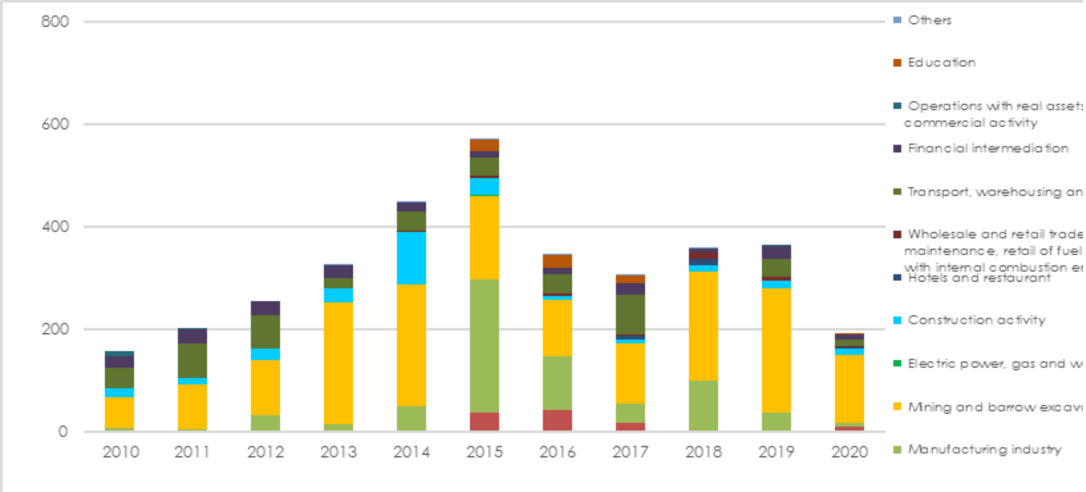

Figure 3. 21. Tajikistan's FDI inward stock, 2010-2021 (US$ million in current prices and percent of GDP)




Source: World Bank staff elaboration based on the UNCTAD database

- **The mining and, to some extent, the manufacturing sector has historically driven FDI inflows, while efficiency-seeking investment has been scarce.** According to the National Bank of Tajikistan, the mining and manufacturing sectors have received an average of US$155 million and US$60 million, respectively, over the past decade (fig. 3.22). While overall FDI inflows decreased over the past decade, FDI into the mining sector remained on fairly stable level, thus contributing to a significant increase in the sector's share in overall inflows, from 38 percent in 2010 to 68 percent in 2020. Thus, while Tajikistan has historically attracted in the majority natural resource-seeking investments, it has not been able to attract efficiency-seeking investment which is important to promote economic diversification of the country.

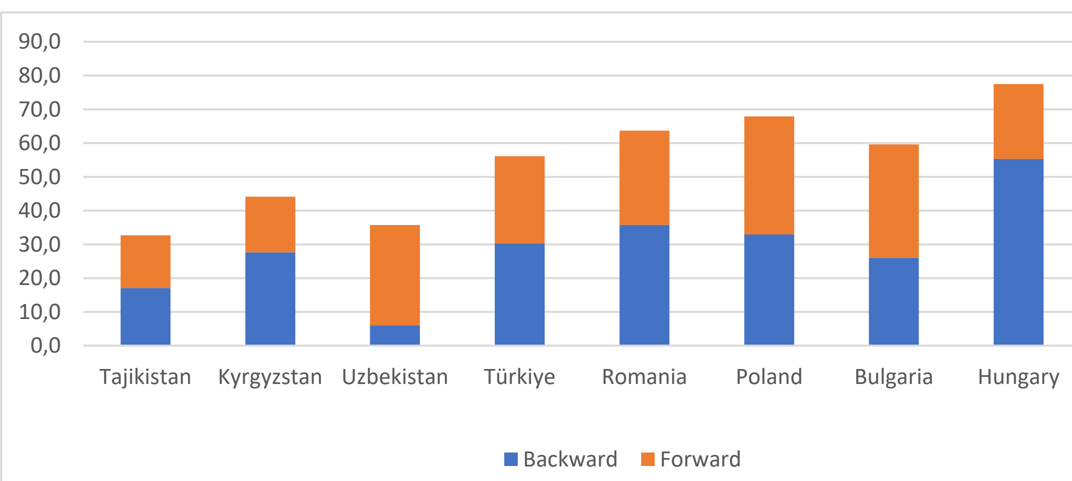
Figure 3. 22. Tajikistan's inflow of FDI by sector (UD$ million in current prices) 2010-2020




Source: World Bank staff elaboration based on the National Bank of Tajikistan database

- **Tajikistan does not leverage the full potential of FDI for global value chain (GVC) integrations.** In fact, based on the latest available information, Tajikistan had one of the lowest GVC participation rates among its peers, with only $258 million and $281 million in forward and backward participation, compared to an average of $19 billion and $27 billion, respectively. Figure 3.23. shows that Tajikistan is outperformed by its peers regarding forward and backward GVC participation as percentage of exports. To promote economic growth and development, Tajikistan needs to attract more FDI to sectors with higher potential for generating linkages, spurring innovation, and contributing to economic upgrading.

Figure 3. 23. Forward and Backward GVC participation by Tajikistan and comparators, 2018 (% of exports)




Source: World Bank staff elaboration based on the UNCTAD database

- **China has become the main source of FDI inflows to Tajikistan.** According to the National Bank of Tajikistan, as much as 85 percent of FDI inflows in 2020 came from upper-middle and high-income countries. With a share of 74 percent, China stands out as the leading source market for FDI in Tajikistan, followed by Russia with a share of 7 percent and USA, Turkiye, and Switzerland with 3 percent respectively (fig. 3.24). Between 2010 and 2020, China had the highest volume of FDI with US$177 million, which accounted for 69 percent of the total FDI inflows (fig. 3.25). In comparison, Russia's contribution was US$36.6 million, representing 14 percent of the total FDI inflows. The remaining source countries collectively accounted for 42 percent of the FDI, equivalent to US$107 million. Despite Russia's more stable inflow of FDI over the years, its FDI inflow was significantly lower than China's, with a large disparity of US$128 million on average between the two countries in the past decade.

Figure 3. 24. Leading source countries of FDI inflows, 2020

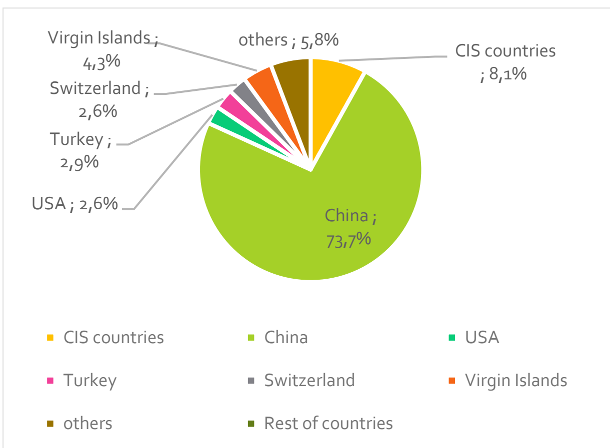
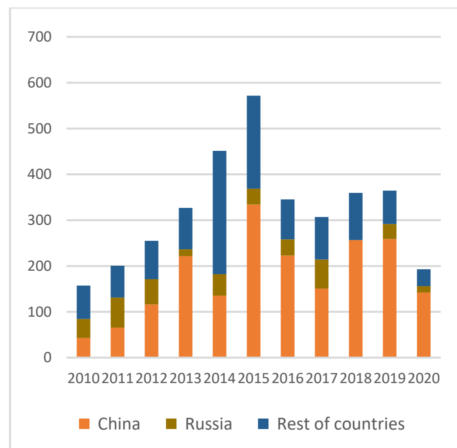



Figure 3. 25. China and Russia vs. the rest of the countries' FDI Inflows (US$ million in current prices) 2010-2020




Source: World Bank staff elaboration based on the National Bank of Tajikistan database

- **Against this backdrop of low levels of FDI attraction, the following section aims at identifying the key barriers to FDI entry and expansion, with a focus on Tajikistan's investment law and policy framework (Box 3.3).** The review aims to identify the main barriers and strategic policy levers for the Government of Tajikistan to consider for attracting and retaining more and higher-quality investments. The analysis was based on a review of currently applicable policies, laws, and regulations. Secondary sources were also consulted. However, *de facto* implementation of laws and regulations in the country and investor perception is not captured, other than through secondary sources. It is thus not a comprehensive review of the entire legal and policy framework affecting investment. Moreover, the information presented is not exhaustive but illustrative of the main topics and issues covered (for example, it does not exhaustively list all available tax and financial incentives in the country). Given these limitations, the information presented should be interpreted and used keeping in view the overall country context and realities.

## Box 3. 3. Overview of Tajikistan's Investment Law and Policy Framework

### *FDI laws and regulations*

The primary law governing foreign and domestic investments in Tajikistan is Law No. 1299 "On Investment" of 2016 ("Investment Law" or "IL"), which creates a uniform regime for local and foreign companies. This law governs several areas, including establishing the investment promotion agency, restrictions of investments for national interests, legal stabilization, investor guarantees and investment protection, transparency, state support, and investor rights and obligations. The law allows for individual investment agreements between an investor and the Government under certain conditions. It applies to domestic and foreign direct investment in all sectors of the Tajik economy and does not exclude its application to any specific sector or activity. The definition of investment and, consequently, the scope of the IL is broad and contains tangible and intangible assets.

A second important piece of legislation is the Law on Investment Agreements, which regulates investment contracts concluded between the State and investors on projects identified as priorities. The Law allows the Government to strike an agreement with investors containing rights and obligations as well as guarantees and incentives which go beyond the Investment Law or any other domestic law. For example, it may concern licensing requirements, the tax and customs regime, employment issues, property ownership, dispute resolution, etc. The Law does not apply to projects that operate under a concession agreement, production sharing agreement, public-private partnership, or for investments made by a foreign state. Parliament must ratify any investment agreement.

FDI is further regulated by horizontal and sector-specific laws and regulations: the Constitution of the Republic of Tajikistan, the Law on Public-Private Partnerships, the Law on Production Sharing Agreements, the Civil Code, the Law on the Licensing of Certain Types of Activities, the Law on Free Economic Zones, the Land Code, the Law on Concessions, the Law on Resources, the Law on Legal Status of Foreigners, the Law on Joint Stock Companies, the Law on State Protection and Support of Entrepreneurs, the Law on Public-Private Partnership, the Law on Public Services, and the Tax and Customs Codes, among others. In addition, foreign investment is subject to sector-specific laws and regulations in certain sectors. These laws generally apply equally to domestic and foreign investors, with a few exceptions where restrictions are placed on foreign ownership (see further below).

### *International legal framework*

The Republic of Tajikistan has undertaken legally binding international investment commitments through various international agreements— signed at the bilateral, plurilateral, and multilateral levels. These commitments mainly cover entry and establishment conditions, protection, and the legality of specific types of incentives (see Table B3.3.1). Therefore, Tajikistan must reflect these commitments in its domestic legal framework to ensure consistency and monitor compliance.

Table B3.3.1. Tajikistan's International Investment Framework

| Agreement(s) as the basis of Commitments | Type of Agreement | Investment Policy Dimensions Covered |
|---|---|---|
| WTO GATS Agreements | Multilateral | Entry and Establishment |
| WTO TRIMs Agreement | Multilateral | Entry and Establishment, Incentives |

| Agreement(s) as the basis of Commitments | Type of Agreement | Investment Policy Dimensions Covered |
|---|---|---|
| WTO SCM Agreement | Multilateral | Incentives |
| WTO TRIPS Agreement | Multilateral | Protection |
| Treaties with Investment Provisions (7 signed, out of which six are in force) | Plurilateral or Bilateral | May cover Entry and Establishment, Protection, Incentives |
| Bilateral Investment Treaties (37 signed, out of which 25 are in force) | Bilateral | May cover Entry and Establishment, Protection, Incentives |
| Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) | Multilateral | Protection (Dispute settlement) |
| IMF Articles of Agreement (Art. VIII Acceptance) | Multilateral | Protection |
| Double Taxation Avoidance Agreements (33 treaties in force)[95] | Bilateral | Taxation |

### *3.3.1. Limited capacity of TajInvest (Tajikistan's Investment Promotion Agency)*

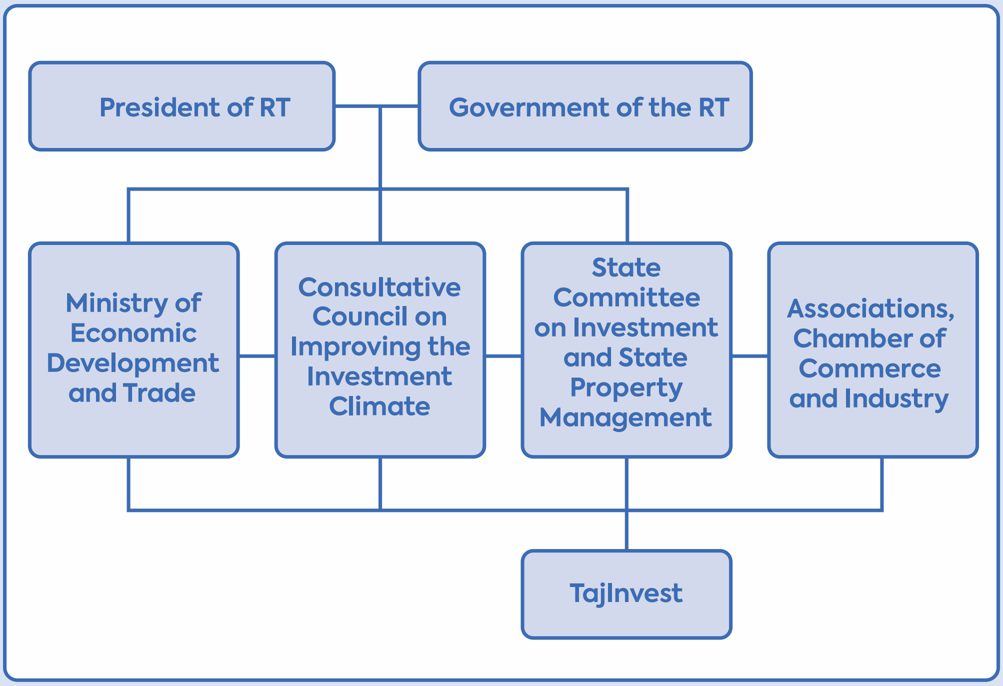
- **The basis for Tajikistan's institutional framework for investment policy and promotion is sound (see Box 3.4), but TajInvest's role as an investment promotion agency needs to be strengthened.** TajInvest is only one of several contact points for foreign investors. In fact, different agencies are frequently observed as having competing interests (US Department of State 2022). These other ministries and regional organizations conduct their investment promotion efforts, and while TajInvest may participate, the agency is not leading them. To strengthen TajInvest's role, it should be made the contact point for all foreign investors, and coordination with different government bodies should be strengthened. In addition, effective investment promotion functions should be developed. Four services are particularly important: marketing, information provision, investor assistance, and advocacy to improve the investment climate (see further Heilbron and Aranda-Larrey 2020).

**Box 3. 4. Overview of Tajikistan's Institutional Framework for Investment Policy and Promotion**

Several institutions are involved in investment policy-making and promotion in Tajikistan. Figure B3.4.1. maps the various institutions involved in different stages of an investment lifecycle – that is, FDI vision and strategy, attraction, entry and establishment, protection, incentives, and linkages.

[95] Price Waterhouse Coopers. 2023. Link: See https://taxsummaries.pwc.com/tajikistan/corporate/withholding-taxes

Figure B 3. 3. Key investment policy and promotion institutions in Tajikistan




The different institutions have the following main functions:

- *Ministry of Economic Development and Trade (MEDT).* The MEDT is the central executive authority in developing state policy for all socio-economic sectors of the country. It carries out the functions of developing and implementing state policy and legal regulation, including foreign economic activity. The Ministry prepares and implements the Economic Development Strategy for the country. The Department of Free Economic Zones (FEZs) under the MEDT is responsible for formulating general policies for developing FEZs. The Department aims to improve these zones' investment conditions and design policies to attract investors.
- *Consultative Council on Improvement of the Investment Climate.* The Consultative Council on the Improvement of the Investment Climate is a public-private dialogue mechanism chaired by the President of Tajikistan. The Council meets several times yearly to discuss specific issues brought up by individual companies or groups of companies and to formulate action plans. It aims to improve the investment climate in the manufacturing, tourism, securities market, and insurance sectors. It also organizes roundtables, forums, and seminars, through which the Council gathers inputs for action plans.
- *State Committee on Investment and State Property Management (SCISPM).* The State Committee on Investment and State Property Management, established in 2006 and reporting to the President and the Government, is responsible for designing investment policy. The State Committee is the "dedicated government agency in the sphere of investment," as referred to in Art. 6 of the Investment Law. It also supervises TajInvest. The SCISPM provides the following facilitation services to foreign investors:

- ✓ Building an effective dialogue platform with investors and facilitating observance of their rights and legal interests.
- ✓ Cooperating with investors and implementing priority investment projects.
- ✓ Providing information services to investors.
- ✓ Performing other investment facilitation functions.

- *TajInvest.* Under the Committee, TajInvest, an agency established in 2010, is responsible for promoting foreign and domestic investment, proposing ways to improve the investment environment, analyzing investment contracts and assessing their implementation, and helping the country to realize its export potential. In practice, the agency primarily provides business development services to domestic companies (OECD 2022).

- *Chambers and Associations.* Domestic associations include the Chamber of Commerce and Industry of the Republic of Tajikistan, with three regional offices (Pamir, Khatlon, Sughd) and the American Chamber of Commerce. These associations provide policy advocacy inputs to the Government, facilitate doing business for their members, and promote Tajikistan as an investment destination for potential members.

- **TajInvest's investment promotion efforts are characterized by the lack of a clear strategy.** The agency seems to have no promotion strategy, investment plan, target markets, or investment products. Investment promotion continues to be characterized by a general marketing approach that lacks specific proposals and information. TajInvest should develop an action plan that selects target sectors and activities and tailor its offering accordingly (UNCTAD 2022). The main sectors of the economy where investment is needed are laid out in two documents which should be the basis for TajInvest's approach: the State policy for attraction and protection (approved by the Decree of the Government of the Republic of Tajikistan on December 29, 2012, №755) and the Programme of State Investments for 2021–2025 (approved by the Resolution of the Government of the Republic of Tajikistan №358 dated September 2, 2021). The sectors comprise agriculture and irrigation, energy, transport, education and science, medical healthcare and social protection, labor, migration, and employment.

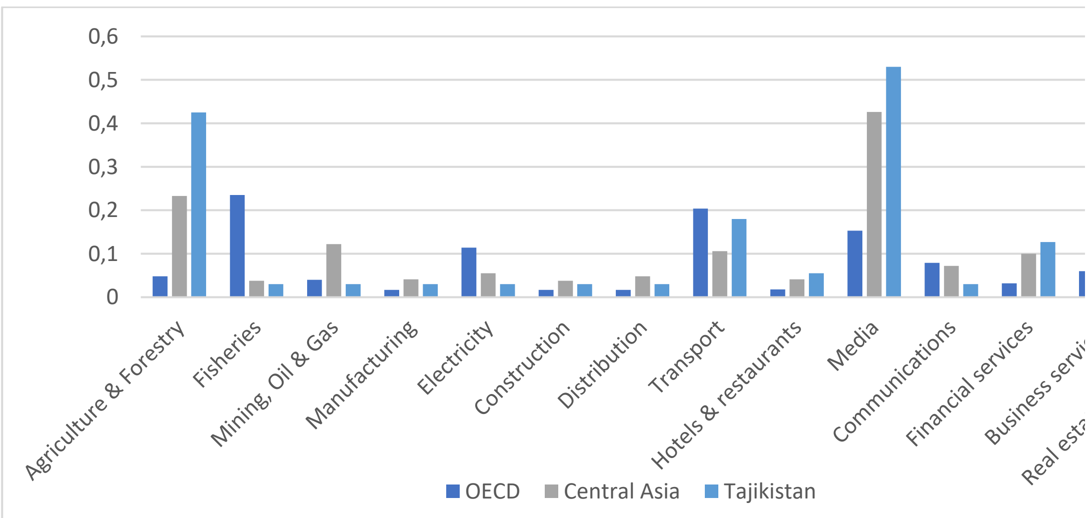
- **TajInvest currently also does not target specific countries or investors.** If planned and delivered properly, targeting can give governments some influence over the types of investment attracted. Whether successful or not, it invariably provides valuable insights into what a location can do to improve its attractiveness to investors. Without outreach, a location's investment promotion depends on investors to "make the first move." To facilitate this, TajInvest should create a database identifying the contacts of potential investors (UNCTAD 2022).

- **SCISPM and TajInvest have no dedicated monitoring, evaluation, or reporting mechanism in place.** Therefore, to improve SCISPM's and TajInvest's functions, it should be considered to introduce such mechanisms, including by setting input targets (e.g., number of meetings, business plans received) and output targets (e.g., number of projects secured, new jobs created), as well as publish annual reports assessing the agency's performance.

### 3.3.2. Burdensome investment entry and establishment procedures

- **De jure, Tajikistan is relatively open to foreign investment, and existing restrictions are unlikely to account for low levels of FDI attraction in the country.** According to the OECD FDI Restrictiveness Index, which measures statutory limitations to FDI, Tajikistan is close to the average for non-OECD countries in most sectors and in line with regional peers (fig. 3.26). The sectors in which legal restrictions remain considerably more stringent than in OECD countries include agriculture and forestry, media, and legal services. No foreign equity is permitted in legal establishments; under 25 percent of foreign equity is permitted in media companies. Some restrictions also exist regarding the employment of foreign personnel in specific sectors such as agriculture and media[96].

Figure 3. 26. OECD 2020 FDI Regulatory Restrictiveness Index; sectoral restrictions in Tajikistan




Source: OECD FDI Regulatory Restrictiveness Index, https://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX
Note: Open=0, closed=1

- **Transparency on existing de jure restrictions could be improved by publishing a 'negative list' for which FDI is limited or prohibited.** Potential investors need reliable information about entry restrictions, such as reserved and restricted sectors. However, this information is difficult to obtain because no central place provides all restrictions. While Article 5 of the 2016 Investment Law includes the general safeguard clause that limits or prohibits foreign investments based on national interest considerations, the law does not include a Negative List nor clarify what constitutes these national interests. Nor does any other legal act provide a list or other criteria for the limited or prohibited areas for FDI. A Negative List including all restrictions and reservations in the form of secondary legislation would serve this purpose.

[96] Agriculture land cannot be directly issued to foreign citizens or foreign companies. Foreign citizens are also not allowed to be a founder of media companies and foreign companies with equity of more than 25 percent are not allowed either.

- **While progress has been made in reforming business establishment procedures, challenges remain.** Many reforms have been implemented to reduce the time, cost, and number of procedures required to start a business, declare and pay taxes, import and export, obtain electricity, and manage insolvency. Among the most important are the removal of the State fee for business registration, E-Systems to connect to the electric grid, the declaration and payment of taxes online, and the establishment of single windows for construction permits, property registration, and import and export procedures. Yet, the required efforts and costs related to establishing a business remain high, and enforcement of licensing and inspections is inadequate due to weak supervision and coordination (UNCTAD 2022). Overall, the business establishment process still requires significant legal and human resources, government connections, and time (OECD 2021; US State Department 2022). For example, while the registration process should take less than five business days, it may take longer, sometimes even months, due to the inappropriate or unlawful actions of registering agencies. Closing a business also remains complex and can take six months or more (UNCTAD 2022). Therefore, the Government of Tajikistan should further finalize the centralization of business registration procedures into a single window, lower the costs of registering businesses, and adopt measures to simplify procedures for closing businesses to increase the transparency and efficiency of administrative requirements.

- **Tajikistan is among the few countries in Central Asia to maintain a screening mechanism for FDI, including in its Free Economic Zones (FEZs).** SCIPM is formally responsible for screening, which can be lengthy and non-transparent. The MEDT mainly performs *de facto* screening. Investors must submit their proposals to all relevant government agencies for feedback or objection. Screening often involves background checks on the company, the person(s) representing the company, and identifying a financial source to comply with anti-money laundering regulations (US State Department 2022). In the absence of clear information regarding FDI requirements and the timetable for requests, businesses may be more inclined to rely on personal connections with senior officials, which would tend to favor market incumbents while easing pressure on the government to improve the transparency and consistency of its investment regime (OECD 2021). Firms and development organizations in Dushanbe have noted that the process for Chinese firms entering Tajikistan differs, creating further uncertainty for potential investors regarding competition and market entry requirements (Ibid).

- **The Government of Tajikistan might consider minimizing the screening process to ease barriers to FDI and reduce space for arbitrary decisions.** Screening processes, especially when applied in discriminatory ways, significantly deter FDI. This effect is especially strong for service sectors and efficiency-seeking investment, which is more mobile than other types of FDI and can choose host countries with simpler and more favorable business environments (Mistura and Roulet 2019). Although, in principle, governments use screening mechanisms as legitimate tools for pursuing economic objectives, deficiencies in the design of these mechanisms may impose significant burdens on investors without advancing the intended objectives. Even if the mechanisms are well designed, their poor or discretionary administration may increase costs and uncertainty for investors without achieving the desired benefits. Depending on specific policy objectives, there are possible alternatives to screening that the Government of Tajikistan should consider, that is, other ways in which host economies can organize the entry process for foreign investment: (i) company registration complemented with notification; (ii) licensing processes; and (iii) strengthening efforts to combat fraudulent or illegal practices. If the existing screening mechanism in Tajikistan is preferred, it should be restricted to a limited number of sectors and made transparent and efficient.

- **Moreover, the work permit process could be improved.** According to the "Rules on Issuance of the Work Permits to Foreign Citizens," work permit issuance is processed within the annual quota for immigration and attraction of foreign workers set by the President. The current quota system for hiring does not prioritize sectors with the need for specific skills often unavailable in the local labor market. The work permit system should instead target those sectors needing foreign skills and provide easy access to them. An in-depth analysis with a transparent methodology should be conducted to establish a targeted quota to assess the need for skilled labor not available in the local labor market. Further, a fast-track procedure for foreign workers with specific skills should be established so employers can recruit foreign labor when needed and not after a lengthy bureaucratic process. Finally, the introduction of a single application process to obtain a work visa and work permit through a single procedure should be considered.

- **Despite recent efforts to streamline the land registry, there is space to further improve access to land for foreign investors.** Several reforms were introduced, particularly in establishing a single window for property registration. Electronic database systems were also developed to register borders, check plans, and provide cadastral information, including the geographical information system. Launched in 2020, they are available at baqaydgiri.tj and geoportal.tj (UNCTAD 2022). At the same time, foreign citizens and legal entities cannot hold a primary right to use agricultural land; they may only lease agricultural plots from Tajik right holders, which has the potential to negatively affect the development of the agricultural sector of the Republic of Tajikistan. The Government may consider reviewing limitations regarding the access to land by foreign investors while taking the legitimate interests of domestic smallholders properly into account. Or else it could allocate specific plots to foreign investors for agricultural investments in the form of a land bank if the general ban on accessing agricultural land cannot be lifted in the short run. In addition, options to improve land markets, including regulations to ensure the alienability of use rights, should be considered.

- **The transparency of investment-related information – including all business establishment procedures – needs to be improved.** The State Committee and TajInvest provide only basic information on procedures and sectors. Details are lacking on the value-proposition of each described sector. The same is valid regarding the information on the Free Economic Zones on the Ministry's website. Moreover, the State Committee and TajInvest offer only limited investment-related items of legislation on their website, and several links to legislation are not functioning. Frequently, documents are not available in English. In addition, updates appear to be irregular. Notably, during the COVID-19 pandemic, the SCISPM and TajInvest have not added new important legal information to investors, such as information on lockdowns, tax measures, and credit support (OECD 2021). The provision of investment-related information needs to be improved. Any reform efforts should be linked to the ongoing initiative by the Ministry of Justice to establish a Unified Information Center.

### 3.3.3. Incomplete investment protection framework

- **Tajikistan's legislation offers the main investment protection guarantees.** Article 14 of the Investment Law protects foreign and domestic investors against expropriation and requisition. The protection covers direct and indirect expropriation, where indirect expropriation is defined as measures equivalent to it. An investor's assets can only be subject to expropriation if the state's action is in the interest of the state or the society, following the domestic legislation and undertaken in a non-discriminatory manner against timely, adequate, and effective compensation. In addition, articles 10 (2) and 11 of the Investment Law allow converting all payments related to an investment in Tajikistan into any other freely convertible currency. Furthermore, the Law "On Foreign Exchange Regulation and Foreign Exchange Control" allows unrestricted foreign currency transfer. Moreover, Art. 7 of the Investment Law provides for national and most-favored-nation treatment.

- **Tajikistan's international investment agreements (IIAs) are mostly not in line with good international practice, putting the country at risk of facing costly investor-State dispute settlement (ISDS) cases.** Tajikistan has signed 37 Bilateral Investment Treaties (BITs), of which 25 are in force, and 7 Treaties with Investment Provisions (TIPs), of which six are in force. These are the majority of so-called "old-generation IIAs" that make Tajikistan highly prone to be sued in investor-State disputes (UNCTAD 2016). Most include an unqualified commitment to treat foreign investors fairly and equitably and free transfer of funds provisions without reservations. Furthermore, many BITs include an umbrella clause, which effectively elevates other commitments by Tajikistan, such as those contained in investment contracts, to an international treaty obligation. They also do not include sustainable development considerations such as social rights and protecting labor safety and the environment. Therefore, the Government might consider developing a strategy to re-negotiate its IIAs and adopting a model BIT, which is a legal text that countries may draft to consolidate their position for negotiating IIAs. Such a model BIT can be the starting point for reforming an IIA regime. It may send positive signals to investors and provide clarity for the Government of Tajikistan on what standards the country seeks to follow.

- **While dispute settlement is provided for in both domestic law and international treaties, issues with contract enforcement and dispute resolution prevail.** The Economic Procedural Code, the Law on Investment, the Law on Arbitration Courts, and the Law on International Arbitration Courts govern dispute settlement for domestic and international businesses. However, even though the country has economic courts that are authorized to hear disputes from both domestic and international businesses, there are no specialist courts to hear disputes relating to land or intellectual property rights (IPR) disputes, nor are there small-claims courts or simplified procedures for SMEs (World Bank 2020).

- **Moreover, international investors continue to complain about a lack of transparency in the justice system and the related problem of unpredictability in contract enforcement and dispute resolution in domestic courts (OECD 2021).** The quality of domestic judicial processes is a key issue hampering effective dispute resolution, with Tajikistan's judicial system characterized by a lack of independence, corruption, and inconsistent interpretation and implementation of laws, all raising the cost of doing business in Tajikistan (World Bank 2018). Some specific issues are that cases are not randomly assigned to judges, and that there are no limits on the number of adjournments that can be granted. Tajikistan also lags in terms of digitalization of court procedures. Companies can pay court fees online but not of filing complaints online; judgments are not published online, and there is no electronic case management (World Bank 2019). Next to necessary procedural reforms, a regulatory framework to improve the statutory independence of the judiciary should be developed (UNCTAD 2022). In addition, the commercial justice system should be strengthened by promoting specific commercial training for first-degree judges and alternative dispute resolution mechanisms (Ibid.). Lack of qualifications and knowledge of international legal norms among judges often delays trials.

- **Specifically, foreign investors suffer from a lack of enforcement of the decisions of international tribunals.** Tajikistan is a signatory to the Recognition and Enforcement of Foreign Arbitral Awards Convention (1958 New York Convention), which governs international arbitration disputes. Yet, while domestic legislation recognizes the validity of rulings by international arbitration courts, foreign investors report difficulty ensuring that decisions are enforced in the country, even when covered by a bilateral IIA (OECD 2021). Partially, this is due to the large role of SOEs in the country, with judicial institutions reluctant to enforce international claims against a publicly-owned enterprise (Hryniuk 2018 in OECD 2021).

- **A formalized mechanism to address investor grievances would help take away some of the burdens from the court system and prevent investor-State disputes.** Investor grievances are formal complaints raised by investors arising from government conduct. Directly engaging with investors through a dedicated mechanism facilitates existing investors to retain, reinvest earnings, and expand investments. Lower perceptions of political risk further have the positive effect of making it easier to attract new FDI. Simultaneously, preventing investor-state arbitration disputes saves governments legal fees and award costs. So far, Tajikistan has been a respondent in two known investor-State dispute settlement (ISDS) cases[97]. It is reported that in many cases, relevant ministries and agencies cannot respond to investor problems promptly and appropriately in Tajikistan. A grievance mechanism would help to remedy this by providing a direct contact point where investors can raise their issues.

### *3.3.4. Insufficient design, administration, and transparency of incentives*

- **Tajikistan's incentives regime is characterized by many incentives that should be rationalized and aligned with national development priorities.** According to the US State Department, estimates of the existing incentives in Tajikistan range from 97 to over 200, depending on the definition. Many of these are unavailable to investors in practice (US State Department 2022). In addition, incentives may be given out on a case-by-case basis through investment agreements (see further below). Incentives are granted across a wide array of sectors. A draft Decree "On the List of priority industries for which tax benefits are provided following the Tax Code, and additional benefits following relevant regulatory legal acts" has been developed to clarify sectors for which incentives can be granted. It is currently under consideration by ministries and departments (UNCTAD 2022). While this is a good starting point, ensuring all incentives (including non-tax incentives) are tailored towards priority sectors aligned with national development priorities is important. Moreover, it should be considered to reduce complexity by adopting a unified corporate income tax rate. Despite the reduction of tax rates through a new tax code adopted in 2021 and entered into force in January 2022, different CIT rates apply depending on the activity.

- **In addition, procedural and legal reforms are necessary to ensure all incentives are granted based on pre-determined objective, clear, and transparent criteria and are not harmful to competition**. Incentives should generally be based on a cost-benefit analysis. Furthermore, the provision of incentives must abide by state aid rules, where the

[97] The first case, filed in 2008 by an investor from Austria, was decided in favor of neither party (liability found, but no damages awarded). The second case was filed in 2019 by a different investor from Austria and is currently pending. See further: https://investmentpolicy.unctad.org/investment-dispute-settlement/country/206/tajikistansee

AMS's prior analysis of potential competition impacts and approval are required. Even though many incentives are available, there is only limited transparency in this regard. Publishing up-to-date information on the types of incentives offered, their legal basis, granted amounts, eligibility criteria, administration process, and other relevant information is an important first step toward increasing transparency. In Tajikistan, no centralized, up-to-date source of information provides such data. Moreover, as mentioned in Section 2.3 above, there is no centralized registry of firms enjoying incentives of any kind from the state, including SOEs. Therefore, creating a registry of measures/incentives granted is equally important as an inventory of incentives available to improve transparency and facilitate monitoring and evaluation.

- **In the long term, it should be considered to dispense with investment agreements.** However, in the short run, such agreements may remain necessary to attract strategic investors and compensate for Tajikistan's investment climate challenges. Moreover, according to interviews with investors and government stakeholders conducted by the OECD, the investor agreement has proven to be a reliable tool that creates a safety net for investors (OECD 2021). Thus, in the short run, the focus should be on streamlining the approval process and standardizing contract treatment conditions. However, in the long run, experiences from other countries suggest that regimes in which contracts guarantee different conditions for each investment may become difficult to administer. Moreover, such a regime may open the door to claims of arbitrariness and discriminatory treatment (UNCTAD 2022). Hence, moving to a general regime applying to all investors, in the long run, should be considered.

### 3.3.5. Selected proposals to remove barriers to entry and expansion of FDI in Tajikistan

- **To strengthen the effectiveness of the investment law and policy framework in Tajikistan and reduce barriers to FDI, the Tajik authorities could consider the recommendations summarized in Table 3.2.** As highlighted initially, the analysis of barriers to FDI is not exhaustive since it was not focused on the entire legal and policy framework affecting investment, and since the *de facto* implementation of laws and regulations in the country and investor perception is not captured other than through secondary sources. Given these limitations, the policy suggestions outlined below should not be seen as an exhaustive set of recommendations but instead as a specific set of measures to help remove barriers to FDI entry and expansion.

Table 3. 2. Selected recommendations to remove barriers to FDI in Tajikistan

| Reform Action | Implementation Period | Implementation Agencies |
|---|---|---|
| **1. Strengthening the role and capacity of TajInvest** | | |
| Adopt an investment promotion strategy, including overall goals, target sectors, and specific methods for investment promotion. | Short-Term | SCISPM, TajInvest |
| Strengthen TajInvest's role by making it the contact point for all foreign investors. | Medium-Term | SCISPM, TajInvest |

| Reform Action | Implementation Period | Implementation Agencies |
|---|---|---|
| Strengthen TajInvest's investor services (information, marketing, assistance, and advocacy services). | Medium-Term | TajInvest |
| Build up TajInvest's capacity to conduct targeted investor outreach. | Short-Term | TajInvest |
| Implement M&E systems for SCISPM and TajInvest. | Medium-Term | TajInvest |
| **2. Streamlining business entry and establishment procedures** | | |
| Reform the screening mechanism by increasing transparency, limiting the scope of screening, and streamlining the process. | Medium-Term | SCISPM |
| Streamline business establishment procedures. | Medium-Term | SCISPM, other relevant agencies |
| Finalize the implementation of the single-window system to improve investment facilitation. | Long-Term | SCISPM, TajInvest, other ministries, and agencies |
| Improve access to land by allocating specific plots to foreign investors investing in agriculture, issue regulations to ensure the alienability of use rights, and consider reviewing limitations regarding access to land by foreign investors. | Medium- to Long-Term | Ministry of Economic Development and Trade, Tax Authorities |
| Streamline work permit procedures, including by reforming the quota system, establishing a fast-track procedure for foreign workers with specific skills, and introducing a single procedure for work permit and visa applications. | Short-Term | Ministry of Labor, Migration and Employment, Ministry of Economic Development and Trade |
| Adopt a negative list of all restrictions to FDI. | Short-Term | SCISPM, Ministry of Justice |
| Improve the transparency of relevant investment information, including by improving web presence addressing foreign investors. | Short-Term | State Committee on Investments, TajInvest, Ministry of Economic Development and Trade |
| **3. Strengthening investment protection** | | |
| Develop a strategy on how to re-negotiate Tajikistan's IIAs. | Short-Term | Consultative Council on Improving the Investment Climate, SCISPM |
| Develop a model IIA | Medium-Term | SCISPM |
| Strengthen the domestic judicial system through digitalization, an improved regulatory framework to ensure the independence of the judiciary and specific training programs. | Medium- to Long-Term | Ministry of Justice |
| Implement a grievance mechanism. | Medium-Term | SCISPM, TajInvest, Ministry of Justice |

| 4. Improving the design, administration, and transparency of incentives | | |
|---|---|---|
| Rationalize investment incentives and align them with national development priorities. | Medium-Term | Ministry of Finance, SCISPM |
| Improve the incentives administration process for incentives. | Medium-Term | Ministry of Finance, SCISPM, AMS |
| Create an incentives inventory (an inventory of available incentives, incl. eligibility criteria, nature of the benefit, legal sources, application process, and contact information of relevant agencies). | Short-Term | SCISPM, TajInvest |
| Standardize treatment conditions in investment agreements. | Short-Term | Consultative Council on Improving the Investment Climate, SCISPM, relevant other ministries |
| Abolish the investment agreements regime. | Long-Term | SCISPM, relevant other ministries |

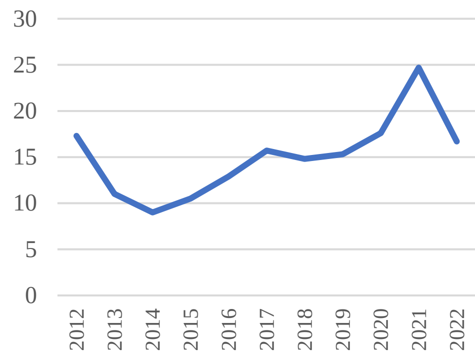
*Note: Short-term refers to a period of 6 months – 1 year, medium-term to a period of 1-2 years, and long-term 3-5 years*

## 3.4. Barriers to Trade

- **Given Tajikistan's geographical constraints, a sustained effort to reduce trade costs by streamlining non-tariff barriers, improving transport and logistics, and implementing trade facilitation measures will be needed to accelerate export growth.** Boosting trade could become an important growth driver as international markets provide significant opportunities over the relatively small domestic market. In contrast, increased trade integration can raise productivity and technology adoption, increasing growth and job creation. Trade in Tajikistan faces many constraints imposed by geography as the country is landlocked, far from large developed markets, and has a difficult topography that complicates shipments across borders and through neighbouring countries. This situation is exacerbated by non-tariff barriers, burdensome trade procedures, and low quality and availability of transport and logistics services that result in high transport costs and long and unpredictable transit times for international shipments. Tajikistan should focus on promoting policies and investments on "soft infrastructure" to reduce trade costs.

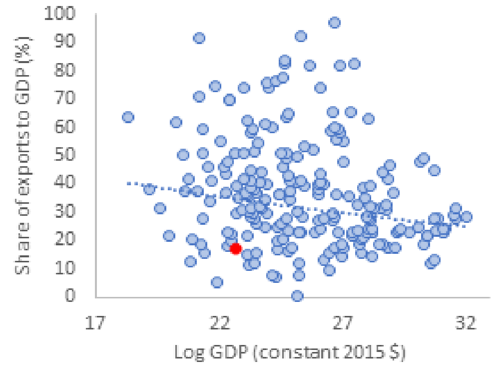
- **The share of Tajikistan's exports in GDP has declined over the past two decades and is below the average for its economic size and income level.** Exports of goods and services as a percentage of GDP declined from 68.1 percent in 2001 to 17.3 percent in 2020 (fig. 3.27). The ratio of exports to GDP declined partly because of strong domestic growth but also due to sluggish export performance that underachieved when compared to global and regional comparator countries until 2015. Based on a comparison with other countries of similar economic size, the gap in the export-to-GDP ratio is large and increasing – with Tajikistan's ratio at about half of the average ratio for a country of similar size (fig. 3.28). Thus, significant export opportunities are available to Tajikistan as exports still have ample room for growth.

Figure 3. 27. Exports of goods and services (% GDP)




Source: WDI

Figure 3. 28. Exports as a share of GDP and economic size

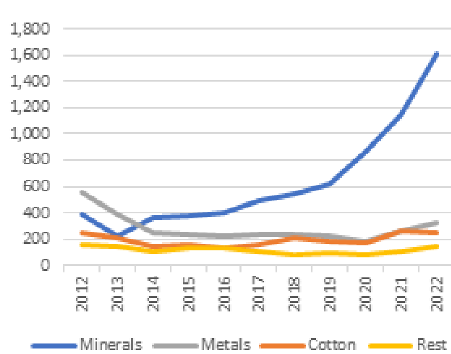



Source: WDI

- **Merchandise exports grew at an average of 5.6 percent between 2012 and 2022, the fastest growth among comparators, driven almost exclusively by gold and other mineral exports.** Exports increased from US$1.4 billion in 2012 to US$2.3 billion in 2022, or a 5.6 percent annual growth rate which is higher than in Kazakhstan (-0.2 percent), the Kyrgyz Republic (1.4 percent), Turkmenistan (-3.4 percent), Uzbekistan (3.2 percent), Turkiye (5.2 percent) and closer to China's export growth (5.8 percent) during the same period. Export growth was driven by the stellar performance of mineral exports, which quadrupled during the last decade among better international prices, and especially by the explosive growth of gold exports. However, non-mineral exports declined from US$ 908 million to US$ 718 million between 2012 and 2022 which represents a 25 percent decline in nominal terms (fig.3.29).

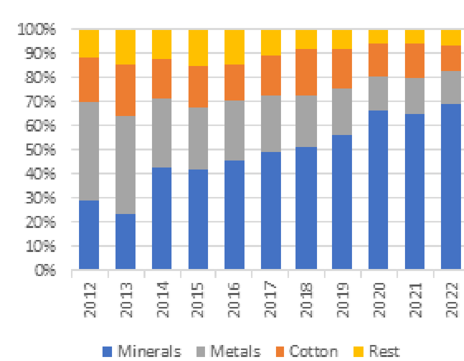
- **The export basket has been limited in its diversification due to the lack of interest of FDI in non-mining industries**. High transport costs and long and unpredictable transit times constrain exports of time-sensitive products more than exports of commodities, which are not time-sensitive and can be transported in bulk at relatively low costs. Export has been dominated by a handful of commodities, such as aluminium, cotton, and minerals which accounted for 90 percent of total exports over the last decade (fig. 3.30). Gold accounts for about half of mineral exports but the country also exports significant quantities of other minerals like copper, zinc, lead, and antinomy, among others.

Figure 3. 29. Merchandise exports (US$ million)




Source: Tajikistan Customs Service

Figure 3. 30. Merchandise exports (% of total)

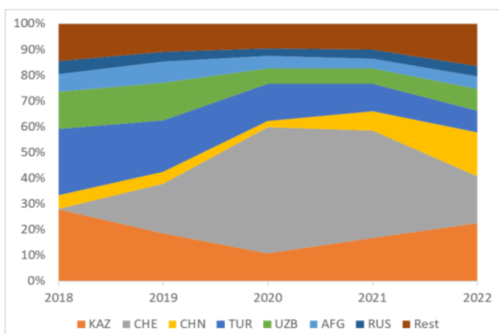



Source: Tajikistan Customs Service

- **Fruits, yarn and fabrics, clothing, and cement are the most dynamic sectors among non-commodity exports.** Non-commodity exports declined in nominal terms between 2012 and 2020 before almost doubling between 2020 and 2022. However, they still represent about 6 percent of total exports. Exports of grapes, dried fruits, cotton yarn, clothing, and cement have increased significantly since 2015 and are now the most important non-commodity exports in Tajikistan. Except for clothing, which is mostly exported to the EU, these exports are mostly destined for regional markets: yarn to Russia and Turkiye, cement to Afghanistan and Uzbekistan, and fruits to Kazakhstan and Russia.

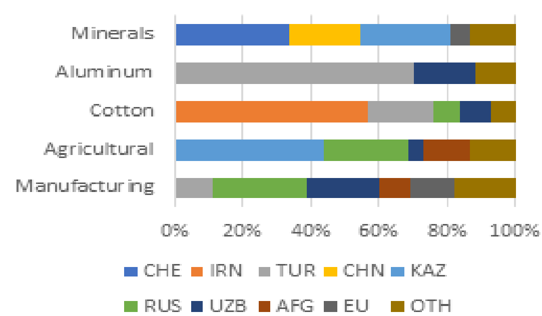
- **Exports destinations are somewhat diversified, with Switzerland, Kazakhstan, Turkiye, Uzbekistan, and China accounting for almost three-quarters of total exports in 2022 (fig.3.31).** Exports of major commodities like minerals, aluminum, and cotton are less diversified than total exports, as the top three destinations account for over 80 percent of exports. Agricultural and manufacturing exports are slightly more diversified and rely more on nearby countries as destinations (fig. 3.32).

Figure 3. 31. Export by country in 2018-2022




Source: Tajikistan Customs Service

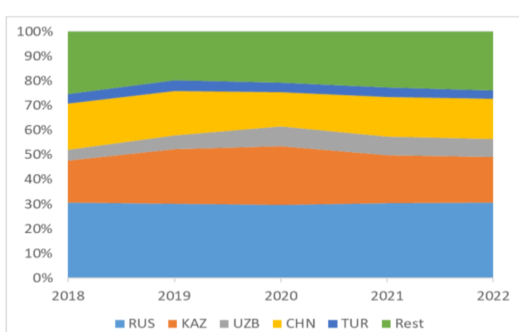
Figure 3. 32. Export destinations by sector in 2022




Source: Tajikistan Customs Service

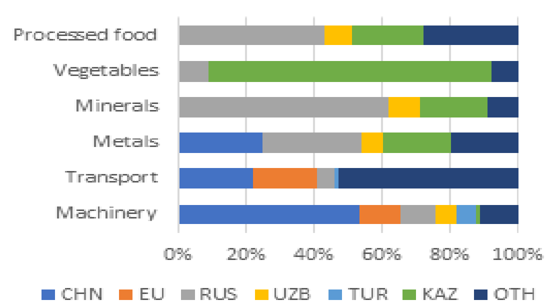
- **Regional neighbors are the main source of imports for Tajikistan, with four countries (Russia, Kazakhstan, China, and Uzbekistan) accounting for roughly three-quarters of imports (fig. 3.33).** CIS countries have become more important sources of Tajikistan imports over the past decade to the detriment of the United States. Russia, Kazakhstan, and Uzbekistan account for 80 percent of agricultural and food imports, while China and the EU are more prominent as suppliers of manufacturing products like transportation equipment and machinery (fig.3.34).

Figure 3. 33. Imports by country in 2018-2022




Source: Tajikistan Customs Service

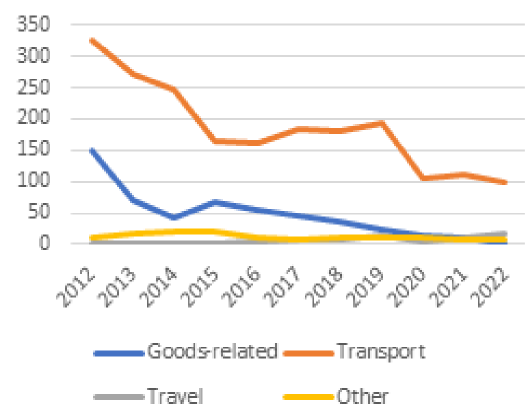
Figure 3. 34. Import origins by sector in 2022




Source: Tajikistan Customs Service

- **Services exports experienced a continuous decline over the past decade in which exports from all major services categories shrank.** Services exports declined from US$488 million in 2012 to US$126 million in 2022 (fig. 3.35). Transport exports, mostly air transport for passengers, declined from 2012 to 2016 and stabilized until 2019, when the COVID-19 pandemic negatively affected operations, declining from US$239 million in 2019 to US$126 million in 2022. Freight transport is the main services import item in Tajikistan and has increased lately as the country demand for international transport services is increasingly met by foreign providers due to high cost and low sophistication of the domestic logistics industry (fig. 3.36).

Figure 3. 35. Services exports (US$ million)




Source: Tajikistan Customs

Figure 3. 36. Services imports (US$ million)


Source: Tajikistan Customs

- **Tajikistan's recent trade performance is consistent with an economy experiencing low productivity and high trade costs.** Labor productivity in Tajikistan is the lowest among Central Asian countries. Trade costs double or triple that of internationally traded goods over domestic goods (WB-UNESCAP 2019). High internal or regional trade costs present a major obstacle to firms' ability to export and connect to global value chains, effectively nullifying any comparative advantage by rendering exports uncompetitive. In a context where low productivity prevents most firms from competing abroad and high trade costs protect domestic industries from competition, firms would tend to devote their resources to the domestic market.

- **Trade policies and institutional reforms aimed at lowering trade costs could help revive trade growth.** Besides Tajikistan's landlocked status, remote location, and difficult topography, underdeveloped transport and logistics, burdensome border procedures, and tariffs and non-tariff measures (NTMs), are factors that increase trade costs significantly and result in unpredictable times for international shipments. Efforts to increase the role of trade in the Tajik economy should start by addressing these issues in the short-term.

### 3.4.1. Pervasiveness of non-tariff measures (NTMs) domestically and abroad

- **Trade policies provide import substitution incentives for domestic market over exports.** Although tariffs are low among comparators (4.6 percent simple average), tariff escalation protects domestic industries and introduces anti-export bias. Varied levels of protection provided to different industries distort competition by favoring some activities and encouraging production for domestic markets to the detriment of exports. The difference between tariffs on inputs and outputs has increased, leading to a high degree of protection, mostly for domestically produced consumer goods. High effective protection rates for sectors like fruits and vegetables (35.5 percent), beverages and tobacco (52.9 percent), cereals (11.7), and textiles (18.7) provide incentives for import substitution over exports, creating anti-export bias.

- **Non-tariff measure (NTM)[98] incidence is high though varies across sectors.** Agricultural and natural resource imports in Tajikistan are generally more heavily regulated, with nearly all trade volume in those goods subject to at least one NTM (fig. 3.37). These indicators are significantly higher than global and regional averages (83.4 percent and 84.9 percent, respectively). Although the coverage ratio for manufacturing products (87.4 percent) is lower relative other sectors, it is still high if compared to regional and global averages (47.8 percent and 45.9 percent, respectively). Tajikistan on average imposes 9.8 NTMs on agricultural products, 2.9 NTMs on manufacturing products and 2.5 NTMs on natural resources. The values of this indicator are higher than regional and global averages for all three sectors.

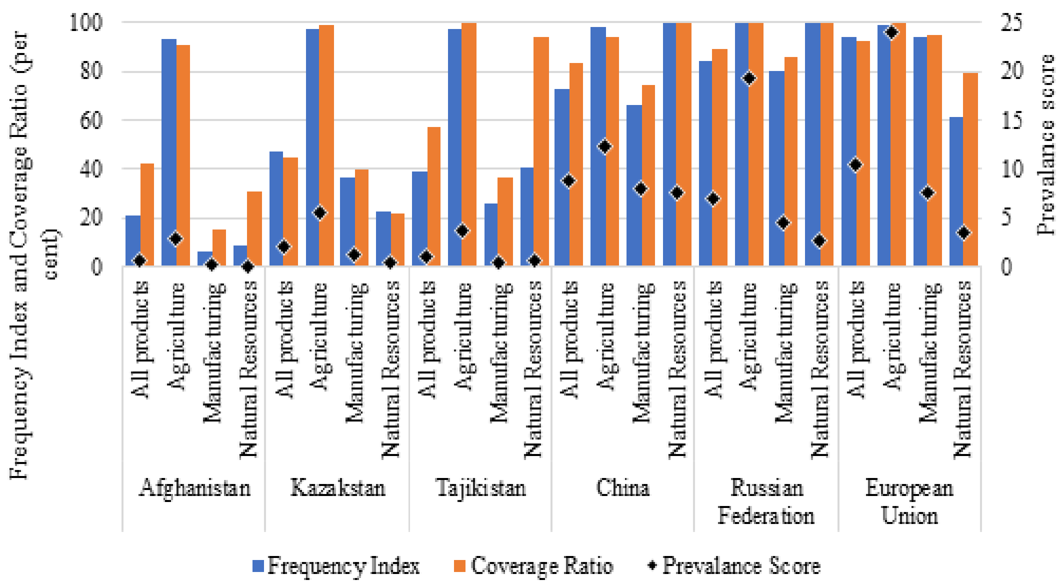
- **A national NTM review process is important to ensure that NTMs achieve their policy objectives without creating unnecessary costs for businesses and households.** Reviewing existing NTMs through cost-benefit analysis should be a priority in the short term. The goal of this exercise is to evaluate the cost of compliance and benefits of regulations to remove NTMs where they impede business growth. Quick identification of the most harmful NTMs can be done based on NTMs data collected by UNCTAD in 2019 and the establishment of round-table discussions involving relevant line ministries and the private sector to prioritize NTMs requiring urgent attention. In the medium term, a continuous process for the regulatory review of newly-proposed NTMs needs to be established.

- **To improve the market access of Tajikistan's products abroad, exporters must meet and satisfy NTM requirements on conformity, quality, testing, and labeling in foreign markets.** On the export side, 69.9 percent of export volume to Russia and 100 percent to Kazakhstan, Tajikistan's top two trade partners, faced at least one NTM. The average share of exports affected by NTMs for all other trade partners was around 58.1 percent. Exports to the Russian Federation and Kazakhstan faced 5.6 and 6.8 NTMs on average, respectively, while all other trade partners faced 3.2 NTMs on average. These

[98] Non-Tariff Measures (NTMs) are policy measures - other than ordinary customs tariffs - that can potentially have an economic effect on international trade in goods, changing quantities traded, or prices or both (UNCTAD, 2012). NTMs include a wide range of public policies, such as technical regulations, pre-shipment inspections, quantitative restrictions, and price control measures.

restrictions may hinder smaller firms from participating in export markets as they lack the capacity to comply with these NTMs, the costs of which are often quite high.

Figure 3. 37. Frequency Index, Coverage Ratio, and Prevalence Scores of NTMs, by sector




Source: UNCTAD, 2017

- **The negative impact of tariffs and NTMs is heightened because imported inputs are key for domestic firms.** Nearly half (43.5 percent) of manufacturing firms report using inputs of foreign origin, and almost a third of inputs are foreign (30.9 percent). High input tariffs and NTMs add to import costs and restrict firms' choice when making productive and technological decisions – particularly because close to 90 percent of imports come from countries with which Tajikistan does not have an operational trade agreement.

## 3.4.2. Underdeveloped logistics and transit supporting systems

- **Customs escorts, a practice phased out in most countries, increase transportation costs and introduce uncertainty in delivery times.** Customs require escorts for all type of goods, no matter their risk status, shipped within the territory of Tajikistan without TIR Carnet. Waiting time for customs escort is the most time-consuming process after clearance at the border as customs escorts are organized only once a day in most border crossing points (BCPs) and trucks have to wait several hours at the border if they miss the previous escort group. Escorts have been generally phased out by customs agencies globally, due to their limited effects on compliance, resource diversion of staff, and costs incurred for cargo owners by the idling of commercial vehicles at the borders.

- **Access to international road transport permits is a bottleneck for foreign trade operations.** International transport permits are based on bilateral agreements and exchanged under reciprocity principles with partner countries. There is an imbalance in the number of foreign carriers hauling cargo in and out of Tajikistan which results in a limited number of permits for foreign transport operators. Large and well-connected firms have easier access to permits while smaller firms struggle to secure permits or obtain them at a substantial cost. Introducing transparency in the permit allocation process, by granting permits to all transport companies that comply with minimum technical requirements on a first-come first-served basis, would improve the environment and reduce informality and rent seeking opportunities.

- **Lack of progress in negotiations on the international status of certain border crossing points doubles the travel time and distance for goods to and from China.** The Karamyk BCP with Kyrgyz Republic does not have international status which means that Tajikistan cannot use this route to access China for trade purposes. Due to the bilateral status of the Karamyk BCP, all shipments to and from China must go through longer and more difficult alternative routes through Khujand and Osh (425 kilometers longer) or use the high-altitude Kulma pass which suffers from disruptions due to seasonal impassability of roads.

- **Air logistics infrastructure remains underutilized due to the small size of the domestic market and more competitive regional offerings.** An air cargo terminal was built at Dushanbe International Airport but capacity utilization remains low and terminal fees remain higher than in other comparators in the region. The normalization of bilateral relations with Uzbekistan in 2018 has brought significant competition for air cargo with Tashkent, which has the largest widebody aircraft cargo capacity in Central Asia and cheaper rates. As a result, a growing number of exporters and importers in Tajikistan choose to use international transit to and from Uzbekistan and the Tashkent airport for air shipments. Although the low domestic demand for air freight in Tajikistan is a constraint in this area, efforts to increase staff training and improve processes are needed to increase the competitiveness of the Dushanbe air cargo terminal.

### 3.4.3. High regulatory and procedural barriers to trade

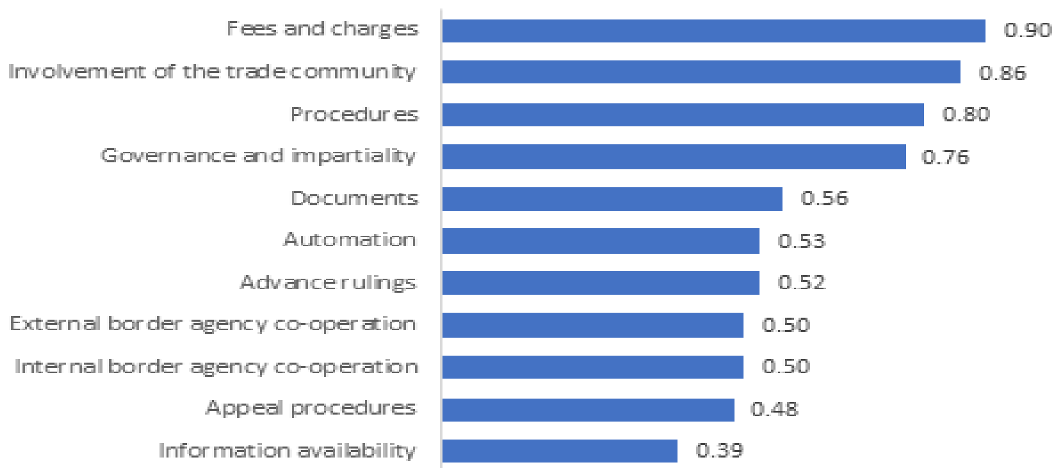
- **Burdensome trade procedures result in delays and high trading costs**. International trade in Tajikistan is characterized by poor quality and insufficient IT infrastructure, low use of electronic documents in trade transactions, many documents required for export and import procedures, and informal payments. All these barriers lead to lengthy border crossing procedures and significant delays.[99] As an example, the export procedures for fresh fruits and vegetables include up to 35 steps, requiring the submission of 47 documents to 12 different public agencies and costing up to US$600 to obtain the necessary permits.[100] Streamlining these procedures in line with best practices remains critical before any further efforts to expand the functionalities of automated systems take place.

- **Tajikistan has implemented several trade facilitation measures in recent years, but there is still room for significant improvement.** Improved processes around export and import operations, fees and charges, formalities on trade documents, and procedures such as border control and single submission points led to significant reductions in clearance times for exports (from 11 hours to 5 hours and 28 minutes) and imports (from 22 hours to 15 hours) between 2017 and 2020. However, despite ongoing efforts to address trade barriers, the country still lags behind its peers in implementing trade facilitation. Information availability, border agency cooperation, simplification of documents, and

[99] UNECE (2020)
[100] Tajikistan Trade Portal (https://tajtrade.tj/?l=en). Accessed on May 24th, 2023.

automation and streamlining of procedures are among the areas where significant improvements are needed (fig. 3.38).

Figure 3. 38. Trade Facilitation Indicators Gap: Tajikistan as % of Best Practice




Source: OECD Trade Facilitation Indicators

- **Information availability has improved since the launch of the online trade portal in 2019 but more efforts should be made to make it available to more traders.** The trade portal provides detailed information about export, import, and transit procedures, costs, and contact points for state agencies covering over 1,500 individual products and helped Tajikistan improve its rank in the access to information category. However, due to the country's low internet penetration, efforts to facilitate small traders access to the trade portal by providing kiosk with reliable internet connectivity along border posts are needed.

- **Duplication of functions and limited collaboration among border control agencies are still rampant.** Formalities at the border or inland facilities and for the release of goods are opaque, with different law enforcement practices at different customs stations. Border checks often replicate those of other agencies (for example, repeated examination of goods by different organizations), or are insufficiently coordinated. Recent cross-border cooperation experiences, like electronic data exchange between customs agencies, should be replicated with the biggest trading partners in the region like Uzbekistan and Kazakhstan.

- **Further steps to improve border and customs risk management could support greater trade facilitation.** Tajikistan still operates a nearly 100 percent physical, real-time 'intervention' control model, with numerous government agencies involved in the customs clearance process. To alleviate the delays at border posts brought about by adherence to existing customs clearance policies, Tajik customs should adopt a modern risk management approach that stresses sampling and the use of better technology and equipment to detect anomalies. The Tajik Customs Code has foreseen the use of risk management principles since 2008 but proper implementation has been a challenge although the customs processing system (UAIS) is set up for the development and application of few risk profiles.

- **Streamlining licenses and permits for international trade is needed before further efforts at digitalization of procedures.** Firms must obtain numerous and overlapping licenses and permits from different government agencies prior to most foreign trade transactions. Many internal processes by trade facilitation agencies have been reported to be inefficient, adding to cost of doing business and eroding competitiveness. The many duplicative roles played by these agencies add to the cost of doing business and restrict the expansion of exports. Many of these licenses serve the purpose of collecting taxes and fees or statistical information instead of regulatory objectives such as the protection of safety, public health or the environment. Although some licenses have been managed electronically through the Electronic Single Window, there is a need to simplify first the long list of permits and licenses before digitalizing them.

- **The Electronic Single Window (ESW) has been rolled out, but its reach remains limited.** The ESW was developed with an aim to facilitate the online processing of documents, and bringing together all regulatory agencies on a single, transparent platform. Although the ESW has been rolled out to facilitate the online processing of documents, numerous competent authorities continue to require traders to submit hard copies of relevant documents. In addition, the electronic payment of fees and taxes to government agencies other than Customs still need to be incorporated into the ESW.

### 3.4.4. Selected proposals to remove barriers to trade in Tajikistan

- **To accelerate export growth and introduce competition in the domestic market, the Tajik authorities could consider the recommendations summarized in Table 3.3.** As highlighted initially, the analysis of trade barriers in Tajikistan is not exhaustive since it was focused on trade policies and trade facilitation measures that could be implemented without incurring large fiscal outlays. Given these limitations, the policy suggestions outlined below should not be seen as an exhaustive set of recommendations but rather a specific set of measures to help remove barriers to trade in Tajikistan.

Table 3. 3. Selected recommendations to reduce trade costs in Tajikistan

| Reform Action | Implementation Period | Implementation Agencies |
|---|---|---|
| **1. Reducing trade policy barriers** | | |
| Reduce tariff peaks with special emphasis in intermediate inputs and machinery used by exporters and domestic industry. | Short-Term | MEDT, MOF |
| Develop and maintain a national NTM database to facilitate their review | Short-Term | MEDT |
| Establish a task force inside the Ministry of Economic Development and Trade to lead the review (cost-benefit analysis) of current NTMs | Short-Term | MEDT, MOF, CS |
| Establish an inter-ministerial committee to implement the use of regulatory impact assessment to curtail the development of new NTMs | Short-Term | MEDT, MOF, CS |
| Improve quality infrastructure to reduce the compliance costs associated with NTMs in foreign markets. | Long-Term | CS |

| | | |
|---|---|---|
| **2. Improve trade and transit-supporting services** | | |
| Phase out Customs escort services to reduce transport costs and time waiting at the border | Short-Term | CS |
| Introduce transparency into the allocation of road transport permits to reduce informality and rent seeking opportunities | Short-Term | CS |
| Negotiate granting international status to Karamyk BCP to allow shorter transit routes to China | Medium-Term | CS |
| **3. Implementing trade facilitation measures** | | |
| Streamline and digitize licenses and permits for international trade | Medium-Term | CS |
| Introduce a Risk Management System in Customs to reduce physical and documentary controls and time to export/import | Medium-Term | CS |
| Introduce an electronic payment system for trade fees, taxes, and VAT rebates | Long-Term | CS |
| Establish regular collaboration between joint border agencies and Joint Border Committees with border agencies and private sector in neighbouring countries. | Medium-Term | CS |
| Prioritize the inclusion of trade procedures for key export products and their inputs in the national single window | Medium-Term | CS |
| Strengthen and promote the National Trade Facilitation Committee | Short-term | MEDT, CS |

*Note: Short-term refers to a period of 6 months – 1 year, medium-term to a period of 1-2 years, and long-term 3-5 years*

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# ANNEX 1: SOCIAL ASSISTANCE REFORMS

**Social assistance in Tajikistan is amongst the lowest in the world.** The social protection system in Tajikistan comprises contributory social insurance schemes, noncontributory social assistance benefits and services, and labor market programs. Even though about 40 percent of the population receives at least one social protection benefit, social protection interventions are dominated by social insurance schemes (mainly pensions). In contrast, social assistance targeted to the poorest and most vulnerable population, as well as labor market programs, reaches about 15 percent of the population and is small in amount. Tajikistan has allocated about 0.5 percent of its GDP to social assistance programs over the past few years. This is below the average for low-middle-income countries and the lowest in the ECA region at an average of 1.75 percent of GDP. Extremely poor households in Tajikistan which receive Targeted Social Assistance (TSA)[101] tend to self-classify as poor (55 percent vs. 41 percent among the total population), use costly coping strategies – e.g., reducing food for basic needs (45 percent vs. 27 percent), and have more food deprivation (on average deprived in 2.6 indicators vs. 1.64 indicators of food insecurity[102]). The L2T survey suggests that TSA has clear impacts when received but that the amounts are too small for durable improvements.

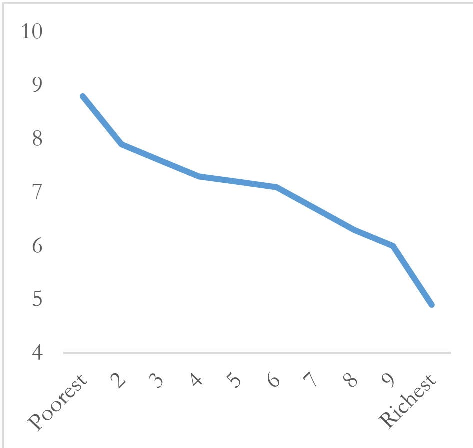
**The authorities have scaled up the social assistance program, but the system requires further improvement.** In 2020 with the start of the COVID-19 pandemic, the TSA was scaled up to the national level and covered around 250,000 low-income families. The annual cash allowance per household under the TSA program was raised from TJS 480 in 2021 to TJS 512 in 2022. This was further topped up by a one-off cash transfer equaling the minimum wage of TJS 600 by the end of 2022. The one-off payments were received by nearly half a million vulnerable people.

**Despite significant progress, several limitations of the TSA program and a scope for further improvement have been identified.** Benefit amounts are still insufficient to lift people out of poverty, the targeting formula should be improved, and amounts linked to household size. In Tajikistan, household size is strongly inversely related to consumption per capita, and the poverty rate rises linearly with household size (fig. A 1). As a result, the practice of distributing flat benefit amounts for all families has limited the poverty-reducing impact of the TSA program compared to an alternative approach calculated in per capita terms. Moreover, a flat rate disregarded different families' depth of poverty (fig. A 2).

[101] The TSA program is the government's flagship consolidated program of social assistance, which covers around 15 of the poorest families in the country. The program uses a proxy-means test (PMT) as a targeting tool and operates a centralized electronic database of records of beneficiaries under the management of the State Agency of Social Protection of the Population under the Ministry of Health and Social Protection of the Population of the Republic of Tajikistan. It provides for both regular cash benefits and various public services at a subsidized rate, including health benefits.

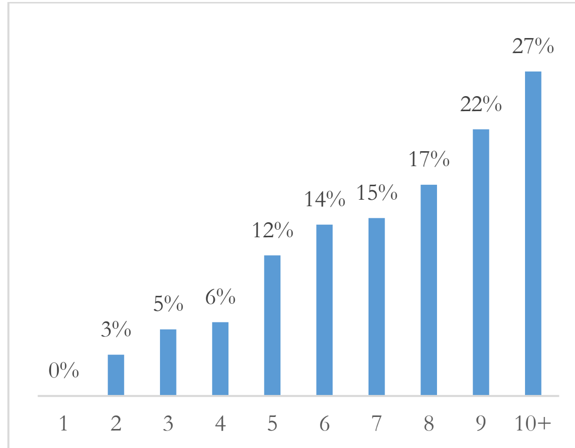
[102] Food insecurity indicators include not eating the whole day, going hungry because food cannot be afforded, experiencing a day where food ran out, eating less than needed, skipping a meal due to shortage, consuming low diversity food, consuming unhealthy food, and concern over the inability to buy food.

Figure A. 1. Household Size by Consumption Decile




Source: HBS, 2021

Figure A. 2. Poverty Rate by Household Size at US$3.2 international poverty line




Source: HBS, 2021

**The authorities are working to strengthen the social protection system by adopting new policies and programs[103].** In 2023, the Government launched the TSA reform to enhance resilience to shocks among the most vulnerable and low-income families. Two main improvements were introduced: (a) a new proxy-means test (PMT) formula to identify beneficiaries' welfare better;[104] and (b) a new approach to determine TSA benefit amounts that are higher in size and based on a per child under 16 years old approach.[105] The modernized PMT formula will improve the targeting and progressiveness of the TSA program. The benefit allowance will equal nine budgetary units in 2023 and be supported by an additional 0.5 budgetary units for each child[106]. The reform plan envisages that the TSA allowance will be raised further to 10 budgetary units (+ 1 unit per child) in 2024 and to 11 budgetary units (+2 units per child) in 2025. The amounts will be adjusted to account for inflation. The modernized system is projected to cover 1.4 million people and increase coverage of the poorest decile from 38 percent to 63 percent. The TSA program budget will increase from TJS 128 million in 2021 to about TJS 300 million within the next three years. Additionally, the government plans to expand the coverage of the recently introduced Free School Meals pilot program under social safety net initiatives. The school feeding program that was launched on a pilot basis in 24 rural districts in 2022 to provide socio-economic support for poor children will be slightly expanded to 25 districts in 2023 with the addition of the Temurmalik rural district located in Khatlon province, one of the country's poorest regions[107]. Around 15,338 primary school children across 43 schools are expected to benefit from daily nutritious lunches in 2023. These reforms are expected to double the budget allocated to social assistance in Tajikistan, bringing the total budget allocations from 0.1 percent of GDP in 2021 to 0.2 percent by 2025.

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[103] In 2022, several strategic documents were approved, including (i) the Strategy for the Development of Social Protection of the Population until 2040, (ii) the Concept for the Development of Productive Employment in Tajikistan until 2040[103], and (iii) a Roadmap of the Ministry of Labor, Migration and Employment for 2022-2026. In 2023 additional documents are set for adoption, including the Action Plan for the medium term Strategy for Social Protection, the State Program to Support the Elderly for 2023-2027, and the State Program to Promote Employment for 2023-2025.

[104] "Methodology for Determining the Low-income Status of Citizens and Families for Receiving Targeted Social Assistance," Order of the Ministry of Health and Social Protection of the Republic of Tajikistan, No 738, October 6, 2022.

[105] Government Resolution, No 548, November 23, 2022.

[106] The budgetary unit is updated each year in the State Budget Law and has been set at TJS 68 for 2023.

[107] Government Resolution, No 626, December 29, 2022

# ANNEX 2: SELECTED MACROECONOMIC AND SOCIAL INDICATORS

| | 2020 actual | 2021 actual | 2022 est. | 2023 proj. | 2024 proj. | 2025 proj. |
|---|---|---|---|---|---|---|
| **National Income and Prices** | | | | | | |
| Real GDP growth | 4.4 | 9.4 | 8.0 | 6.5 | 5.0 | 4.5 |
| Private consumption, growth | 3.4 | 4.7 | 9.0 | -0.1 | 3.2 | 3.1 |
| Gross investment, growth | -4.6 | 12.0 | 11.4 | 10.1 | 5.6 | 4.6 |
| Consumer price inflation, period average | 8.6 | 9.0 | 6.6 | 4.5 | 6.0 | 6.1 |
| Average exchange rate (TJS per USD) | 10.3 | 11.3 | 11.0 | ... | ... | ... |
| | In percent of GDP | | | | | |
| **External Accounts** | | | | | | |
| Current Account Balance | 4.3 | 8.2 | 15.6 | 4.3 | 3.5 | 2.8 |
| Goods export | 15.6 | 22.5 | 15.4 | 13.2 | 12.3 | 11.8 |
| Goods import | 33.4 | 41.7 | 43.6 | 35.9 | 35.1 | 34.6 |
| Services, net | -3.3 | -4.3 | -5.2 | -4.8 | -4.5 | -4.2 |
| Remittances, net | 26.1 | 31.2 | 49.2 | 31.8 | 30.7 | 29.8 |
| Other income | -0.6 | 0.5 | -0.2 | 0.0 | 0.0 | 0.0 |
| Foreign direct investment, net | 0.4 | 0.4 | 1.5 | 1.7 | 2.5 | 2.8 |
| Total external debt | 84.9 | 63.5 | 49.1 | 44.0 | 41.6 | 40.1 |
| | In percent of GDP | | | | | |
| **Consolidated Fiscal Accounts** | | | | | | |
| Revenues | 25.8 | 26.7 | 28.0 | 25.8 | 26.1 | 26.1 |
| Expenditures | 29.2 | 28.0 | 29.1 | 28.2 | 28.6 | 28.6 |
| Overall fiscal balance | -3.5 | -1.3 | -1.2 | -2.5 | -2.5 | -2.5 |
| Total PPG Debt | 46.5 | 41.9 | 34.8 | 38.4 | 38.3 | 40.8 |
| **Monetary Accounts** | | | | | | |
| Broad money growth | 18.5 | 8.2 | 40.4 | ... | ... | ... |
| Reserve money growth | 20.3 | 11.6 | 52.9 | ... | ... | ... |
| Private sector credit growth | 12.7 | 10.0 | 10.4 | ... | ... | ... |
| Refinance rate, end of period | 10.75 | 13.25 | 13.0 | ... | ... | ... |
| **Social Indicators** | | | | | | |
| Population, total (millions) | 9.5 | 9.8 | 10.0 | ... | ... | ... |
| Population growth (percent) | 2.2 | 2.1 | 2.1 | ... | ... | ... |
| Unemployment rate (ILO-modelled estimate) | 7.5 | 7.7 | ... | ... | ... | ... |
| International poverty rate ($2.15 in 2017 PPP) | 3.5 | 2.8 | 2.7 | 2.4 | 2.3 | 2.2 |
| Lower middle-income poverty rate ($3.65 in 2017 PPP) | 16.2 | 14.3 | 13.4 | 12.6 | 12.0 | 11.3 |
| Upper middle-income poverty rate ($6.85 in 2017 PPP) | 54.8 | 50.6 | 49.4 | 47.6 | 46.0 | 44.4 |
| Inequality – Gini coefficient | ... | 37.8 | ... | ... | ... | ... |
| Life expectancy (years) | 68.0 | ... | ... | ... | ... | ... |

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

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