

Beyond the Current Crisis: Tajikistan's Need for Reforms

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While Tajikistan's economic growth this year is still positive, the global crisis is severely affecting low-income households. The policy response from the government and donors has been timely, but will not fully prevent a decline in per-capita disposable income. The economic recovery is likely to be slow, especially when compared with the strong growth of recent years, in part because of the need to withdraw fiscal stimulus. Therefore, reforms of the business environment and in the agriculture sector are more important than ever to ensure that poverty returns to a downward trend.

Tajikistan's economy is holding up relatively well in the current global recession, though low-income households in particular face hard times. The country is being hit by declining remittances (down 35 percent in 2009 so far) and falling exports of aluminum and cotton. Still, economic growth reached almost 3 percent through September. While this is much below the 8 percent achieved in 2008, it is much better than the negative growth seen in many countries around the world. There are two main reasons for this. First, the government, with the support of donors, responded quickly to external shocks and put in place a fiscal stimulus of 1½ percent of GDP for 2009, centered on increasing social spending. Second, the decline in disposable income translated mainly into a fall in imports, which became more expensive as the somoni weakened in response to the crisis. Nonetheless, the global crisis is having a severe impact on the poor households. In particular, recent gains in poverty reduction may be partially reversing, as real disposable incomes of households are likely to decline by 8 percent in 2009.

Economic prospects should improve in 2010, but much will depend on the government's policies. The global economy is emerging from the worst recession since the Great Depression. As a result, growth in Tajikistan's trading partners should translate into greater export demand, and the recovery in Russia should help stabilize remittance inflows. However, the impact of these positive external factors is likely to be muted at first, and there will be a continued need for supportive macroeconomic policies to achieve the government's growth objective of 5 percent for 2010. Against this backdrop, the proposed 2010 budget targets further increases in social spending, while allowing for a modest widening of the overall fiscal deficit. Donors have pledged their continued support for these policies, and are thus helping the government realize its spending plans.

Looking beyond post-crisis recovery, the government needs to create conditions that will foster sustained high growth. Such growth is unlikely to come exclusively from government spending or remittances. A vibrant private sector that will help fuel domestic demand and exports must emerge as a driver of growth. But, in recent years, private investment has averaged only 4–7 percent of GDP, and Tajikistan has consistently had one of the lowest investment-to-GDP ratios in the world. Economic reforms should thus focus on strengthening the business environment and investment climate, as well as developing the necessary

infrastructure, including a reliable and affordable energy supply. Ongoing reforms in the agriculture sector are bound to have a particularly large pay-off, given that 70 percent of Tajikistan's population and most low-income households are concentrated in rural areas and depend on agriculture. The recent strong growth of non-cotton agriculture has demonstrated the pay-offs from agricultural diversification. Lastly, as a landlocked country, regional cooperation can also open growth opportunities for Tajikistan, including in water management and energy trade.

Once growth has regained traction, the government needs to develop an exit strategy from its accommodative fiscal policy stance and devise a medium-term fiscal strategy. By 2010, as a result of the government's anti-crisis measures, public and publicly-guaranteed debt is likely to exceed the 40 percent of GDP ceiling that the government adopted in its 2008 debt strategy. In addition, due to the past misuse of public resources for cotton financing, the government will have to absorb the costs of recapitalizing the National Bank of Tajikistan (NBT), which could cost more than 10 percent of GDP. Fiscal policy needs to reverse these trends and return the public debt ratio to below 40 percent of GDP over time, while ensuring that there are sufficient resources to meet infrastructure and social spending needs. Continued donor support would greatly help meet these challenges.

The International Monetary Fund (IMF), for its part, supports the government's and the NBT's economic policies with a three-year \$116 million concessional loan. The program underpins the macroeconomic component of the government's anti-crisis plan, aimed at maintaining macroeconomic stability, which is a necessary condition for sustained high growth and poverty reduction. Structural reforms in the financial, agriculture, and large state-owned enterprise sectors are designed to enhance the growth potential of the economy over the medium-term. And, the program's revenue collection and social spending floors, and envisaged reforms in public sector financial management, should ensure that social spending can be increased, while improving its targeting. The mix of financing and reforms embodied in the IMF-supported program thus aims to assist the authorities to continue the push for growth and poverty reduction during a particularly difficult time. A recent IMF mission noted good progress on these fronts.