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HELPDESK REQUEST

What does previous literature identify as the private sector bottlenecks and competitive sub-sectors in Tajikistan?

Literature Review in support of the GREAT/FFPSD Programme

David Symington

Oxford Policy Management

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Abbreviations

B2B – Business to Business

DfID – Department for International Development

FDI – Foreign Direct Investment

FFPSD – Framework and Finance for Private Sector Development in Tajikistan

G2P – Government to Person

GDP – Gross Domestic Product

GIZ – Gesellschaft fuer Internationale Zusammenarbeit

GREAT - Growth in Rural Economy and Agriculture in Tajikistan

RICA – Rural Investment Climate Assessment

SOE – State Owned Enterprise

1 Motivation

This PEAKS output is atypical both in scope and content. It is a two day literature review to be used as a direct input for the project design phase for possible future interventions for DfID's and GIZ's Growth in Rural Economy and Agriculture in Tajikistan (GREAT)/ Framework and Finance for Private Sector Development in Tajikistan (FFPSD) programmes. As such it is a high level overview of the limited literature available on private sector development sub-sector opportunities and constraints. Specifically, the design phase of GREAT/FFPSD sought to identify sub-sectors that support the achievement of the programme objectives of creating jobs and improving livelihoods especially in rural areas and make recommendations on programmatic approaches. The literature review requested through the PEAKS provides an introduction to the private sector in Tajikistan (Section 2), an overview of the bottlenecks for private sector development in Tajikistan (Section 3.1) and identifies competitive sub-sectors including the constraints and opportunities in these sub-sectors (Section 3.2) and ends with recommendations and areas for future research arising in the available reports (Section 4). The review identifies transportation services, the construction industry, agribusiness and extractives value chains as the key sectors which show potential.

2 Introduction

Tajikistan has experienced impressive high single digit to low double digit GDP growth for the last decade, notwithstanding a dip to 3.9% in 2009 in the wake of the Global Financial Crisis and remains one of the poorest countries in Central Asia. The economy is fragile and dependent on remittances and aluminium and cotton exports. In 2013 Remittances make up 48% of GDP and are generated by the estimated one million (mainly male) Tajik migrant workers in Russia and Kazakhstan.

Roughly one in eight of the population is an international migrant worker, which accounts for the significance of remittances in the local economy. These financial flows can be erratic, typically accruing to the male workers' parents rather than directly to his wife and children. Estimates suggest that 95% of remittances in were used for current consumption of goods and services, rather than for investment. Rural to urban migration is also on the increase with urban centres' growing at a faster rate (2.7%) than rural areas (2.5%). This has put extra stress on urban centres' infrastructure, housing, and job opportunities. However, Tajikistan is still mainly a rural population (73%) and, with the migration of a significant proportion of the male work force, a predominately female working age population together with the young and elderly, remains.

Agriculture provides the majority of employment in the country (40% directly and 20% from agriculture-related service activities) and this is especially so in rural areas. Few Tajik workers have regular jobs (only 35% in rural areas). Farming continues to be mainly subsistence based and has large employment impacts despite in making up 26% of GDP. Rural households are dependent on a mix of agriculture (60% of household), remittances (50% households receiving) and non-farm wages (40% of households). Despite the average agricultural wages doubling between 2009 and 2013, it remains one of the lowest paid sectors (averaging USD 57.8 per month). Farms are small (only 7% of landholding were more than 1.7 ha.) with very limited financial inclusion of with only 2.53% of the population over 15 with an account at a formal financial institution¹.

¹ World Bank, Financial Inclusion Data (2012), <http://datatopics.worldbank.org/financialinclusion/>

Aluminium is produced by a state-owned enterprise (SOE), TALCO, which contributes 61.4% of the government's total tax arrears and uses the largest share of the country's subsidies electricity. There has been significant loan investment made to TALCO by the weak banking sector. During the Soviet era, cotton was the key mono-crop produced in Tajikistan, with few major food crops produced during these times. This left the country food insecure post-independence. Given the limited rainfall in Tajikistan, cotton production was based upon vast irrigation systems that were developed in the Soviet period. However, much of this is in need of repair and upgrading to realise potential cotton and other agricultural production. Despite these weaknesses, cotton continues to be the main export agricultural product and one of the only ones where value addition occurs along the production chain. About 61 cotton gins produce roughly 100,000 tons of high quality ginned cotton, which is mostly exported to other countries. Annually, about 12,000 tons of cotton yarn is processed internally. Dried apricots as well as other fresh and processed fruits and vegetables (such as shallots and onions) have increasingly become a small, yet significant part of the export basket.

Geographically, Tajikistan is landlocked and is the smallest country in Central Asia. More than 50% of the country is over 3,000 meters above sea level with the only major areas of lower land in the north (part of the Fergana Valley) and in the southern Kofarnihon and Vakhsh river valleys (the Amu Darya). Only 30% of Tajikistan's overall territory, approximately 4.1 million ha, can be used for agricultural production. Tajikistan's mountainous land mass and fast-flowing glacial rivers produce cheap and seasonal hydroelectricity through its aged Soviet energy infrastructure. There is a large summer energy surplus, but a severe energy deficit in winter - when the glaciers refreeze, the river runoff declines and energy demand for heating across the country increases. Approximately 70% of Tajiks suffer from extensive shortages of electricity during winter and impose an economic loss estimated at 3% of GDP² as well discouraging FDI. Tajikistan is likely to construct a new dual fuel³ (coal & gas) thermal plants as one action to address this deficit that could be fuelled by the under-exploited Tajik coal resources or imported gas from Turkmenistan via Uzbekistan.

At present, Tajikistan has a single railway line out of the country through Uzbekistan that is its main freight transit route and this is highly expensive. Many of the road networks close in winter as mountainous routes are impassable. The cost of ten tons of freight by road? from Dushambe to Khujand, a journey of 341 km, was USD 1,940. This transport cost is a large barrier to competitiveness. The US Department of Trade and Investment speculate the large Tajik SOE enterprises in transportation, infrastructure, and electricity distribution will remain in government ownership for the foreseeable future.

Tajikistan has one of the youngest population in Central Asia with 54% of the population under the age of 24 with only 3% of its population over 65 (though it is forecasted to increase to 9% by 2050). This is a major resource and if the educational and vocational training system can equip young people with the right skills to compete in the labour market, Tajikistan could benefit from a demographic dividend⁴ such as the East Asian tiger economies.

² For calculations see World Bank (2012), Tajikistan's Winter Energy Crisis: Electricity Supply and Demand Analysis

³ These are power plants whose turbines can be transformed from using gas to coal and vice versa

⁴ A demographic dividend is the freeing up of resources for a country's economic development and the future prosperity of its populace as it switches from an agrarian to an industrial economy. In the initial stages of this transition, fertility rates fall, leading to a labour force that is temporarily growing faster than the population dependent on it. All else being equal, per capita income grows more rapidly during this time too.

However, Tajikistan's working aged population has one of the lowest shares of people with tertiary education in Central Asia. Indeed, 30%-40% of Tajik enterprises have reported the lack of skills to be a significant barrier to doing business.

There are relatively unexploited natural and human resources with significant mining opportunities in gold, silver, coal, safe drinking water, textiles, and in raw and processed agriculture. The business environment is challenging and while Tajikistan has recorded improvements in its overall ranking in the World Bank's Doing Business Indicators, it is positioned 141st out of 185 economies. The country's control of corruption is limited (ranked 183rd of 202 in 2011) and so is its regulatory quality (ranked 166th of 202 in 2011).

Tajikistan's post-civil war settlement has left a small political and business elite who control much of the business networks. The government is still rather statist and inhibits enterprises development, access to finance and innovation. Corruption and rent-seeking are reportedly common. Despite their often being changes of policy or legislation at the national level, these reforms often take a long time to be felt at the regional and district levels of government. Since 2008, there has been a significant decrease in the net inflows of FDI into Tajikistan. In 2008, FDI net flows were the equivalent of 7.3% of GDP, however this remained at between 0.2%-0.3% of GDP between 2009 and 2011.

Narcotics trafficking from Afghanistan, especially opium, is acknowledged to be an increasingly serious problem as this illegal business activity can yield large returns in a country with few well paid jobs and with a large underemployed and youthful population. A more positive recent development has been the rapid increase in cellular phone cover across the country. In 2007 only 32.3% of the population had a mobile phone and by 2011 this had increased to 90.6%. This creates opportunities to leverage this cellular platform to improve the efficiency and safety of financial transactions and information sharing.

3 Overview of private sector bottlenecks and prioritisation of sectors in Tajikistan

3.1 Overview of Private Sector Bottleneck

Doing Business, World Bank (2014)

The key bottlenecks highlighted by the Doing Business Report are the *Trading across borders* (188th/189), *Dealing with construction permits* (184th/189), *Paying Taxes* (178th/189), and *Getting Credit* (159th/189). The report highlights three trading across borders' indicators to targets for reform, these are reducing the *number of documents to export* (12 documents), the *cost to import* (USD 10,250), and *cost to export* (USD 8,650). In each of these indicator Tajikistan is in the bottom 1% of global performance.

Enterprise Survey, World Bank (2008)

After being presented with a list of 15 business environment obstacles, business owners and top managers in 360 firms were asked to choose the biggest obstacles to their businesses. The top 3 constraints identified were *electricity* (24.8% of managers), *tax rates* (22.5% of managers), and *access to finance* (17.5% of managers).

Rural Investment Climate Assessment, World Bank (2013)

This report covered the weaknesses of the rural investment climate for crop and livestock production and for rural enterprise based on interviews with rural farmers and

entrepreneurs. The report identifies the main weaknesses of Tajikistan's rural investment climate for *crop and livestock production*:

- *Irrigation*: Poor availability of water ranks as a constraint among all the 41 subcategories of problems that farmers were asked about. 31% of farmers perceived unavailability of irrigation (including maintenance and irrigation networks) as a major or severe problem.
- *Land*: Problems related to the insufficient land, inability to rotate crops due to small plot sizes and lack of land certificates is perceived as the second most binding constraint with crop farmers. Additionally, the land rental and sales markets appear to be very thin with only 5% of landowners reported to be renting out land.
- *Knowledge of Land Laws*: 42% of respondents believe that it is not legal to acquire land from other farmers or entrepreneurs. Farmers are not familiar with the legal provision concerning the conversion of arable land and pastures into orchards and vineyards - prerequisites for increasing the area in perennials.
- *Agricultural Inputs and Services for livestock production*: Unavailability of feed, fodder, grazing pastures, watering points and supplements are viewed by farmers as major constraints by 57% of livestock producers. Prices of feed, fodder and nutritional supplements, poor breeds of stocks, and lack veterinary services are viewed as a major constraint by 20%-30% of livestock breeders. Livestock farmers also identify lack of storage and shelter as major or severe constraints especially the lack of winter shelter or refrigeration storage as key binding constraints.
- *Rural Infrastructure*: Crop and livestock farmers both view distance and road conditions as a big problem that impacts on the input supply and price problems due to lack of infrastructure as unreliable transport.
- *Credit*: Crop and livestock farmers rate credit as a major constraint and point to high interest rates and complex procedures a key obstacles.

The main weaknesses of Tajikistan's rural investment climate for *rural enterprises* are broadly grouped as:

- *Taxation*: About 31% of the enterprises (out of total 800 enterprises) considered high tax rates as a major or severe constraint. 17% viewed tax administration as an important obstacle. Indeed among farm households paying taxes, about similar percentages expressed concerns about tax rates and administration. Household survey data also indicated many households were paying land taxes even though they were paying unified taxes (which included land tax already).
- *Infrastructure*: Lack of infrastructure appears to be an important concern of rural enterprises as well. 30% of the enterprises viewed lack of (irrigation) water supply as a major or severe constraint to their enterprise operation. Unreliability of electricity supply is a major or severe constraint for 23% of enterprises. 16 percent perceived transport as an important obstacle.
- *Finance*: About 22% of enterprises rated access to finance as a major or severe constraint. About 11% of respondents have an overdraft facility and 18% have a line of credit or a loan from a financial institution. About 78% of the enterprises in the survey did not apply for any loans or lines of credit in 2011. High interest rates, complex procedures and collateral requirements are important obstacles to loan applications.
- *Governance and regulatory issues*: Some of the enterprises also expressed concerns about some governance issues (corruption: 13%, inspection: 11%). On average 19% of the enterprises make side payments to obtain services. Most incidences of corruption and side/informal payments occur in the cases of obtaining licenses, permits, and tax inspections.

Investment Climate Statement (ICS), US Department of State (2013)

The statement summaries the main constraints to investing in Tajikistan were identified as (i) *corruption*, (ii) *weak rule of law*, and (iii) *unreliable electricity supplies*. The key messages in relations to constraints of the private sector were:

Investment Promotion Coordination: There are no established criteria for screening investment proposals and potential investors go through a lengthy review process by all concerned government agencies, rather than working with a single investment promotion agency. Although there are no limits on foreign participation, in many circumstances non-transparent decisions are made that favour investors with connections to the existing power structure.

Regulatory Systems: The Tajikistan regulatory systems lacks transparency and poses a serious impediment to business operations. Regulators and officials often apply laws arbitrarily and are unable or unwilling to make decisions without a supervisor's permission leading to lengthy delays. Executive documents (Presidential decrees, laws, government orders, ministerial memos, and regulations, etc.) are often inaccessible, leaving businesses and investors in the dark about rules.

3.2 Prioritisation of Sectors in Tajikistan – Opportunities and Constraints

Aluminium: Aluminium Smelter (TadAZ) is the country's largest enterprise located in the south-west of the country, its overall capacity exceeds 520,000 tons annually, accounting for 57% (2012) percent of total exports. In 2012, Tajikistan exported USD 482 million worth of aluminium. An estimated 5,000 tons is consumed domestically to produce kitchenware and other household necessities. TadAZ employs 12,000 workers, consumes nearly 40% of the country's total power supply, and indirectly supports a community of 100,000. More work need to be undertaken than is available in the current literature to assess the viability of this sector once government subsidies are removed. The only downstream industries at present are a cable and foil plant. Opportunities should be researched to develop more value addition and create jobs in downstream industries such as in Mozambique with the Mozal smelter⁵. However, aluminium value additional enterprise development is constrained by the strategic involvement of the government, expensive transportation of costs, and availability of electricity during winter, in addition to the business environment challenges mentioned in the previous section.

Silver: Deposits of silver are estimated at about 60,000 tons with the Koni Mansur mine reportedly by the GoT as the second largest silver deposit in the world. There are also sizable zinc and lead deposits. Developing forward and backward linkages around this emerging industry could provide a large number of jobs. There have been many delays in the award of the mining license. The availability of electricity and transportation costs are also a serious potential constraint on the industry.

Coal: Tajikistan has six large coalfields with the coal mining company, Sugdugol, having an annual output of only 4,000 tons. Sugdugol plans to supply various regions in Uzbekistan's Fergana Valley with 190,000- 220,000 tons annually from the Fan Yagnob and Shurab mines which currently operate below capacity due to low demand within Tajikistan. During the Soviet era, Shurab, with an annual capacity of 650,000 tons, was the main supplier of coal to Tajikistan and parts of Kyrgyzstan and Uzbekistan. Tajikistan is believed to have up to 2 billion tons of coal reserves in the Fan Yagnob mine alone and

⁵ For more details see:

<http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/IDA/0,,contentMDK:21321646~menuPK:4752068~pagePK:51236175~piPK:437394~theSitePK:73154,00.html>

geologists are currently studying deposits in the Hisor range in western Tajikistan. Of great importance are the coal deposits at Kishtut-Zavran and Fon-Yaghnob where coal can be converted into low cost liquid natural gas at about \$120-130 per ton. Opportunities could be explored in the development of the up and downstream value chains if coal exploitation is increased. Constraints would involve the climate change impacts of this action, the timing of any future mining, the willingness of mining companies to be involved in enterprise development initiatives, and the sustainability of any intervention given the cyclical nature of coal mining industry.

Construction: With the possible increase the number of projects in Tajikistan in transport (roads, bridges, etc.), in tourism developments, in hydropower plants renovation and thermal power plant construction, agro-processing plants, and housing there are opportunities for professional and skilled construction firms will emerge. Even if this is in the form of joint ventures or as secondary contractors for Tajik firms, the construction industry provide a large employment opportunities. Additionally, with Tajikistan's low ranking in "Dealing with Construction Permits" indicators from the World Bank, this is an area that could unleash opportunities for regulation and business environment reform.

Mobile Payment Systems: Tajikistan has over 90% of its population with a mobile phone. Leveraging this network to further enable a payments system could provide more efficiency and financial inclusion This could enable more G2P transactions, paying bills or taxes, or faster payments between B2B for remote rural populations. Additionally, if there is a development of mobile banking there could be opportunities to offer greater financial inclusion to rural populations such as saving products and microloans. The development of appropriate legislation in this area and providing sufficient protection to users would be key. Additionally, designing products that are affordable and meet the needs of rural populations would require further studies and product development.

Tourism: Tajikistan's Pamir Mountains and ancient sites could be a very attractive destination for tourists. At present a number of tour operators offer trekking, hiking, mountaineering, wildlife safaris (Marco-Polo sheep, ibex, wolf, etc.), rafting and cycling tours. There are a number of constraints on the potential of this being realised. Transportation links to Tajikistan are very limited and to fly to the country from other parts of the world is time consuming, expensive and with limited choice of airline providers outside of Central Asia. Also, in addition to obtaining a visa to enter the country tourists need permits to enter different regions. The transport infrastructure inside the country is limited making it very hard to travel around the country during winter. There are also few major foreign languages, with the exception of Russian, spoken by Tajiks outside of the main cities making it difficult for tourists to travel to some of the most beautiful and scenic parts of the country.

Textiles: Textiles, clothing, and handicrafts are a long tradition in Tajikistan and were a major source of employment during the Soviet era especially for women. Unlike many other countries, Tajikistan covers the full value chain, starting with the production of raw materials, especially cotton, to spinning, weaving and knitting to produce fabrics, as well as garment production itself. About 61 gins produce roughly 100,000 tons of high quality ginned cotton, which is mostly exported to other countries. Annually, about 12,000 tons of cotton yarn is processed internally.

Agriculture: The major constraints to agriculture are covered more in depth in the previous section. There are opportunities especially in the diversification and improving the value chain for agriculture. Beyond cotton, Tajikistan has opportunities in its apricot, apples, onions and shallots. The high cost of transportation and limited processing facilities are challenges for the sector. Lack of irrigation continues to be a serious constraint in farmers' eyes and the RICA report highlights the land reform continues to . Given the transport links and possible border delays, this makes low weight, high value fruit, which can be stored such as dried apricots, fruit juices, cherries and shallots an attractive investment

area and may explain why they currently capture a high proportion of the fruit and vegetable export mix.

4 Recommendations & Future Research

Political Economy Analysis: Given the challenging business environment in Tajikistan and strong links between government and business. It would be very useful to carry out a political economy analysis of each of the selected sub-sector for interventions to be aware of the political interests and potential ramification of interventions.

Local governance and the business enabling environment: Tajikistan consistently has performed very poorly in business environment and investment climate indices. A starting point would be to tackle the worst poorly performing indicators from the Doing Business Report, namely those in dealing with construction permits, getting credit, paying taxes, and trading across borders.

Transport: As was pointed out in the most recent the Doing Business Report, interventions to reduce the number of documents to export, the cost to import, and cost to export should be a priority. Interventions in the hauling business should also be supported as this could improve competitiveness of many of the potential export industries Interventions could include (i) promoting the development of freight consolidating services to take advantage of backhaul capacity available; (ii) revising the regulations for entry and operation in business supporting services (distribution, transport logistics, telecommunications, finance) within the population hubs to facilitate entry and improve productivity; (iii) building the needed transport (feeder roads) and market (services and market places) infrastructure to improve the connectivity, (iv) and establishing a competent export promotion agency to provide advisory services and market information to the business community.

Construction Industry & Business Environment: Working to build the skills and quality of construction firms in Tajikistan could provide multiple private sector benefits by enabling Tajik companies to win contracts (and sub-contracted) to meet the large infrastructure deficit in the country such as roads, energy facilities, etc. Interventions could provide assistance to firms to upgrade their business services, necessary ISO certifications and financial needs. Construction is a large employment generating activity and given the low educational attainment levels and the young population this could be an industry that Tajikistan could competitively enter. Much reform is also required to start work on “Dealing with Construction Permits” as identified by the Doing Business Report.

Agriculture: The main areas highlighted in the WB’s RICA are to (i) further develop the land registration and cadastre and protecting land rights; (ii) improving governance of Agro Invest Bank and building bank skills in agriculture lending; (iii) rehabilitating irrigation scheme where there is a clear economic or social justification and establishing an institutional framework for water regulation and delivery; (iv) improving rural infrastructure to improve access to markets and improving utilities to enable rural businesses to operate effectively; creating a policy framework conducive to private investment in the seeds sector; strengthening implementation of animal disease control strategies ad building private veterinary services; (vii) building sustainable rural advisory services; and (viii) improving tax literacy and continuing to implement the 2012 tax reforms.

Extractives Forward & Backward Linkages Program: The development of the value chains around extractives industries should be a key priority for new industrial development. Given the range of current and potential future extractive work, the work could start by assessing the forecasted demand for goods and services from the extractives industries and to assess

the capabilities and the ease of upgrading Tajik enterprises to meet the necessary standards, quality, price competitiveness, and frequency that would be required in goods and services to be supplied to new investments in silver or coal mines. This demand and supply gap analysis could be the basis of creating an enterprise development centre, an access to finance component, developing local content policies, or leveraging the existing SEZs and business zones to promote FDI in competitive and job creating support industries.

Mobile Money & Leveraging Telecom Network: The support in the further development of mobile payment systems and the creation of mobile banking could provide ways to increase financial inclusion in rural populations at a low cost.

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