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## Leveraging SME finance through value chains in Tajikistan

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**ADB Working Paper Series**

**LEVERAGING SME FINANCE THROUGH  
VALUE CHAINS IN TAJIKISTAN**

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**Abstract**

Tajikistan's outlook for small and medium-sized enterprises (SMEs) remains challenging as it continues to recover from economic downturn. The SME sector is small but steadily growing in terms of value addition and share of total employment, although access to finance remains poor and financial literacy is low. The prospects are that unless the business environment, entrepreneurial skills, and banking sector improve, the ability of SMEs to withstand future economic shocks will weaken. The Government of Tajikistan has helped to implement much needed reforms, such as the creation of stock exchange and credit bureau, as well as strengthening regulation and improving the ease of doing business, but a shallow financial sector and underdeveloped capital markets risk reversing the gains from past reforms. Despite modest interest in Tajikistan's value chains, private investment is low and emerging comparative advantages in niche sectors are therefore not capitalized on. In this context, the authors recommend that sufficient support infrastructure to help SMEs leverage finance should include the rollout of business incubation and acceleration facilities, business associations, and crowdfunding platforms. The existing nontransparent financing architecture, and stakeholders' weakly coordinated efforts to improve financial literacy and corporate governance standards among SMEs, will continue to hamper value chain development if not adequately addressed.

**Keywords:** small and medium-sized enterprises, access to finance, value chain development, Tajikistan

**JEL Classification:** G10, G28, G38, L20, L26, L50

## Contents

1.	INTRODUCTION AND OVERVIEW OF SMES' ROLE IN ECONOMY AND SME FINANCE .....	1
1.1	Overview of Financial Sector.....	4
2.	STATUS OF FINANCIAL INCLUSION FOR SMEs.....	8
3.	FINANCIAL KNOWLEDGE AND SKILLS OF SME ENTREPRENEURS .....	9
4.	BARRIERS TO SME FINANCE .....	11
5.	STATUS OF VALUE CHAINS AND VALUE CHAIN FINANCING IN TAJIKISTAN ..	14
5.1	Dairy Industry .....	19
5.2	Beef Industry .....	19
5.3	Value Chain Financing .....	21
6.	POLICIES TO PROMOTE SME FINANCE .....	23
7.	CONCLUSIONS AND RECOMMENDATIONS.....	25
7.1	Policy Recommendations.....	27
	BIBLIOGRAPHY .....	30
	ANNEX 1: GLOBAL INDICES ON ECONOMIC AND BUSINESS PERFORMANCE FOR TAJIKISTAN, 2010–2018 .....	37

# 1. INTRODUCTION AND OVERVIEW OF SMES' ROLE IN ECONOMY AND SME FINANCE

Despite 27 years of robust economic growth, Tajikistan is still far away from economic resilience and remains the poorest and least developed country in Central Asia. The economy is still at an early stage of development with a relatively low value added and narrow export base.<sup>1</sup> Since 2010, economic growth has averaged 6.3% annually, while poverty was halved to less than 30% of the population during the period 2000–2017. In 2017, the size of the economy was about \$7.1 billion, with per capita GDP close to \$813. More recently, Tajikistan was hit by adverse economic shocks – a sharp drop in commodity prices,<sup>2</sup> a significant slowdown in major trading partners,<sup>3</sup> and a loss in competitiveness due to sluggish investment in value chains in comparison with neighboring countries.<sup>4</sup> Economic growth has continued to be driven by growth in remittances and public investment. Accordingly, low foreign investment and depressed domestic demand mean that future growth is likely to be unsustainable in the presence of external economic shocks.

Labor migration continues to fuel Tajikistan's GDP growth through consumption, with personal remittances comprising about \$2.5 billion in 2017. The Asian Development Bank (ADB) argues that growth would be as low as 3.1% if remittances were taken out of the equation.<sup>5</sup> Remittances represented 49.6% of GDP in 2013 (the highest recorded figure for Tajikistan as a share of gross domestic product), and by 2017 they had declined to 35.5% of GDP, and have since stabilized around those levels. In addition, growth should be at least 9% to keep pace with demographics. This highlights the country's vulnerability to the external economic environment,<sup>6</sup> with implications for growth and trade.

The domestic labor market is weak, with workers often underpaid, unskilled, and lacking incentives. Labor migration represents one of only a few exit strategies for households, particularly in rural areas, and fiscal buffers (e.g., reserves and deficit) are unlikely to withstand another economic downturn. At the same time, emerging sectors such as garments, handicrafts, financial intermediation, renewable energy, tourism, and information and communication technology (ICT) may spearhead the country's long-term growth. For this to happen, private investment and the density of SMEs need to grow. According to ADB, the ratio of private investment to total investment is only 26%, while the average among lower-middle-income countries (LMICs) is 75%. Total employment declined by 7.8% between 2010 and 2016, while mean productivity increased by 39.8%

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<sup>1</sup> According to the World Bank and the National Development Strategy (NDS) 2016–2030, the government's ambitious goal of doubling the country's gross domestic product (GDP) by 2030 requires the daunting task of maintaining at least 7% annualized real growth rates.

<sup>2</sup> Particularly for oil and metals, such as gold and aluminum. Tajikistan is a nonoil economy, but there is a high correlation with the changes in oil price because over 80% of remittances come from the oil-rich Russian Federation.

<sup>3</sup> Especially the Russian Federation and Kazakhstan (both countries are oil exporters).

<sup>4</sup> Alongside a decrease in the value of the Tajik somoni by more than 70% against the dollar during 2015–2018.

<sup>5</sup> In the meantime, about 181,000 Tajik nationals are still banned from entering the Russian Federation, which puts severe pressure on creating jobs at home. A recent recovery in remittances contributed to growth as well as a narrowing of the current account deficit – namely, from -\$361.5 million in 2016 to -\$35.7 million in 2017.

<sup>6</sup> Structurally, Tajikistan is highly exposed to the Russian Federation, especially through the labor market and currency channels. The EBRD estimates that a 1 percentage point decline in the Russian Federation's growth translates into a decline in growth of 0.2 percentage points in Central Asia.

during the same period. Agriculture is the biggest employer, having expanded from 41% of total employment in 1991 to about 60% in 2017. Productivity in services has declined and employment in manufacturing – despite its recent surge – declined from 46% to 17% during the period 1991–2016.<sup>7</sup> This trend should be reversed and new jobs created, particularly in productive sectors and by SMEs, for structural transformation to kick in in Tajikistan.

The Law of the Republic of Tajikistan “On the State Protection and Support of Entrepreneurship” (Article 5) distinguishes commercial legal entities between small (with a gross turnover of up to 500,000 somoni, or about \$53,000), medium (with a gross turnover amounting to between 500,000 and 15,000,000 somoni, or up to \$1,591,500), and large firms (with a turnover of above 15,000,000 somoni, or above \$1,591,500). This distinction was adopted by the Government of Tajikistan in March 2015, but is rarely used in official government statistics or policy making. Instead, the government and national stakeholders distinguish SMEs not by gross turnover but by employment level (i.e., the size of the workforce in an enterprise).<sup>8</sup>

Small and medium-sized enterprises (SMEs) play an important role as a source of employment, but their contribution to GDP remains low, not least due to the relatively small gross turnover per firm (see Figure 1). Based on Agency for Statistics data from 2017, there are 499,372 commercial taxpayers consisting of 64,592 firms, 197,138 individual entrepreneurs working with a patent, 73,011 individual entrepreneurs working with a certificate, and 164,631 dekhkan farms paying single tax. Only the first group, i.e., commercial taxpayers, are broadly regarded as SMEs. According to official government sources, the share of SMEs in total employment is about 35% in Tajikistan.<sup>9</sup> The economy outside the industrial complex (i.e., extractives and manufacturing) is dominated by small, family-run companies and SMEs are seen as part of the growth transmission mechanism contributing to the well-being of households. However, SMEs’ contribution to GDP in Tajikistan is relatively low (about 30%) compared to the OECD average of 50% in 2017. This indicates that SMEs are mainly operating in low-productivity sectors (see Figure 2), but, as the following sections will elaborate in greater detail, growth prospects for businesses are being held back by regulatory and economic impediments.

Despite steps undertaken by the Government of Tajikistan to privatize companies,<sup>10</sup> state-owned enterprises (SOEs) continue to exercise control over strategically important sectors, such as electricity and heating, ferrous and nonferrous metals, mining, food processing, agriculture, construction, transport, and telecommunications. In 2017, assets of the 24 largest SOEs (out of about 1,100) accounted for 51% of GDP.<sup>11</sup> They also accounted for over 30% of total employment and continue to receive sizeable state financial support, which undermines potential market entry by smaller firms and discourages the creation of a level playing field in terms of competition and access to resources.

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<sup>7</sup> Sources: Ministry of Economic Development and Trade (MoEDT) of the Republic of Tajikistan and ADB.

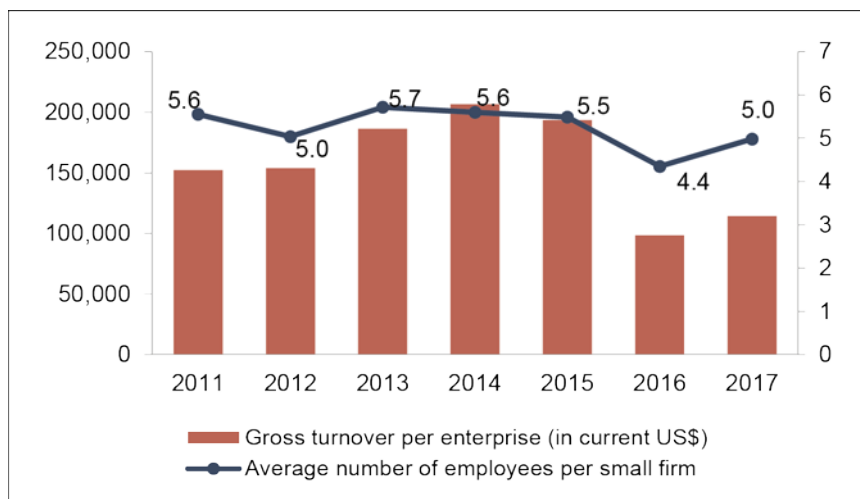
<sup>8</sup> Small firms – up to 30 employees; medium-sized firms – between 31 and 200 employees; and large firms – more than 200 employees (source: Agency for Statistics under the President of the Republic of Tajikistan).

<sup>9</sup> Ten years ago, according to the Agency for Statistics under the President of the Republic of Tajikistan, the share of SMEs in total *formal* employment was approximately 48%.

<sup>10</sup> According to the State Committee on Investment and State Property Management (SCISPM), over 9,600 small firms and over 1,300 medium-sized and large firms have been privatized since the country’s independence.

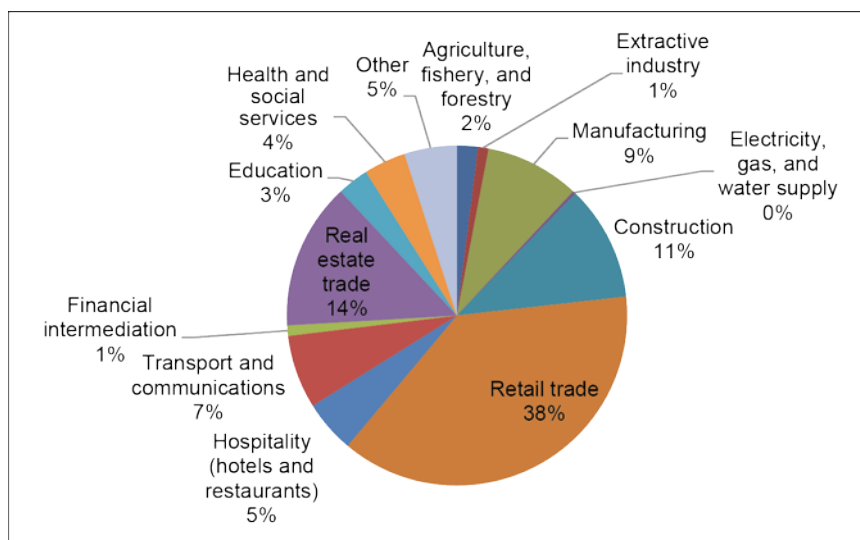
<sup>11</sup> Or 35% of GDP excluding current assets as receivables.

**Figure 1: Selected Indicators for Early-stage (Small) Enterprises in Tajikistan, 2011–2017**



Source: Agency for Statistics under the President of the Republic of Tajikistan (TAJSTAT).

**Figure 2: Distribution of Small and Medium-sized Enterprises (SMEs) in Tajikistan, 2017 (in %)**



Source: Agency for Statistics under the President of the Republic of Tajikistan (TAJSTAT).

SMEs’ price competitiveness and capacity to absorb new employment have weakened significantly in the past decade, not least because exports are concentrated on products with inelastic demand. Since 1995, there has been virtually no change in the composition of Tajikistan’s exports. The country continues to rely on a few commodities for its export revenue, such as aluminum alloys (26.3%), gold (17%), zinc ores (9.5%), lead ores (8.6%), and cotton (7.1%). The export concentration and heavy dependence on natural resources make Tajikistan’s exports vulnerable to volatile international commodity prices. For instance, aluminum – the largest metal export product – amounted to 25% of the total share of exports in 2017 whereas prices were 65% lower compared to 2013. In terms of light industry, for example, knitwear, shoes, and cotton and silk fabric production have shrunk significantly despite the country’s



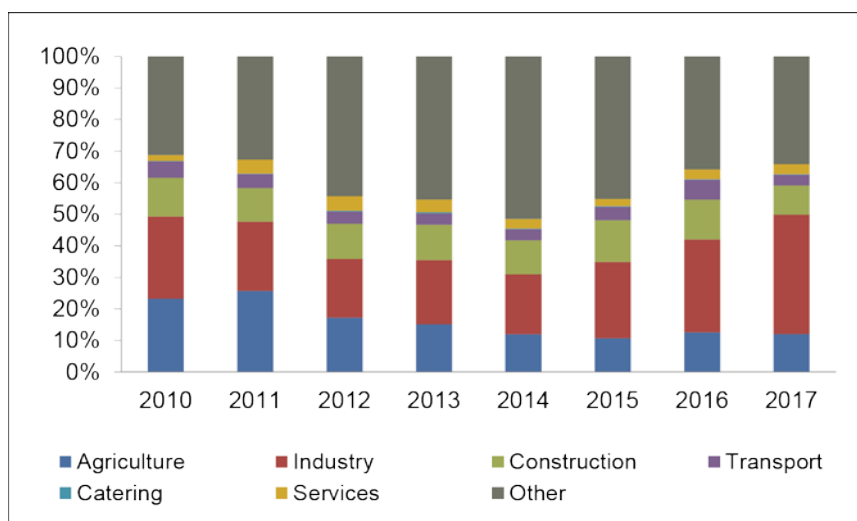
comparative advantage. This is because investment in these niche sectors has been low and value chains underdeveloped. In spite of a surge in heavy industry, financing comes primarily from the People's Republic of China (PRC), albeit on concessional terms. The mining sector is already a contributor to Tajikistan's export earnings, driving tax revenues, domestic production, and employment, but remains poorly regulated and heavily dependent on a few major operations.<sup>12</sup> On the other hand, agriculture has performed well, even though its productivity margins remain relatively low.

## 1.1 Overview of Financial Sector

In Tajikistan, SMEs access financial services from 16 commercial banks and 80 microfinance institutions (MFIs)<sup>13</sup> operating in the domestic financial system. The traditional banking sector comprises 16 banks, of which six are classified by the National Bank of Tajikistan (NBT) as systemically important. The largest banks are Agroinvestbank (AIB), Tojiksodirotbank (TSB), Oriyonbank, and Amonatbank, and they account for over 70% of all bank assets in Tajikistan. Local banks have 256 branches and 1,028 banking service centers, representing a significant expansion in outreach compared to the early 2000s. The fragility of Tajikistan's banking sector constrains access to finance, as well as the range of consumer products and services offered by SMEs.

According to the NBT, banks and MFIs lend heavily to firms in agriculture and industry (see Figure 3). In fact, industry is the largest sector in the lending portfolio of banks (38%), followed by foreign trade (17%), agriculture (12%), consumption (11%), and construction (9%). Consumption loans account for the majority of loans issued by MFIs (34%), followed by credit to SMEs in agriculture (26%), industry (13%), and services (12%). The balance (i.e., 15%) includes SMEs belonging to construction, catering and transport, foreign trade, and other sectors (see Figure 4).

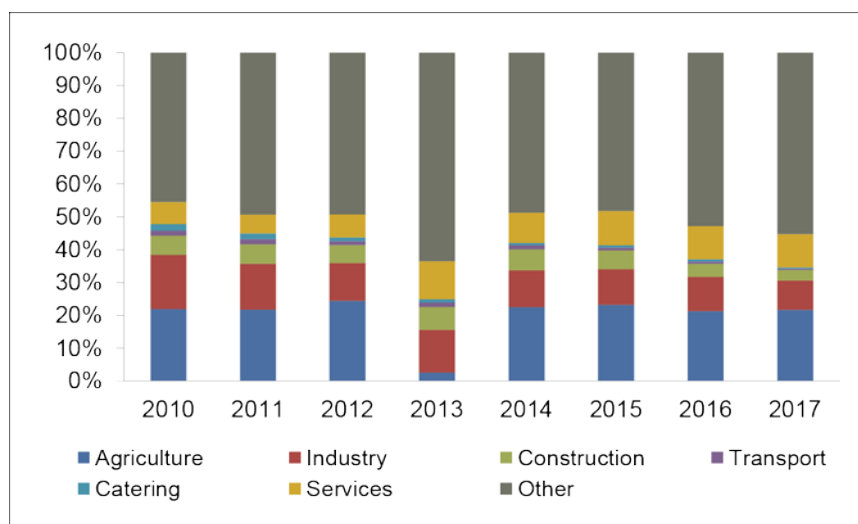
**Figure 3: Loans from Banks by Key Economic Sectors in Tajikistan, 2010–2017**



Source: National Bank of Tajikistan (NBT).

<sup>12</sup> In Tajikistan, TALCO – an aluminum smelter – is responsible for up to 35% of export earnings.

<sup>13</sup> Of these, 34 are MDOs, 13 MCOs, and 33 MCFs.

**Figure 4: Loans from MFIs by Key Economic Sectors in Tajikistan, 2010–2017**

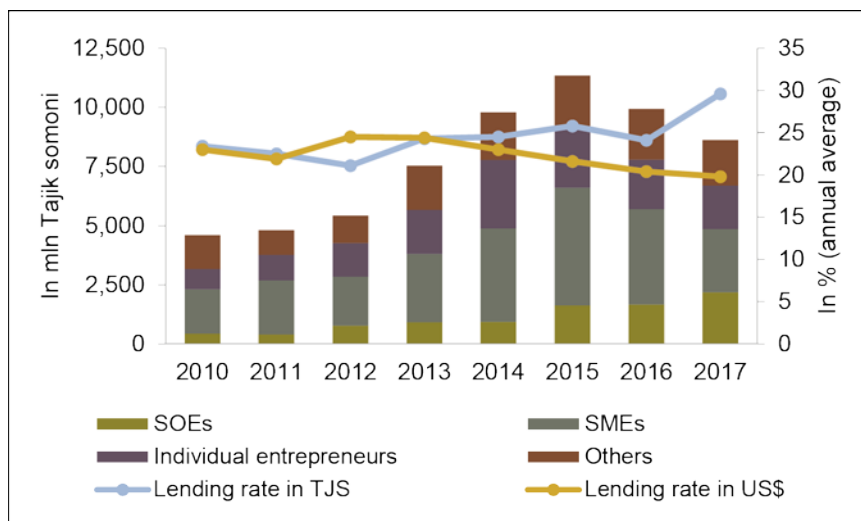
Source: National Bank of Tajikistan (NBT).

All banks and MFIs rely heavily on debt as their primary financial service to smaller firms, which is always collateralized and often guaranteed by third parties, such as other banks or international development partners (e.g., EBRD, KfW, IFC, SECO, and others). In 2017, credit to the private sector was 13.7% of GDP. Unlike banks that rely on foreign currency lending, MFIs lend to SMEs and individual entrepreneurs mainly in local currency (see Figure 6). The total volume of bank loans to SMEs in foreign currency has declined from \$1.2 billion in 2015 to \$0.6 billion in 2017, and they now account for 37.6% of banks' total loan portfolio as of January 2018 (compared to 49.9% in 2015). Local banks provide loans mostly to enterprises (including SOEs), but MFIs have a more balanced portfolio between individuals and SMEs.

Local banks have limited or, particularly amongst banks that face liquidity shortages, no access to international debt markets. Access to local currency funding also remains a challenge for financial institutions, while capital markets are virtually nonexistent for enterprises to raise money.

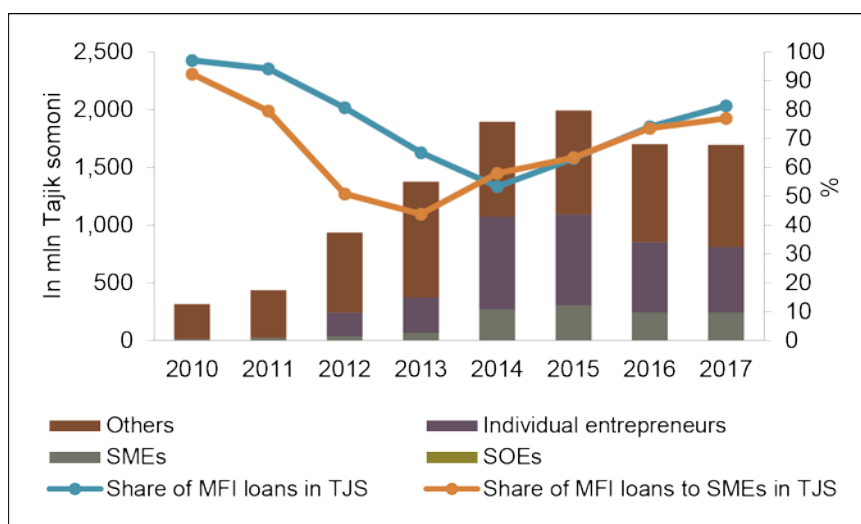
In 2017, 21.3% of all bank loans were disbursed to individual entrepreneurs, while SMEs received 31% of all bank loans (compared to 50.1% in 2010) and SOEs accounted for 25.4% (compared to 11.7% in 2000). As for the MFIs, almost half of their total lending (i.e., 48.7%) goes to individuals for consumption purposes, followed by individual entrepreneurs (33.4%) and SMEs (14.5%). To date, SOEs have been a negligible part of the lending portfolio of MFIs. The latter also appear to be better shielded against directed lending practices and related party lending, which are still prevalent in banks. In addition, individual entrepreneurs seem to be more eager to get loans from MFIs, as total volumes of MFI lending to individuals have kept stable over time and have actually surpassed those of banks since 2017. This could be a combination of better terms provided by MFIs, a lower appetite on the part of banks for the SME segment of the market, and a lack of trust by bank customers. For more information on lending, see Figures 5–6.

**Figure 5: Bank Loans by Type of Borrower and Average Lending Rates in Tajikistan, 2010–2017**



Source: National Bank of Tajikistan (NBT).

**Figure 6: MFI Loans by Type of Borrower and MFI Lending in LCUs in Tajikistan, 2010–2017**



Source: National Bank of Tajikistan (NBT).

The high proportion of nonperforming loans (NPLs) remains one of the biggest impediments for SMEs in accessing credit from banks. The NPL ratio had risen to more than 50% of all assets by early 2017, while the capital adequacy ratio declined to 11.5% in March 2016, driven by the largest banks. This poses serious threats to bank solvency and banking stability, with adverse spillovers resulting in a higher cost of credit to local firms. NPLs have grown rapidly, especially in large banks, while official numbers mask major asset quality weaknesses in some banks. In addition, the lack of proper classification and inadequate reporting by banks has kept the NBT in the dark as to the size, quality, constitution, and distribution of NPLs. Other mezzanine products – e.g., equity investments – are rarely employed and traditional lending instruments (including credit guarantees) represent one of the few financial products available for SMEs in Tajikistan.

The microfinance sector in Tajikistan has grown rapidly in the past several years, albeit from a very low base, and it provides an important source of finance to SMEs, as well as a crucial opportunity to save. Financial participation has been growing from a very low base<sup>14</sup> and increased more than fourfold to 11.5% of adults over the age of 15 having an account at a financial institution in 2014. Rural financial penetration increased over the same period, although it did not reach the low-income country average, while more than a quarter of adults reported having borrowed money in 2014. While the preference for informal savings and borrowing is still strong, there is great potential for further growth of the microfinance sector, but its rapid growth, especially in an environment of limited regulatory capacity and weak financial consumer capability, has presented significant risks.

As external shocks increased in summer 2015,<sup>15</sup> and with a worsening portfolio performance, pressures mounted on the microfinance and banking sectors to consolidate. The NBT hiked capital requirements drastically, such that eight MDOs and more than 20 MCOs have effectively struggled to reach the new benchmark, merge, or exit the market since the end of 2015. While the penetration of financial services was still very low, the microfinance sector was expanding rapidly, forex-denominated lending was widespread, and the risks in the financial sector appeared quite high. MFIs had overexposed themselves by lending excessively to nonhedged corporate borrowers. This partly accounted for severe portfolio deterioration among MFIs between 2015 and 2017. Financial institutions also relied too heavily on collateral, which discouraged many otherwise eligible SMEs from accessing credit from MFIs.

Thus, it was important to measure household levels of overindebtedness, strengthen financial consumer protection, and improve financial capability at the grassroots level. In 2016, those who were borrowing indicated a high degree of stress (Pratt 2016). The survey had found that 50% of borrowers recognized a debt dependency to maintain their lifestyle, 30% of borrowers indicated loan repayment difficulties, and 40% had committed basic expenditures in excess of 75% of their income. The picture in Tajikistan was of a microfinance sector that would struggle to grow its client base without increasing financial pressure on the balance sheets of SMEs. Lending in foreign currency and larger loan sizes against collateralized microcredits increased the vulnerability of smaller firms who were, and are, highly sensitive to cost-of-living increases, currency depreciation, and external price shocks.

Tajikistan's insurance sector is perhaps the least developed in Central Asia (bar Turkmenistan). Legal provisions have been recently accepted to move the insurance supervisor as a subentity to the NBT, effective from January 2017. Although the 2010 Law of the Republic of Tajikistan "On Insurance Activity" (updated from 1994 and approved in 2014) set out to abolish the state monopoly on mandatory insurance classes, this monopoly is effectively still in place. There are 21 insurance companies in Tajikistan, of which two are state-owned and only one is foreign. Insurance claims by SMEs are rare and usually unattended, which significantly undermines trust in the insurance sector. Insurance of privately owned assets and property is voluntary, and most SMEs opt out of insuring their corporate assets. The absence of insurance experts, actuaries,

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<sup>14</sup> World Bank Financial Inclusion database (Findex). In 2011, the percentage of adults aged over 15 having an account at a financial institution in Tajikistan was 2.5%, compared to a significantly increased 47% in 2017.

<sup>15</sup> In particular, sharp depreciation of the Kazakh tenge, Russian ruble, and the yuan in mid-2015 put strong pressure on the Tajik somoni to depreciate, while NBT efforts in Tajikistan to control against depreciation reduced liquidity in the market. Higher-priced imported goods and slowing economic growth were also factors weakening household incomes and the repayment capacity of corporate borrowers.

underwriters, and loss adjusters further complicates the sluggish relationship between SMEs and local insurance providers.

Furthermore, Tajikistan's financial system is shallow in terms of fundraising for corporate needs. The OJSC "Central Asia Stock Exchange" (CASE) was established in 2015, but interest from corporate clients remains low. The country's securities and capital market is in its infancy but, once fully established, will raise capital for SMEs, create investment opportunities for individual investors, and provide a cost-effective trading platform for B2B transactions. According to the 2014 survey, 59% of companies were ready to be open for foreign investors<sup>16</sup> and 82% of companies knew that issuance of shares is considered a financing source. Moreover, 53% of surveyed financial institutions were willing to use investment and debt securities as an alternative source of financing. The average annual capital need of surveyed FIs was approximately \$12 million, and close to \$3 million of financing was needed by SMEs. Past assessments showed that market capitalization of the Tajikistan market could reach \$80 million<sup>17</sup> in the five years after the creation of the stock exchange. To date, the OJSC "Bank Eskhata" has issued corporate bonds<sup>18</sup> worth 20 million somoni (about \$2.1 million), but other financial institutions and SMEs have so far been reluctant to raise funding or quote their shares on a stock exchange.

## 2. STATUS OF FINANCIAL INCLUSION FOR SMEs

To the detriment of fuller and more detailed analysis, up-to-date information and statistics on the SMEs' access to finance in Tajikistan are virtually unavailable from either government sources or international development partners. When data for previous years are available, they are too outdated (e.g., from five or more years ago) or unreliable (e.g., based on government-commissioned or donor-funded surveys).

According to the NBT, only 17% of small firms and 24% of medium firms use bank loans as a source of financing for investments – as opposed to 42% of large firms in 2017.<sup>19</sup> Exclusion from financial services extends beyond credit products: Only 75% of SMEs possessed a checking account, as opposed to 88.6% in Europe and Central Asia (World Bank 2013).

Several large banks and MFIs provide mobile banking services, but penetration rates are still low. The NBT reports that the total number of online managed accounts reached 67,600 and the number of accounts accessible from mobile devices was 59,300. In general, the government's objective is to facilitate financial inclusion of the currently unbanked population and commercial entities through the implementation of electronic and digital financial service (EDFS) solutions by various providers and their networks. EDFs can be a powerful tool for directing remittance flows into the formal financial sector, which is highly relevant for Tajikistan. Notwithstanding the support currently provided by a number of bilateral (e.g., SECO) and multilateral institutions (e.g., IFC), this is a long-term reform effort.

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<sup>16</sup> At the same time, 79% of surveyed companies did not have state participants in their shares.

<sup>17</sup> And the corporate bond market could reach up to \$1 million.

<sup>18</sup> At a fixed rate of 22% per annum in local currency.

<sup>19</sup> According to the National Bank of Tajikistan, the total amount of loans disbursed by banks reached 8.6 billion somoni (equivalent to around \$1 billion), which made up 14.1% of GDP in 2017. However, the total credit portfolio increase is combined with a high level of nonperforming loans, particularly among individual borrowers. NPLs rose sharply from 9% in 2012 to 36.5% in 2017.

In Tajikistan, money transfer services are an important means for SMEs and individual entrepreneurs to access nonbank sources of funding to maintain operational activity. This is also an important business line for local financial institutions in Tajikistan. In 2017, 11.7% of adults sent or received domestic remittances using an account (higher than LMICs and close to the ECA average), up from a mere 1% in 2014. Yet a significant percentage of adults send or receive remittances in person and in cash only (10.2%), or through an over-the-counter service (7.8%). These figures have also grown with respect to 2014, suggesting that entrepreneurs have not yet chosen banks or MFIs as their preferred means to remit incomes from labor migrants working abroad back home and into entrepreneurial activity.

Furthermore, SMEs often rely on financial technology to advance their products and reach out to a potential customer base. To that end, the national payment system “Korti Milli” as well as international payment systems, such as Visa, Mastercard and UnionPay, are uniformly used in Tajikistan’s financial system. This is in line with the National Payment Systems Strategy for 2015–2025, which was adopted by the NBT Board in October 2014. Furthermore, the draft law “On payment services and payment systems” is currently in the Parliament pending review and approval. Similarly, the NBT is in the process of procuring a new automated transfer system, which will significantly enhance the efficiency, functionality, and soundness of the payment infrastructure. Once these reforms are in place, the NBT will be able to address more effectively payment system oversight issues, challenges associated with remittance systems, and lackluster growth in the use of cashless systems by SMEs and individual entrepreneurs.

A recent ADBI report argues that the total number of payment cards issued by local financial institutions reached 1,746,621 at the end of June 2018. This represents a 3.5% increase year on year, with “Korti Milli” accounting for 80.5% of all issued cards (Mogilevskii and Asadov 2018). The surge in payment cards and current accounts in local banks is partially explained by the requirement for social payments to be transferred over to individual accounts, e.g., for pensions and salaries. The next steps include the introduction of electronic payment of communal services via POS terminals, championed by large state-owned utility companies such as Barqi Tojik (power supply), Dushanbe Vodokanal (water supply), and Tajiktelecom (fixed-line telephone). The total share of cards issued by the state-owned Amonatbank<sup>20</sup> is 75.9%, which shows the low degree of diversification of financial technology in the country. While successful and well reasoned, the newly introduced payment system is mainly used for cash withdrawals rather than bank-to-bank or bank-to-business transactions among entrepreneurs.

### **3. FINANCIAL KNOWLEDGE AND SKILLS OF SME ENTREPRENEURS**

The financial sector in Tajikistan is characterized by a strong imbalance in financial information or information asymmetry. Reducing this information asymmetry often has three components, namely: (i) consumer protection, as executed by the NBT; (ii) financial literacy, as executed by state and nonstate parties; and (iii) dispute resolution, as executed via a specific financial sector ombudsman or via the introduction of a specific framework for voluntary dispute resolution outside of the court system. To that end, a good financial literacy system effectively aims to reduce the potential of credit bubbles and system risks by inducing a more responsible behavior on the part of both

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<sup>20</sup> Amonatbank processes and disburses all public sector salaries, state pensions, and other social payments.

financial institutions (to lend wisely) and corporate clients, or SMEs (to borrow wisely). This is relevant to Tajikistan, as recent overindebtedness studies have shown both the potential buildup of a microfinance bubble and the lack of understanding by entrepreneurs of how to borrow wisely.

Following the consumer protection and financial literacy (CPFL) diagnostic carried out by the World Bank in April 2013, the Government of Tajikistan decided to develop the financial education strategy, but a banking sector crisis delayed this process. At the present time, the NBT has developed and agreed its concept “Strategic Priorities of NBT on Development of Mechanisms on Protection of the Rights of Consumers of Financial Services in the Republic of Tajikistan for 2017–2019.”<sup>21</sup> In addition to adopting the principles of SmartCampaign<sup>22</sup> by local financial institutions, the NBT has partnered with international development partners to undertake training courses and awareness-raising events to strengthen financial literacy among individual and corporate borrowers.

Currently, the Government of Tajikistan reviews draft changes to current laws, for example, on protection of consumer rights and on banking activities. In line with the National Development Strategy (NDS) of the Republic of Tajikistan for 2016–2030, it is imperative for the government to develop and implement the State Program on the Improvement of Financial Literacy of the Population. The program is not yet in place, but efforts have already been undertaken nationally and regionally, for instance, via financial literacy weeks, awareness-raising workshops, and specialized training courses to target underserved and financially illiterate segments of the population. These efforts remain largely ad hoc and nonsystemic, although they are reportedly effective and impactful.

Since 2010, IFC, GIZ, AKF, and other multilaterals have piloted financial counseling services to consumers and demonstrated that counseling significantly improved the financial planning, savings, and even incomes of entrepreneurs in rural areas (although it had a negligible impact on arrears). The following impact assessments (IFC and M-Vector 2016) revealed that financial counseling demonstrated significant positive impacts on planning, budgeting, and even income generation. Interestingly, counseling showed impacts on SME debt exposure and income generation. Nearly all project completion reports by IFIs claimed reductions in the ratio of entrepreneurs’ loan repayments to monthly income.

In addition, Germany and Switzerland have supported product and service innovations as a complementary, market-based measure to guide, remind, and nudge entrepreneurs into making financial choices more in their self-interest. These and a number of government-led programs raised awareness of the psychological and behavioral aspects of financial decision-making by SMEs and individual entrepreneurs. Preparation of corporate savings plans through ExpressPay terminals, product simplification, the use of mobile applications such as e-Wallet, financial management and accounting, and the use of more cost-effective electronic services are examples of topics of these training courses and support initiatives. These initiatives have reportedly helped entrepreneurs to progress from knowing that they should improve to actually improving their financial management and accounting practices.

A 2018 study funded by ADB claimed that more than 91% of surveyed firms in Tajikistan find the lack of candidates with suitable skills very problematic in regard to running day-

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<sup>21</sup> Available in English on the official NBT website: [http://www.nbt.tj/files/Protection/strategiya/Strategiya\\_en.pdf](http://www.nbt.tj/files/Protection/strategiya/Strategiya_en.pdf).

<sup>22</sup> SmartCampaign represents a global initiative aimed at strengthening the consumer protection in microfinance.

to-day business (Mirzoev 2018). When put on the same scale as taxes, a shallow labor force, and current legislation, the lack of adequately skilled (and trained) professionals overshadows other influencing factors. However, in the past year employers on average have offered no more than six days of skills development for approximately 25% of personnel. This suggested that while SMEs are concerned about the lack of skilled professionals in the labor market, entrepreneurs' own efforts to enhance the skills of current personnel have been limited. SMEs recognize that financial skills are a problem but are not quite ready to invest in their own personnel to fill the skills gap.

Other assessments undertaken by financial institutions, such as FINCA International's Client Assessment Tool, as well as IMON International's and the First Microfinance Bank's client surveys, showed greater difficulty in obtaining loans for lower-income groups, and greater reliance on collateral and guarantees, reflecting a more conservative approach to lending. A linear relationship between the portfolio quality of MFIs and the financial literacy of local entrepreneurs raised the question of whether SMEs are financially excluded from financial products and services, or if products other than credit are needed to respond to SMEs' financial needs.

SMEs can also benefit from advisory services and mentoring programs available through specialized networking and acceleration services, e.g., offered through incubators and coworking workspaces, which are presently located mainly in Dushanbe. Training and mentoring themes span from business planning and marketing to export promotion and product diversification. Basic financial education and literacy of entrepreneurs is an integral part of these programs.

In the past decade, the Aga Khan Development Network (AKDN) and 55 Group have separately set up their own enterprise growth accelerators and an enterprise investment fund. For instance, the AKDN's Accelerate Prosperity currently has two offices in Dushanbe and Khorog. From July 2016, it began to establish a network of mentors (i.e., seasoned entrepreneurs), and built an entrepreneurship support program in close collaboration with the University of Central Asia. In parallel, 55 Group has also created the School of Young Entrepreneurs, which offers courses for small businesses in areas such as marketing research, business planning, risk assessment, and others.

Business associations, such as the National Association of Medium and Small Business (NAMSB), the National Association of Business Women in Tajikistan, the Association of Innovative Technology in Entrepreneurship, the Association of Banks of Tajikistan, and the Trade and Commerce Chamber of the Republic of Tajikistan, provide acceleration services and financial education courses to entrepreneurs and, specifically, women-led businesses. Various start-up and SME competitions, for instance, the Prosperity Cup and the female entrepreneurship competition "Farah," have become popular and effective means of fostering greater understanding of financial risks and financial management issues in running a business. Since 2010, an estimated 10,000 individual entrepreneurs and over 2,000 SMEs have benefited from financial education courses and awareness raising rendered by various in-country stakeholders and international development partners.

## **4. BARRIERS TO SME FINANCE**

Access to finance for SMEs in Tajikistan is limited by demand side, supply side, and broader business environment constraints (see Table 1). These affect the ability of SMEs to access credit, information, and know-how in order to develop their



businesses. In Tajikistan, a demand-driven and client-based approach to SME development – e.g., through access to the right mix of affordable financial products and tools tailored to their needs and specific stage of their growth – is critically lacking. Significant financial sector constraints in Tajikistan have led to greater burden for the private sector and, according to the Tax Committee, resulted in approximately 27,000 businesses (with up to 90% of them being individual entrepreneurs) effectively closing between 2015 and 2017.

**Table 1: Key Barriers to SME Finance in Tajikistan**

Demand-side Constraints	Supply-side Constraints	Business Environment Constraints
<ul style="list-style-type: none"> <li>• Weak corporate governance</li> <li>• Limited financial literacy</li> <li>• Low transparency</li> <li>• Insufficient collateral</li> <li>• Lack of investor information</li> <li>• Low risk appetite</li> <li>• Lack of corporate know-how</li> <li>• Lack of incentive to formalize</li> <li>• Low trust in banking system</li> </ul>	<ul style="list-style-type: none"> <li>• Information asymmetries</li> <li>• Lack of corporate know-how</li> <li>• Portfolio constraints</li> <li>• Limited range of financial products</li> <li>• High collateral requirements</li> <li>• Low risk appetite</li> <li>• Shallow credit guarantee system</li> <li>• Limited acceleration services</li> <li>• Underdeveloped capital markets</li> </ul>	<ul style="list-style-type: none"> <li>• Weak macroeconomic management</li> <li>• Inadequate banking supervision</li> <li>• Weak regulatory role of the NBT</li> <li>• NBT's administrative measures</li> <li>• Lack of investment incentives</li> <li>• Absence of a level playing field</li> <li>• Volatility of prices and local currency</li> <li>• High rates of NPLs in banking sector</li> <li>• Volatility of remittances</li> </ul>

The financial sector in Tajikistan is weak and shallow. Credit to the private sector is low, equivalent to less than 14% of GDP, and is significantly behind other countries in the region. In addition, the small volume and short maturity of deposits limit the ability of banks to provide credit.

Confidence in Tajikistan's banking sector remains low, not least due to liquidity problems, the insolvency of several large banks, and deposit withdrawal issues<sup>23</sup> from these banks. Local consumers have understandably lost trust in the banking sector and continue to withdraw deposits. Between 2015 and 2017 local financial institutions (FIs) gained 17.4% in the total volume of deposits, but mostly because deposit holders were unable to withdraw funding from troubled banks. While the first devaluation led customers to turn their deposits into dollars, the second devaluation triggered a rush of deposit withdrawals, even those made in dollars. Delays, administrative restrictions imposed by the NBT, and conversion losses have made SMEs less willing to put trust in local banks. To counter this, the NBT raised its key policy rate from 6.9% in 2014 to 14% in 2018. The rate is now at its highest level since 2008. This inevitably increases the cost of borrowing, further hindering the loan market for SMEs, which otherwise have limited alternative means of raise funding.<sup>24</sup>

For SMEs, obtaining loans with more than three years of maturity is particularly challenging. According to the World Bank's 2018 Systematic Country Diagnostic (SCD), only 5% of all investments in 2013 were financed by commercial bank loans. The main reasons for not taking loans from local banks, based on the 2013–2014 Enterprise Surveys, are a lack of long-term financing, high interest rates, and prohibitive collateral

<sup>23</sup> At the present time, depositors are only insured up to 17,500 Tajik somoni (or about \$1,850) per single deposit account. Accordingly, reform of Tajikistan's Deposit Insurance Fund (DIF) is needed to fully insure depositors and compensate those affected by the insolvency of the AIB, TSB, and the liquidated banks (Tojprombank and Fononbank).

<sup>24</sup> SMEs often raise capital through other means, including selling assets and borrowing from other companies or individuals, thereby undermining and bypassing the country's formal financial system. However, the limited and ad hoc nature of private funding keeps businesses small (SCD 2018).

requirements.<sup>25</sup> The recent financial crisis made the banking sector fragile; thus, banking sector vulnerabilities resulted in more difficult access to loans for SME clients.

Interest rates are high – ranging from 18% in foreign currency to about 35% in local currency – and collateral requirements are difficult to meet.<sup>26</sup> The high cost of credit is being passed on to business, while the limited amount of financing available is often provided on short tenors and in foreign currency. As a result, SMEs are unable to raise long-term financing in the same currency as their revenues, thereby choking off capital investment and exacerbating foreign exchange risk. In these challenging circumstances, SMEs find it difficult to repay loans or borrow at favorable rates in local currency.

Currency depreciation increases market volatility and reduces the resilience of SMEs to shocks. The somoni has lost about 75% of its value against the dollar since 2015 and speculation in the foreign exchange market soared until the NBT employed administrative controls. The impact of the currency depreciation on the banking sector was severe, with system-wide NPLs spiraling to more than 47% by 2016 (up from 7.4% in 2010), and the capital adequacy ratio falling to 16.6% by the end of 2014 and rising to 22.9% in 2017, driven primarily by the financial position of the largest banks.

The low success rate of transformation of SMEs in Tajikistan is partly due to increasingly risk-averse financial institutions. SMEs are chronically undersupplied with finance, which constrains their expansion, while virtually no credit is available to start-ups because default and currency risks are far too high.<sup>27</sup> This is where the microfinance sector<sup>28</sup> comes into play, but arguably less than one third of all MFI clients are entrepreneurs. Specifically, with regards to start-ups, the only source of funding comes from grant-based ad hoc competitions run by donor-funded initiatives such as the Prosperity Cup and Start-Up Weekend. This is neither sustainable nor conducive to balanced growth of early-stage businesses.

In addition, the availability of financial products is limited only to debt instruments. In the absence of donor-backed risk-sharing facilities and credit guarantees, SMEs are prohibited from accessing equity investment, royalty-based deals, factoring, supply chain finance, export insurance, and other mezzanine products. Leasing is offered by eight companies but the terms offered to SMEs are generally unfavorable unless stimulated through grant-based funding from international development partners (e.g., GIZ, ITC). Limited venture capital and the low number of angel investors and privately managed investment funds further complicate the challenging environment for SMEs whose growing demand for financing remains unmet.

Directed lending, weak underwriting and governance standards, and overall regulatory weaknesses have continued to be at the forefront of the vulnerabilities of the sector. According to the IMF's 2016 Financial Sector Stability Assessment, a number of local

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<sup>25</sup> The World Bank's 2018 SCD notes high levels of collateral requirements as a business constraint to getting loans. According to the 2013–14 Enterprise Survey, "firms were required to pledge a collateral valued at 165% of the loan on average. The volume of collaterals was significantly higher for credits extended to the retail sector (271%) than for manufacturing (137%). The high collateral requirement reflects weaknesses in creditor rights as discussed above, as well as the lack of standard evaluation method for assets in Tajikistan."

<sup>26</sup> Often ranging from 120 to 200 % of the value of the loan.

<sup>27</sup> SMEs are often referred to as the "missing middle," i.e., too large for most MFIs but too small and risky for banks.

<sup>28</sup> The microfinance sector in Tajikistan is governed by the National Strategy for the Development of the Microfinance Sector 2015–2025 and offers modest funding to early-stage firms, but it comes at a very high cost, demands significant collateral requirements, and rarely exceeds 36-month maturity.

banks had offered uncollateralized liquidity at unusually high maturities to affiliated businesses. This practice has potentially crowded out investment to underserved SMEs and resulted in the shrinkage of the loan portfolios of several top systemic banks. Tojiksodirotbank, the country's largest deposit holding bank, was temporarily put under administration, while another large bank, Agroinvestbank, reported negative capital and significantly reduced liquidity. The remaining 12 banks experienced underperformance in at least one basic prudential norm.<sup>29</sup> Since bank lending is heavily skewed towards corporate loans to SMEs (as opposed to retail lending among MFIs), the banking crisis reduced access to credit for SMEs.

## 5. STATUS OF VALUE CHAINS AND VALUE CHAIN FINANCING IN TAJIKISTAN

Although SMEs in Tajikistan have made significant progress since 2010, they are still poorly connected to regional and global markets, and struggling to transition to a market-based economy. Opportunities to link up to the markets in South Asia (e.g., Afghanistan and Pakistan) will take time to materialize, leaving it highly vulnerable in the interim to external shocks and instability. Much improved relations with Uzbekistan, energy connectivity (e.g., CASA-1000),<sup>30</sup> and the construction of the Rogun Dam are opening up opportunities, but limited information, resources, and networks of SMEs is hampering the development of, and access to, global value chains (GVCs).<sup>31</sup>

Since the early 2000s, the country has also become increasingly dependent on the PRC as the main creditor and vital trade partner amid the implementation of the Belt and Road Initiative. Tajikistan's accession to the Eurasian Economic Union is a distinct possibility, but the extent to which SMEs may be able to take advantage of global value chains and attract investment will depend on concurrent improvements to its business environment and banking system.

Notwithstanding a number of regulatory and institutional impediments to growth, the opportunities for SMEs in value chains are significant. The Government of Tajikistan and national nonstate stakeholders have not adopted the definition of global value chains; hence, there is no national definition to use.

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<sup>29</sup> These basic prudential norms are: 1) capital adequacy ratio, 2) liquidity ratio, 3) large exposure limits, 4) insider lending, and 5) shares in other entities.

<sup>30</sup> Resumed trade and gas supply from warming Uzbekistan is welcome, but Tajikistan's limited capacity and obsolete condition of its existing energy infrastructure remains unaddressed. And while hydropower projects, such as the construction of the Rogun Dam, as well as the rehabilitation of HPPs in Nurek and Kayrakkum, have drawn significant attention from the government and IFIs, the country will place greater emphasis on nonhydro renewables and solar energy, rural electricity services, and cross-border transmission connectivity.

<sup>31</sup> In addition, the challenging terrain and proximity to Afghanistan highlight security and infrastructure concerns.

To that end, the term “value chain” refers to a firm’s basic framework for business linkages between its activities (from producing to consuming a product or service) to promote firm competitiveness.<sup>32</sup> “In its most basic form, a value-added chain is the process by which technology is combined with material and labor inputs, and then processed inputs are assembled, marketed, and distributed.”<sup>33</sup> ADB treats GVCs as a broader concept than production networks, and argues that SMEs face a dual task: (i) to access a global value chain, and (ii) to move up the tiers through firm expansion and growth.<sup>34</sup> The World Trade Organization (WTO) identifies GVCs as a framework involving “the generation and transfer of value within the system as a consequence of firm efforts to optimize production networks and, conversely, the mechanism of how the value distribution structure affects the firm’s choice of the organizational form of international production networks.” These considerations triggered SMEs to reach out to opportunities beyond Tajikistan’s borders. However, deeper specialization and broadening of the production portfolio has proven to be a difficult task due to the high cost of credit and of market entry, a lack of investment, unfair competition practices, and a challenging regulatory environment.

At the present time, Tajikistan faces the challenge of putting in place basic preconditions for integration into GVCs. These preconditions are: diversification of production and trade; private investment; professional education and training (relevant for skills development); financial system development; transport and communications infrastructure; and business regulation.<sup>35</sup> The country lingers in the bottom 30% of countries according to its Doing Business ranking, has suffered from a damaging banking sector crisis, offers prohibitively costly credit to the private sector, and remains a net exporter of low-skilled labor.

Tajikistan’s high exposure to the Russian Federation’s economy through remittances and trade channels puts competitive pressures on SMEs, affecting their ability to increase and sustain profits. Moreover, sector-based (i.e., vertical) initiatives should complement ongoing efforts to accelerate structural and economy-wide (i.e., horizontal) reform. Several crosscutting issues merit further attention, such as macroeconomic fundamentals, access to quality education and training, technology upgrading, trade facilitation, and removing barriers to participation.

According to Table 2, the choice of value chains was based on the attempt to answer the basic question: What value chains can serve as good proxies for job creation and competitiveness policies in Tajikistan? A three-step methodology for the selection of value chains included: overall assessment of Tajikistan’s economy (step 1), identification of a long list of subsectors (step 2), and selection of up to two VCs (step 3).

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<sup>32</sup> Porter, M. (1985) “Competitive Advantage, Creating and Sustaining Superior Performance.” New York: Free Press.

<sup>33</sup> Gereffi, G. et al. (2005) “The Governance of Global Value Chains.” *Review of International Political Economy* 12:1.

<sup>34</sup> ADB (2015). *Integrating SMEs in Global Value Chains: Challenges and Policy Actions in Asia*.

<sup>35</sup> Firms can specialize in some stages of the value chain or integrate some of them, but the main assumption is that all SMEs benefit from an enabling business environment. Without it, the growth of SMEs will remain marginal.

**Table 2: Key Objectives Achievable by SMEs Employing a Value Chain Approach**

Improved Employment Outcomes	Improved Firm-level Competitiveness
<ul style="list-style-type: none"> <li>Identifying what activities can best catalyze job creation (more jobs)</li> <li>Empowering SMEs to capture more value and engage in skills upgrading (better jobs)</li> <li>Integrating small firms with established sources of demand (inclusive jobs)</li> </ul>	<ul style="list-style-type: none"> <li>Understanding competitive pressures and key trends in demand (markets)</li> <li>Identifying growth strategies and constraints based on shared challenges along the value chain</li> <li>Figuring out what skills sets are, and will be, required to sustain successful business models</li> </ul>

**Table 3: Sectoral Breakdown of Value Addition and Employment in Tajikistan, 2010–2017**

	Value Added (in mln somoni, 2010=100)			Total Employment		
	2010	2017*	% Change	2010	2017	% Change
Agriculture (crops and livestock)	4,713.3	7,645.8	62.2	1,469,100	1,538,500	4.7
Fishery and forestry	5.3	17.0	219.0	200	400	100.0
Extractive industry	1,082.1	1,107.6	2.4	21,000	11,430	-45.6
Food products	752.1	1,364.2	81.4	7,300	9,150	25.3
Metallurgy and metals	520.6	692.5	33.0	13,200	14,309	8.4
Chemical and petrochemical	17.6	58.3	231.8	2,200	1,320	-40.0
Machinery and equipment	84.5	42.2	-50.1	4,800	1,672	-65.2
Light industry	353.2	1,226.4	247.2	18,000	21,258	18.1
Other sectors (industry)	38.6	90.7	134.7	5,900	7,734	31.1
Electricity, gas, and water supply	214.8	1,008.0	369.3	16,800	17,848	6.2
Construction	2,124.6	4,146.1	95.1	72,300	67,100	-7.2
Trade, auto repairs, and catering	5,188.0	5,182.6	-0.1	144,400	161,700	12.0
Transport and communications	3,656.3	4,257.1	16.4	57,200	56,000	-2.1
Financial services	98.8	259.1	162.3	27,200	44,400	63.2
Public admin., social insurance	889.4	2,036.0	128.9	33,100	36,500	10.3
Education	1,111.7	1,739.8	56.5	181,800	220,500	21.3
Health care	469.4	703.4	49.8	81,300	106,700	31.2
Social and individual services	667.0	1,258.6	88.7	77,500	68,900	-11.1

\* Monetary data for 2017 are presented in constant 2010 prices.

Source: Agency for Statistics under the President of the Republic of Tajikistan.

In reference to Table 3, agriculture has been selected – and meat/beef and dairy value chains (VCs)<sup>36</sup> within the agriculture sector – based on the criteria presented in Table 4 (see below). Additionally, the President of the Republic of Tajikistan in his latest address to the Parliament explicitly pointed to agribusiness, including its underdeveloped niche sectors with proven potential, as one of the sectors that will provide an impetus to growth. Furthermore, the Government of Tajikistan has recently

<sup>36</sup> Other potential “candidates” included value chains belonging to a number of sectors such as textile and clothing, tourism/hospitality, construction materials, dried fruits (e.g., apricots, grapes, etc.), mining, and cotton.

waived value added tax (VAT) and import duties for agricultural equipment, particularly for processing (incl. dairy and meat). Thus, in addition to economic rationale, these two VCs were also selected on the basis of strategic prioritization of “food security” sectors, which are meant to “feed” growth (literally and metaphorically).

**Table 4: Filtering from 18 to 2 VCs based on Established Selection Criteria**

<b>Competitiveness</b> Scale and Upgrading Potential	<b>Jobs</b> Impact on Target Groups	<b>Momentum</b> Readiness and Change, Additionality
1. Existing scale and scope	1. Employment intensity/multiplier	1. Organization and representation
2. Trade competitiveness	2. Reach to specific target groups	2. Political will
3. Value addition potential	3. Impact on poverty (better-paid jobs)	3. Ongoing interventions
4. Investment requirements	4. Fostering stable jobs (vs. seasonal)	

In 2017, agriculture accounted for 60% of the total employment and 23% of Tajikistan’s GDP. The potential to develop the agribusiness and agro-processing sectors would yield comparative advantages in Central Asia, particularly because of Tajikistan’s soil, water, and weather conditions. More than 70% of the population resides in rural areas, which is where the demand is with respect to labor-intensive crops and livestock breeding. In short, the supply of low-skilled labor in rural areas far exceeds the demand by SMEs. However, value chains in agribusiness are generally accepted to be fragmented and disjointed. The lack of access to machinery, know-how, financial resources, and skilled labor and nonlabor inputs<sup>37</sup> explains why agribusiness is lagging behind its neighbors in Central Asia. On top of the aforementioned barriers, the rural population forgoes opportunities in agriculture due to the reservation wage.<sup>38</sup> The latter is a direct result of remittances coming from rural-based family members, which by and large meet basic household consumption needs in Tajikistan.

Most farmers often operate ageing and outdated equipment and machinery, while levels of production remain low. Productivity increases in agriculture since 2010 have been marginal, and limited access to farm machinery prevents SMEs from realizing their full potential. Food processing plants have been supported by international development partners, but low domestic demand and limited production capability of farmers mean that food processing plants operate at a fraction of their capacity.

Although both the dairy and meat industries are underdeveloped owing to a lack of investments and access to capital as well as poor infrastructure and entrepreneurial capacity, Tajikistan does have the potential to develop these areas to improve food security. Dairy and meat products carry essential nutrients, and there are increasing external and internal demands for them in the market. Afghanistan, its neighboring country, with a population of over 30 million, is looking for perishable goods, such as dairy and meat products, to import from its closest neighbors. There have been several cases where Afghan businesses have approached Tajik entrepreneurs directly or through international development partners (e.g., IFC) to set up joint ventures and export dairy and meat products to Mazari Sharif, Herat, and Kabul where the demand is increasing; but owing to military conflicts there, the risk of building the physical

<sup>37</sup> Farmers are often unable to obtain seeds, fertilizers and pesticides. This is why post-harvest losses are disruptive.

<sup>38</sup> The reservation wage refers to the lowest salary rate for which a person would have to be willing to work. Normally employees reject it due to opportunity cost considerations.

infrastructure required for establishing factories and plants is too high. Furthermore, there is also an increasing domestic demand for dairy and meat products, as discussed further below.

## 5.1 Dairy Industry

In 2017, there was a population of 2.3 million cattle (51.4% cows) in Tajikistan and almost a million tons of milk was produced that year.<sup>39</sup> The average estimated milk yield in private households is 780 liters (3 liters per day multiplied by an average 260 days of lactation) per lactation, which is several times less than in other neighboring countries. Currently, only around 10% of milk is processed in the country by 55 large and small processors, and they have to compete domestically with imported products from the Russian Federation, the Kyrgyz Republic, the Islamic Republic of Iran, and other countries.

According to the Agency for Statistics under the President, the production of dairy products increased by 43.8% in the period 2010–2017. Similarly, the annual sales growth of dairy products amounted to 15% in the same period. According to a UN Food and Agriculture Organization (FAO) study, in the last four years, 82% of the population have consumed dairy products. The potential capacity of the market for milk and dairy products is estimated to be approximately 1.7 million tons.<sup>40</sup>

The dairy trade is decentralized, and export volumes are low. In fact, most dairy products are imported from neighboring Kazakhstan, the Kyrgyz Republic, and Uzbekistan. In 2017, fresh milk imports equaled 581 tons and condensed milk imports equaled 2,282 tons. It is difficult to quantify the number of households that offer commercialized milk and dairy products, let alone small-scale dairy farms that export (or plan to export) their produce overseas.

Large processors produce yogurts, fresh cheese, cottage cheese, and other cultured milk products. These processors are largely outdated and technologically challenged facilities, which lack investment and know-how. Hard-cheese production is limited, while storage and refrigeration facilities<sup>41</sup> require massive investment in order to develop distribution channels (such as allowing the trade of cottage cheese and fresh milk), which are relatively primitive.

There are no decentralized milk collection and cooling facilities, and large processors operate significantly under capacity due to capitalization issues, unreliable electricity access, old technology, and varying degrees of demand for dairy products due to seasonality and geography. Investment in these areas could spur value chain development in the dairy sector. Accordingly, the cost of capital and lack of investment are important impediments to value chain development for milk products in Tajikistan.

## 5.2 Beef Industry

Beef is the single most consumed meat product in Tajikistan, accounting for over 55% of domestic meat consumption. Most of the beef, which is produced domestically, has a dual purpose – dairy and meat production. According to official statistics, on average, meat consumption per capita per year is 15 kg. However, the demand for meat is estimated to have reached approximately 40 kg per capita per year. With a population of

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<sup>39</sup> *Social and Economic Condition of the Republic of Tajikistan*, Annual Bulletin, Agency for Statistics under the President of the Republic of Tajikistan. January 2017.

<sup>40</sup> Bearing in mind that the population in 2018 is an estimated 9.1 million, on average,  $(242-57.5) \times 9,100,000 = 1.7$  million tons of milk and other dairy products would ideally meet the current market demand in Tajikistan.

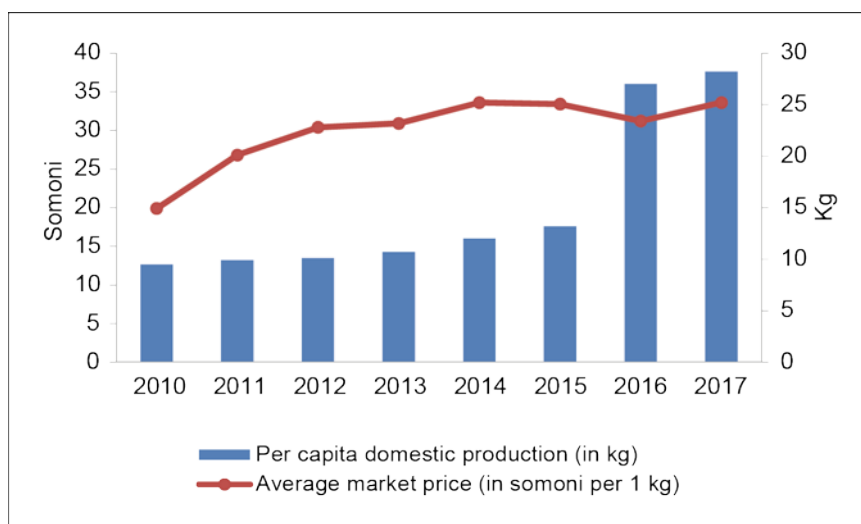
<sup>41</sup> The lack of refrigeration facilities, including refrigerated transport, limits the geographical range for milk sales.



9.1 million, Tajikistan needs to produce around 364,000 tons of meat each year. To put it simply, the demand for beef is already high and will continue to increase.

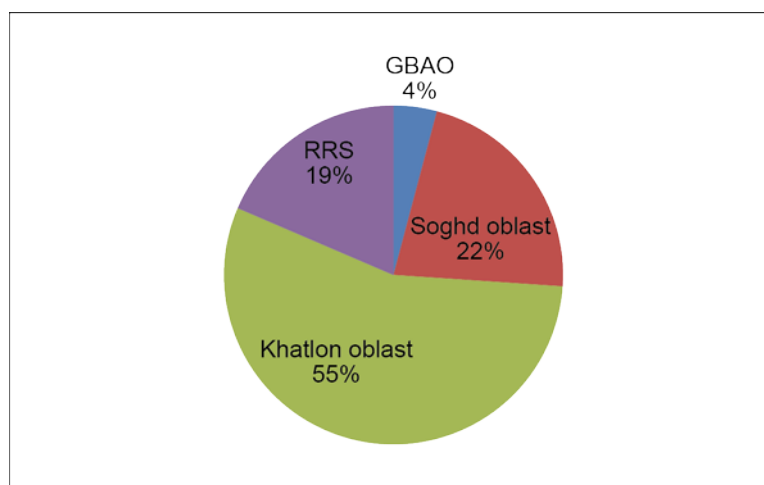
The vast majority of the country’s meat production – and specifically beef production – is consumed domestically (see Figure 8). Despite rising production volumes of meat products, an increase in the volume of exports did not follow. In 2017, only 84 tons of cattle meat (fresh or frozen) were exported overseas at a total cost of about \$100,000, while imports comprised 1,507 tons at a cost of about \$1.8 million. This negative trade balance was sustained each year during the period 2010–2017.

**Figure 7: Per Capita Production and Average Market Price of Beef in Tajikistan, 2010–2017**



Source: Agency for Statistics under the President of the Republic of Tajikistan.

**Figure 8: Domestic Meat Production by Region in Tajikistan, 2017**



Source: Agency for Statistics under the President of the Republic of Tajikistan.

Perhaps the biggest impediment to the growth of the beef industry is per-capita consumption, which is the lowest in Central Asia and has reportedly decreased by more than 50% since 1992.<sup>42</sup> However, this also presents opportunities for not only increasing domestic per capita consumption but also increasing production capacity in order to export meat/beef products to neighboring countries with larger markets and higher average market prices such as Afghanistan, Kazakhstan, and Uzbekistan. Beef is losing ground to other meat products due to high market prices and low domestic production volumes, but opportunities are being explored by individual investors and a handful of SMEs to increase supply and reduce the cost of finishing beef, which would translate into lower beef prices in Tajikistan.

Innovative technological solutions are needed through private investment in the beef value chain to achieve improved cattle fattening and reduce the cost of raising cattle. Opportunities exist to ensure the most cost-effective balanced ration for the production. The various feed components are readily available at the household level or in the local market, but the main obstacle to the commercialization of improved livestock feed is farmer education. Unfortunately, ration development expertise is not readily available and, in a similar vein, there is currently little to no connection between feed rationing and new technologies. Such technologies can only come alongside private investment in beef value chains.

### 5.3 Value Chain Financing

Traditional financing for SMEs in beef and milk value chains has been limited. Although aggregate data are unavailable for bank and MFI loans in these markets, the biggest challenge has come from the nonavailability of a wider range of financial products to meat and dairy farms, e.g., investment loans, equity financing, working capital instruments, export finance, and others. Financial instruments like factoring or supply chain finance would help SMEs in these sectors secure their revenue, which is a persistent problem. Most households that control cattle and meat-dairy production usually secure financing through informal networks from friends and extended relatives who work abroad. Moreover, a quite simple combination of direct credit or leasing to dairy farms and processors could significantly increase their production; and using the equipment as collateral would have a strong effect if combined with affordable interest rates.

In other instances, financing schemes are available from local financial institutions, but the obstacles are limited awareness of opportunities and SMEs' difficulty in meeting lender requirements with regards to corporate governance standards, due diligence, and financial sustainability. There are a number of donor-funded projects that help SMEs, including those in the meat and dairy industries, to identify appropriate lenders, understand the requirements, and submit credible and comprehensive business plans. These projects offer partnerships with local financial institutions in order to on-lend to SMEs in local currency at subsidized interest and longer maturities. Notwithstanding the positive effect of these efforts, they are often limited to just a few sectors, such as agribusiness, climate resilience, or energy efficiency. For example, the EU-funded Enhanced Competitiveness of Tajik Agribusiness Project,<sup>43</sup> implemented by the EBRD, offers loans and extension services to agricultural producers and aggregators. A similar

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<sup>42</sup> Due to the civil war between 1993 and 1997 and outward migration of Tajikistan's labor, primarily for work to the Russian Federation.

<sup>43</sup> Offers matching EU grants for equipment and machinery (up to 20% of the total project cost, e.g., up to \$50,000) and a guarantee mechanism through the EBRD. The program is implemented jointly with the Frankfurt School of Management (FSM).

project, currently implemented by GIZ and called “Towards Rural Inclusive Growth and Economic Resilience,”<sup>44</sup> improves the competitiveness of SMEs and small producers in selected value chains through business development services in agriculture.

Despite strong demand for meat and dairy products, there are few development agencies focusing on financing agribusiness. Chief among them are ADB, IFC, GIZ, and EBRD. Their main goal is to help increase and diversify agriculture production and improve access to markets through value chain development. Likewise, IFIs target the development of pasturelands and income generation among rural population through new jobs, in particular for female-headed households.

The IFC and EBRD have standalone, replenishable facilities that support SMEs in Tajikistan through finance and advisory services. However, stringent due diligence and the size of credit lines restrict their offer to larger businesses. Direct loans with a lesser degree of flexibility regarding sector focus are also provided by the Eurasian Development Bank and the KfW Development Bank at very reasonable rates, but a high credit threshold renders many SMEs ineligible for financing.

The EBRD’s Small Business Initiative (SBI) is one of several strategic initiatives by the EBRD with a unique mix of skills and expertise, a country-focused approach offering an integrated toolbox for SMEs. On this basis, the EBRD established a funding architecture – the Small Business Impact Fund (SBIF) – that supports SME development more flexibly under the SBI and leverages additional funding from donors supporting SME-related activities in Tajikistan. Switzerland has chosen to channel funds through the SBIF facility. Firms from meat and dairy industries would be eligible for financing and advisory services through the SBIF facility.

In 2017, ADB also implemented the Climate-Resilient Dairy Value Chain Development Project, which links dairy farmers to processors and urban markets through the development of efficient dairy value chains. By partnering with Access Bank, ADB promotes financial inclusion through Greenfield banking, e.g., via the economic activity of underserved farmers and MSMEs through equity investment and loans.

The Tajikistan Climate Resilience Financing Facility offers investment in improved climate-resilient technologies to help make the country’s private sector more resilient to climate change. The program is developed by the EBRD and Climate Investment Funds, and financed by the DFID and the EBRD Early Transition Countries Fund. The facility offers loans to large businesses, farmers, and households through local financial institutions.

Nontraditional partners, such as the European Investment Bank, often skew financing towards relatively more resilient neighbors. The Asian Infrastructure Investment Bank does not render support to SMEs, but Uzbekistan has pledged to provide preferential lending in the amount of \$100 million to support Tajik entrepreneurs doing business with Uzbekistan. The preferred mechanism and oversight structure is not yet set up, although on-lending is expected through local financial institutions.

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<sup>44</sup> This intervention is the successor to the DFID-funded “Growth in the Rural Economy and Agriculture in Tajikistan” (GREAT), which was implemented by GIZ and cofinanced by the German BMZ in 2013–2017.

## 6. POLICIES TO PROMOTE SME FINANCE

In September 2016, the Government of Tajikistan adopted the National Development Strategy (NDS) for 2016–2030 and embarked on a new path to economic development, to be rolled out over the next 15 years.<sup>45</sup> On 22 December 2017, President H.E. Emomali Rahmon delivered the annual address to the government in which he reaffirmed the country's intended transition to an "industrial-innovative" economy by means of greater productive employment, investment in human capital, and innovation.<sup>46</sup> The strategy highlights the need to shift from a remittance-driven model towards greater complexity and diversification of the economy fueled by the growth of SMEs and shared prosperity.

Strong economic institutions are at the forefront of achieving this goal. To prevent sliding back into crisis and mitigate the risk of losing the gains from past reforms, preventive measures have been developed by key economic institutions, which embed accountability and risk management practices. To that end, the government's 2015 crisis mitigation plan demonstrated an urgent need for coherent and evidence-based policy decision-making, and was able to facilitate technical assistance in key areas, such as financial stability, banking supervision, risk management, corporate governance, and NPLs. The National Bank of Tajikistan, the State Committee for Investment and State Property Management, and the Ministry of Economic Development and Trade have been the champions of business environment reforms, including much needed reform of the banking sector.

One way that the Government of Tajikistan has effectively reduced the risk of lending to SMEs is through the creation of the Credit Information Bureau of Tajikistan (CIBT), which has also been supported by the IFC. The bureau provides information on credit histories to individual and corporate clients. Having started its operations by partnering with 12 local financial institutions (FIs) in 2010, the bureau has expanded its reach to 86 FIs and now covers over 90% of Tajikistan's financial market. In 2015, thanks to the CIBT and the NBT's continuous support, the country's Doing Business ranking on getting credit improved from 180 in 2012 to 109 in 2015 (out of 190 economies). In January 2018, the new Law of the Republic of Tajikistan "On Credit Histories" was approved by the legislature, which has improved access to credit histories via private credit bureaus. In April 2018, the CIBT joined the newly created Association of Credit History Providers, which includes private bureaus from Azerbaijan, Belarus, Georgia, Kazakhstan, the Kyrgyz Republic, and Ukraine. And during the period 2017–2018, the CIBT expanded its services by introducing new products: (i) a portfolio monitoring instrument for financial institutions; (ii) a new scoring model developed and adapted specifically for Tajikistan's financial market context; and (iii) a cash-flow-linked agriculture risk assessment tool to help account for the risks of lending to SMEs and individual entrepreneurs in agribusiness.

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<sup>45</sup> The NDS 2016–2030 is positively ambitious and sets the wheels in motion in order to: halve poverty and eliminate extreme poverty; double the GDP; improve ranking in the UN's Human Development Index and the World Bank's Doing Business; significantly increase spending on social safety nets; and bring the share of the middle class up to 50% of the population.

<sup>46</sup> The NDS 2016–2030 presents three development scenarios: 1) inertial (or conservative) scenario where the existing agrarian-industrial model is preserved – resulting in a twofold increase of the GDP; 2) industrial (or median) scenario where existing and prospective projects in energy and infrastructure are implemented in full – resulting in a nearly threefold increase of the GDP; and 3) industrial-innovative (or optimistic) scenario where innovative approaches to addressing long-standing issues in the economy and social sectors will be adopted and implemented. The latter would result in an increase of the GDP by 3.5 times over the next 15 years.

The Government of Tajikistan believes it is important that the banking sector is put on a better footing as there would be no SME funding in Tajikistan without viable banks or a strong regulator. Since May 2015, the NBT has made significant positive changes in its organizational and management structure. New management teams have been put in place and financial stability risk analyses and consumer protection divisions have been established to institutionalize the NBT's mandate in these areas. This has significantly strengthened its regulatory functions, although in the absence of the new IMF program the technical assistance has been limited.

The prevailing view by the authorities has been that banking sector issues will persist unless high NPLs, risk management, and undue interference in lending decisions<sup>47</sup> are addressed by the regulator. A greatly improved bank resolution framework was passed in September 2016, preceded by agreement with key partners such as the IMF, WBG, and EBRD over the need to undertake asset quality reviews of the four systemic banks, improve corporate governance of state-owned banks, and lend liquidity support to the AIB and TSB. All 16 at-risk banks were stress-tested and a financial stability committee was established in 2015. In terms of NPL resolution, a number of key resolutions were passed with the intention of ensuring that the financial institutions are properly provisioned. Furthermore, a complaints department was set up and a consumer protection strategy was developed. These efforts helped stimulate financial sector stability and safeguard the cost of credit to SMEs from rising further in the near future.

Strengthening financial sector resilience is a strong enabler of private sector growth. In this regard, the key areas of focus in Tajikistan remain financial stability, bank resolution, NPLs, and the administrative measures of the NBT. To date, policies that promote SME finance have been undertaken largely by the NBT and include improvements in financial stability, the elimination of nonperforming loans (NPLs), consumer protection, the prevention of illegal currency trade, and insurance. Each reform area has contributed to the improvement of the enabling environment for SMEs, e.g., through greater oversight of banking practices by the regulator, monitoring and managing the risks of borrower default, the operationalization of a Consumer Rights Protection Unit in the NBT, stricter regulation of foreign currency operations, and the establishment of insurance sector oversight mechanisms.

A consumer protection and financial literacy (CPFL) diagnostic was carried out by the World Bank in April 2013. The study was prepared at the request of the NBT and was positively received by policy makers. Three broad areas were covered: banking, microfinance, and insurance. The study assessed Tajikistan's existing legal and legislative framework, institutional arrangements, and market practices, and compared them to international best practice. The list of nine high-priority and one medium-priority recommendations was produced and thoroughly discussed by the Government of Tajikistan and development partners.

One of the first and main recommendations of the CPFL diagnostic was the establishment of a consumer rights protection (CRP) unit, which the NBT began implementing in September 2015. As of today, on the positive side, there is a unit in the NBT, which is mostly focused on dealing with complaints from the public. The unit has also developed a draft strategy, and a set of the basic regulations to be introduced. On the negative side, it is severely limited in its capacity to expand, due, for instance, to the lack of a legislative framework, overall strategy, and institutional arrangements for enforcement. There are no clear, mandatory, standard procedures to be followed in providing information to consumers (including SMEs) about prices, terms, and other

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<sup>47</sup> For example, poor banking practices have resulted in loans against flagship projects that are rarely commercially viable.

features of financial services, and there are no laws or regulations that require financial institutions to provide borrowers with clear, understandable, and timely information.<sup>48</sup>

In the context of NPLs, the question of insolvency and credit rights is one of the potential tools and instruments for providing solutions. In weak insolvency regimes, struggling companies and their assets often languish unproductively, thereby limiting creditor recovery. Effective insolvency reform in Tajikistan will be associated with a lower cost of credit, increased access to credit, improved creditor recovery, strengthened job preservation, the promotion of entrepreneurship, and other benefits for SMEs.

In fact, a modern and efficient insolvency regime helps creditors achieve maximum value for assets, facilitating higher distribution to creditors as a whole and reducing the burden of insolvency.<sup>49</sup> The in-court reform by the Government of Tajikistan includes: (i) modernization of the national insolvency legislation – and related regulations – to introduce rehabilitation and more efficient procedures; and (ii) a training and supervision framework that will increase FIs' competence and accountability. Out-of-court reform is aimed at establishing a workout mechanism to facilitate transparent and structured negotiations for a viable business facing financial troubles in reaching an agreement with its creditors to modify existing credit terms so the business can continue operating. This area is generally considered important for SMEs, and the experience of other countries reiterates its importance in the long run.

The government recognizes that achieving the NDS 2016–2030 targets requires real growth rates of at least 9% per annum, as well as uninterrupted delivery of reforms to improve access to finance, governance, and economic management of future drivers of growth. The World Bank's 2018 Doing Business and 2016 BEEPS indicators suggest that finance-related obstacles to doing business are still formidable. Combined with administrative barriers and inefficient business regulation, this environment has hindered new market entrants and the growth of early-stage SMEs. The Prime Minister's Office and the SCISPM have undertaken a series of vital interventions to improve licensing, permits, and inspection systems, thereby enabling SMEs to “breathe” and spend less time on compliance with the state's regulatory requirements. In the meantime, the appropriate incentive structures should be in place to increase the risk appetite of financial institutions to invest in SMEs, allowing smaller firms<sup>50</sup> unimpeded entry to markets and room to grow, and thus increase jobs and incomes.

## 7. CONCLUSIONS AND RECOMMENDATIONS

Tajikistan is an early transition country with significant cross-sectoral transition challenges, higher-than-average risks, and significant business environment constraints, which are particularly problematic for smaller firms. They often face barriers to market entry and weak protection from takeovers or mergers, although this is based on anecdotal evidence from SMEs and is difficult to ascertain empirically. In addition, political economy constraints have threatened financial system stability. The resulting banking sector crisis was highlighted by the insolvency of the AIB and TSB, and

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<sup>48</sup> As detailed in the World Bank's Consumer Protection and Financial Literacy Diagnostic Report conducted in April 2012 and presented in Dushanbe in June 2013.

<sup>49</sup> In terms of recovering from insolvency, the AIB and TSB are unable to reform quickly. In 2017, the government of Tajikistan paid 2.25 billion somoni (\$263.2 million) and 1.07 billion somoni (\$125.2 million) to bail out troubled banks through Treasury bills. However, the strategy of printing money to do this has come at the cost of higher inflation and a weaker currency. As a result, this is severely depressing business activity.

<sup>50</sup> In 2014, there were only 200 private firms that had more than 200 employees (OECD 2015).

the liquidation of two smaller banks. Even when Tajikistan muddles through the banking sector crisis and recovers from economic downturn, these links between politics and business will continue to affect the growth pattern for years to come. The negative spillovers will be felt by SMEs across the board.

The implementation of investment climate reforms – especially around access to finance for SMEs – has been comprehensive but requires sustained effort to see the reforms through to full implementation. Tax administration and inspections are two notable examples of such nonlinear<sup>51</sup> and complex reforms. While Tajikistan ranked 123rd (out of 190 countries) in the World Bank’s 2018 Doing Business report, it notably lags behind other countries in Europe and Central Asia. The country’s progress on the Doing Business metric is evident, albeit slow – for example, it became easier to start a business, obtain credit, pay taxes, deal with construction permits, and trade across borders over the period between 2013 and 2018, due to coherent and targeted implementation of reforms by key economic institutions.<sup>52</sup> However, investment climate reforms aimed at creating a “level playing field” have not generally worked. Instead, development partners have concentrated their effort on initiatives that have minimal impact on “*de jure*” policies but which signal a shift in policy implementation (e.g., inspections, licensing and permit systems, and other nontariff barriers to trade). Perhaps it is best to adopt the sectoral focus in which effort is concentrated on a few most significant emerging drivers of economic growth.

Tajikistan’s economic development trajectory has not translated into actions by government institutions, or, when action is taken, implementation is weak and poorly monitored. In fact, reform champions often have fluid structures that do not allow for the accumulation of skills or institutional memory. Staff turnover and the low risk appetite of senior decision-makers have compounded the government’s inability to see policies and reform plans through to full implementation. Therefore, the government should step up its commitment to improving access to finance and the overall regulatory environment through reforms in the financial sector and investment climate. There are exceptions, e.g., the National Bank of Tajikistan and the State Committee for Investment and State Property Management, but they are rare. Unless the government reverses the outflow of knowledge and skills from public institutions to the private sector, and adopts modern and more efficient governance and management practices, progress and reforms will continue to be slow.

Value chain financing merits institutionalization of a much broader range of financial products to the private sector, including leasing services and simplified collateral requirements (e.g., using credit histories as substitutes comparable to collateral). In turn, this requires the operationalization of credit bureaus and capital markets to enable SMEs to raise funding outside banks and MFIs. While existing credit bureaus and databases make lending to SMEs less risky, the infancy of capital markets restricts access to nonbank financial resources for SMEs. According to data from the NBT, there has only been one corporate bond issuance since Tajikistan’s independence – namely by Bank Eshkhatra as described earlier. Other than that, there is no corporate bond issuance or transaction record in Tajikistan. Moreover, treasury securities are issued by the Ministry of Finance and the NBT, while the maturity of these securities is too short (often ranging between 18 and 91 days) and the pricing mechanism is inefficient because the securities with the same maturity issued by the NBT and the Ministry of

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<sup>51</sup> In the sense that results are not continuously and directly proportionate to funding.

<sup>52</sup> Specifically, the ease of doing business improved from a score/rank of 44.6/143 in 2013 to 57.1/126 in 2018; getting credit improved from 12.5/159 in 2013 to 40.0/124 in 2018; paying taxes improved from 23.8/178 in 2013 to 61.4/136 in 2018; dealing with construction permits improved from 51.1/184 in 2013 to 61.3/135 in 2018; and trading across borders improved from 3.9/188 in 2013 to 59.1/148 in 2018.

Finance have significant differences in yields (both are guaranteed by the state). A derivative market has not been developed in Tajikistan.

Affordable and long-term local currency lending is hampered by persistent volatility and depends on the strength of regulation and monetary policy instruments employed by the NBT. The cost of credit is largely conditional on the risk appetite of financial institutions, the key policy rate, and the extent of NPLs. Therefore, SME finance along the sectoral value chains would be promoted via a coherent and robust reform implementation in the banking sector, including the elimination of NPLs, as well as raising the financial institutions' risk appetite through credit guarantee schemes. Such risk-sharing facilities are often available through IFIs and MDBs in a limited scope and on a limited scale, but funding should be further pooled to maximize value for money and induce economies of scale.

## 7.1 Policy Recommendations

1. **Invest in business incubation and acceleration facilities:** Enabling smaller firms and start-ups to grow through incubation and acceleration facilities, which offer professional business advisory services and finance, will help address the challenges faced by Tajikistan in generating jobs, increasing productivity, and creating a diversified economy. In fact, most entrepreneurial effort remains underfunded and overlooked. The SME sector can thus drive job creation, in particular for returning labor migrants or their families.<sup>53</sup> While the numbers of returning labor migrants are modest, most of them would safely return given adequate employment opportunities back home. Therefore, promoting SME finance through acceleration facilities offers a way out of poverty for aspiring entrepreneurs through greater incomes and welfare improvements. They would offer standard packages, ranging from foundation courses to more advanced training, to provide start-ups and SMEs with a deep understanding of the skills and knowledge required throughout the entire business life cycle. A general mentoring service and specialist advice would allow SMEs to receive continuous guidance during the first few months of running their business. Furthermore, incubation and acceleration services would offer ample networking opportunities with fellow SMEs and match with potential investors, which is invaluable on the way to growing as a business and contributing to the development of value chains in key economic sectors. Currently, existing incubators are located mainly in the capital, Dushanbe, and are not financially sustainable. The rollout of these facilities outside the capital is essential for SME growth.
2. **Encourage the creation of associations of angel investors and crowdfunding platforms:** In the presence of prohibitively costly financing available from banks and MFIs, this should be regarded as one of the most viable alternatives to traditional bank lending. Unfortunately, these efforts are still in their infancy and funding for early-stage firms – specifically for start-ups – can be accessed only through grant-based start-up competitions funded by international development partners. The barriers to developing such modes include: (i) the absence of adequate legislation and regulation allowing for the operationalization of crowdfunding in Tajikistan; (ii) underdeveloped capital markets; (iii) a high degree of risk in equity investment in local businesses; and (iv) a lack of awareness and understanding of crowd-funding by the vast majority of local SMEs. Local business associations and relevant government institutions should carry out initial consultations to agree on the “implementation roadmap” for the creation of crowdfunding legislation (e.g.,

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<sup>53</sup> An estimated 1.8 million Tajik citizens neither work nor study at the present time (World Bank 2017).



specifically, harmonization with other existing laws and regulations), an institutional framework (e.g., platform limitations, payment systems, and crowdfunding platform type), and an enabling environment (e.g., protection of investors and investment incentives). Angel investment and crowdfunding represent viable routes to nurture early stage businesses, aimed at expanding access to finance for SMEs in Tajikistan.

3. **Improve the financial literacy of entrepreneurs and corporate governance standards of SMEs:** This action merits particular focus given the notable increase of the nonperforming loans in financial institutions over the past few years. Financial literacy is prioritized by the Government of Tajikistan and is evidenced by the National Bank of Tajikistan's (NBT) draft Concept on Financial Literacy, which is publicly accessible and will be approved by the government in 2019. Risk management, strategic and business planning, and accounting and financial management are the skills that are critical for entrepreneurs to get back on their feet in the presence of significant macroeconomic risks and an unfavorable business environment. At the other end of the spectrum, SMEs' corporate governance standards – for example, transparency disclosures, succession planning in family-owned businesses, financial reporting, and conflicts of interests – should improve; otherwise SMEs will continue to miss out on borrowing opportunities.
4. **In select niche sectors (or subsectors), assess the feasibility of establishing credit unions:** A credit union would be owned by representatives of SMEs and be mandated to provide them with financial services. As such, it would not be in the position to provide credit to the more profitable borrowers outside its mandated sector (or subsector), thereby reducing adverse credit selection pressures. Staff would also have detailed knowledge and understanding of the sector's characteristics and needs. This would allow the credit union to make intelligent credit decisions based on deep knowledge of its sector (or subsector) and its management. The reduction in information asymmetry would result in more accurate risk assessment and more favorable lending conditions. The credit union would also be able to provide the sector (or subsector) with financial services and tools that are specifically geared to their needs. While traditional lenders might forgo such provisions due to limited knowledge about the sector (or subsector) or a perceived lack of profitability, the union would face neither of these constraints.
5. **Encourage business associations to crowd in investor interest in storage, warehousing, and refrigeration facilities:** A chronic lack of investment in storage, warehousing, and refrigeration facilities is often named as the most critical problem for SMEs – bar taxation and customs – and is mainly caused by higher risks, the absence of proper investment vehicles, and a cumbersome business environment. Cooling of agricultural produce, including dairy and meat, can greatly improve its quality. Agribusiness contains a number of commercially attractive VC development propositions – for example, dairy, meat, apricots, lemons, cherries, and melons – and local SMEs' export potential will remain limited until adequate resources are invested in the development of refrigeration and storage facilities. Other emerging VCs in Tajikistan – for example, construction materials – require investment in storage and warehousing to withstand corrosion and decay. Neighboring countries – namely, the Kyrgyz Republic and Uzbekistan – are already ahead of the game and thus benefitting from access to large markets in the Russian Federation and Kazakhstan, as well as the PRC's Xinjiang province. Tajikistan's business associations should step up and reach out to potential investors at home and abroad.

6. **Improving the transparency of existing financing facilities:** The only financing facility for SMEs, which has never been nurtured and subsidized by international development partners, is the government's Entrepreneurship Support Fund (ESF). The ESF<sup>54</sup> represents a sustained government effort to offer credit lines to firms and reportedly disbursed over \$16 million in concessional loans to the private sector in 2016. The ESF was created in part to help the government to implement the State Program to Support Entrepreneurship 2012–2020. However, investors in the past have been reluctant to pool funding through the ESF due to a lack of transparency in the screening and funding of SMEs, and inflexible governance arrangements. The ESF structure and governance arrangements should change for it to meaningfully contribute to SME growth and attract nonstate equity investment, which would ease the fiscal burden and significantly increase the credibility of Tajikistan's largest funding facility for SMEs. In particular, the size and composition of the ESF's financing should be calibrated to markets. To enhance participation in domestic and regional value chains, the ESF should target SMEs with complex production processes and high potential for productivity gains. Moreover, the ESF's audited financial reports should be publicly available; and the ESF should establish a structure for joint monitoring and evaluation, as well as reporting (which would allow crowding in financing from external sources).
7. **Improve the effectiveness of the consumer rights protection unit:** Despite the establishment of a consumer rights protection (CRP) unit in 2015, the NBT needs to expand its capacity through the creation of a legislative framework – for example, through new consumer protection law, such as with regard to a dispute resolution mechanism – and the approval of institutional arrangements for its enforcement. Clear, mandatory, and standard procedures should be followed in providing information to consumers (including SMEs) on prices, terms, and other features of financial services. Therefore, new consumer rights protection legislation will need to require financial institutions to provide clear, understandable, and timely information to individual and corporate borrowers.

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<sup>54</sup> The fund was set up in February 2015 in the form of a state-owned enterprise and is accountable to the SCISPM. Its loan portfolio is replenished from the state budget through the Ministry of Finance. The President's address in October 2017 stated that the ESF disbursed about \$200 million to finance 154 projects in 49 locations across the country. The President pledged to boost the ESF's credit portfolio to 1 billion somoni (\$112.7 million) by 2020.

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1. ADB’s Key Indicators database for Tajikistan. October 2018.
2. Agency for Statistics under the President of the Republic of Tajikistan (<http://www.stat.tj>).
3. EBRD’s Transition Indicators database for Tajikistan. October 2018.
4. Global Competitiveness Report dataset 2007–2017 for Tajikistan, World Economic Forum (WEF).
5. Global Findex database for Tajikistan. October 2018.
6. IMF’s Financial Access Survey database. May 2018.
7. IMF’s World Economic Outlook data for Tajikistan. October 2018.
8. USAID data set for Tajikistan. November 2018.
9. World Bank’s Logistics Performance Index (LPI) database. October 2018.
10. World Bank’s World Governance Indicators for 1996–2017. October 2018.
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## ANNEX 1(A): GLOBAL INDICES ON ECONOMIC AND BUSINESS PERFORMANCE FOR TAJIKISTAN, 2010–2018

	2010	2011	2012	2013	2014
<b>Global Competitiveness Index (GCI), value/rank*</b>	3.53/116	3.77/105	3.80/100	n/a	3.93/91
Strength of auditing and reporting standards	3.75/124	3.73/125	3.74/125	n/a	3.85/116
Macroeconomic environment	3.25/131	3.97/120	3.82/120	n/a	4.70/69
Prevalence of trade barriers	3.68/124	3.85/122	3.99/100	n/a	3.72/133
Prevalence of foreign ownership	3.42/128	3.47/130	3.64/125	n/a	3.35/125
Burden of customs procedures	3.56/104	3.60/99	3.68/91	n/a	3.56/98
Intensity of domestic competition	4.01/123	4.08/116	4.23/107	n/a	4.32/122
Affordability of financial services	3.39/118	3.57/108	3.88/88	n/a	3.97/83
Financing through local equity market	2.71/109	3.00/100	3.11/88	n/a	3.01/97
Ease of access to loans	2.51/84	2.82/64	3.14/49	n/a	3.63/22
Venture capital availability	2.51/69	2.71/57	2.89/50	n/a	3.16/38
Soundness of banks	4.01/125	4.42/118	4.59/100	n/a	4.39/94
Financial market development	n/a	3.32/119	3.35/124	n/a	3.40/113
ICT use by local entrepreneurs	1.50/108	1.63/108	1.49/119	n/a	1.55/113
Local supplier quantity	4.00/126	4.32/104	4.52/88	n/a	4.77/48
Value chain breadth	n/a	3.06/110	3.48/77	n/a	3.52/97
Business sophistication	3.13/126	3.38/112	3.71/90	n/a	3.83/82
<b>Doing Business (DB), score/rank**</b>					
Ease of doing business, global score	44.2/152	44.4/147	45.8/141	44.6/143	52.1/138
Starting a business, score	80.7/136	86.8/70	87.6/77	85.5/87	85.8/106
Dealing with construction permits, score	49.4/178	50.1/177	50.9/180	51.1/184	60.9/168
Getting electricity, score	n/a	36.0/178	38.8/181	39.0/186	34.6/178
Registering property, score	68.2/87	68.5/90	70.7/82	71.3/78	60.3/70
Getting credit, score	18.8/168	12.5/177	12.5/180	12.5/159	35.0/116
Protecting minority investors, score	56.7/59	56.7/65	66.7/25	66.7/22	66.7/56
Paying taxes, score	20.7/165	20.6/168	20.6/175	23.8/178	38.8/169
Trading across borders, score	4.2/178	4.1/177	3.9/184	3.9/188	43.6/188
Resolving insolvency, score	40.6/64	41.5/68	39.2/79	32.0/81	32.4/149

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**Annex 1(a) table continued**

	2015	2016	2017	2018
<b>Global Competitiveness Index (GCI), value/rank*</b>	4.03/80	4.12/77	4.14/79	–
Strength of auditing and reporting standards	3.87/114	4.15/96	4.15/96	–
Macroeconomic environment	4.64/78	4.31/89	4.10/103	–
Prevalence of trade barriers	3.96/112	4.12/96	4.12/92	–
Prevalence of foreign ownership	3.49/121	3.52/120	3.52/121	–
Burden of customs procedures	3.89/73	4.20/64	4.20/65	–
Intensity of domestic competition	4.59/107	4.73/97	4.73/99	–
Affordability of financial services	3.97/82	4.01/54	4.01/51	–
Financing through local equity market	3.01/101	3.00/103	3.00/102	–
Ease of access to loans	3.63/22	4.11/59	4.11/50	–
Venture capital availability	3.26/35	3.29/36	3.29/42	–
Soundness of banks	4.52/89	4.33/96	4.33/94	–
Financial market development	3.38/110	3.49/105	3.49/105	–
ICT use by local entrepreneurs	1.48/117	1.55/119	1.78/114	–
Local supplier quantity	4.74/40	4.80/31	4.80/34	–
Value chain breadth	3.49/98	3.58/92	3.58/86	–
Business sophistication	3.80/78	3.84/74	3.87/75	–
<b>Doing Business (DB), score/rank**</b>				
Ease of doing business, global score	54.8/130	56.1/128	57.0/123	57.1/126
Starting a business, score	90.3/57	86.6/85	90.5/57	90.7/60
Dealing with construction permits, score	61.0/152	61.2/162	61.2/136	61.3/135
Getting electricity, score	34.8/177	35.2/173	35.0/171	34.7/173
Registering property, score	60.8/102	62.0/97	63.5/90	63.9/91
Getting credit, score	40.0/109	40.0/118	40.0/122	40.0/124
Protecting minority investors, score	66.7/29	66.7/27	66.7/33	66.7/38
Paying taxes, score	42.8/172	58.1/140	61.8/132	61.4/136
Trading across borders, score	57.1/132	57.1/144	57.2/149	59.1/148
Resolving insolvency, score	32.2/147	31.8/144	31.9/148	30.9/146

\* The WEF's Global Competitiveness Index (GCI) values correspond to a scale from 1 (worst) to 7 (best) across 137 economies in 2017.

\*\* The World Bank's Doing Business (DB) scores correspond to a distance-to-frontier scale from 0 (lowest performance) to 100 (highest performance) across 190 economies in 2018.

Sources: World Economic Forum (WEF), Global Competitiveness Index reports and online database; and the World Bank's Doing Business reports and online database.

## ANNEX 1(B): GLOBAL INDICES ON ECONOMIC AND BUSINESS PERFORMANCE FOR TAJIKISTAN, 2010–2018 (CONTINUED)

	2010	2011	2012	2013	2014
<b>Country Performance and Institutional Assessment (CPIA), rating*</b>					
Building human resources	3.0	3.5	3.5	3.5	3.5
Business and regulatory environment	3.0	3.5	3.5	3.0	3.0
Debt policy	3.5	3.5	3.5	3.5	3.5
Economic management	3.7	3.8	3.8	3.8	3.3
Financial sector	2.5	2.5	2.0	2.0	2.0
Policy rights and rule-based governance	2.5	2.5	2.5	2.5	2.5
Public sector management and institutions	2.8	2.9	3.0	3.0	3.0
Structural policies	3.2	3.2	3.2	3.0	3.0
Trade	4.0	3.5	4.0	4.0	4.0
<b>Logistics Performance Index (LPI), score/rank**</b>					
Customs	1.90/147	n/a	2.43/85	n/a	2.35/115
Infrastructure	2.00/127	n/a	2.03/138	n/a	2.36/108
Ease of shipment	2.42/127	n/a	2.33/135	n/a	2.73/92
Logistics services	2.25/125	n/a	2.22/130	n/a	2.47/113
Ease of tracking	2.25/141	n/a	2.13/143	n/a	2.47/119
Timeliness	3.16/98	n/a	2.51/146	n/a	2.74/133
<b>Worldwide Governance Indicators (WGI), score/rank***</b>					
Government effectiveness	-0.92/19.1	-0.95/17.1	-0.93/18.0	-1.06/14.7	-0.78/22.1
Regulatory quality	-1.02/17.2	-0.98/19.4	-1.00/17.5	-1.06/15.2	-1.02/14.9
Rule of law	-1.21/10.4	-1.23/10.3	-1.20/9.9	-1.25/9.4	-1.01/13.9
Control of corruption	-1.29/4.8	-1.22/8.1	-1.28/6.6	-1.28/7.1	-1.13/12.5
<b>Corruption Perceptions Index (CPI), score/rank****</b>					
	21/154	23/152	22/157	22/174	23/152
<b>Human Development Index (HDI), score/rank</b>					
	0.634/193	0.637/194	0.642/192	0.646/192	0.645/195

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**Annex 1(b) table continued**

	2015	2016	2017	2018
<b>Country Performance &amp; Institutional Assessment (CPIA), rating*</b>				
Building human resources	3.5	3.5	3.5	–
Business and regulatory environment	3.0	3.0	3.5	–
Debt policy	3.5	3.0	2.5	–
Economic management	3.3	3.0	3.0	–
Financial sector	1.5	1.5	1.5	–
Policy rights and rule-based governance	2.5	2.5	2.5	–
Public sector management and institutions	2.9	2.8	2.9	–
Structural policies	2.8	2.7	2.8	–
Trade	4.0	3.5	3.5	–
<b>Logistics Performance Index (LPI), score/rank**</b>				
Customs	n/a	2.06/153	n/a	2.34/134
Infrastructure	n/a	1.93/150	n/a	1.92/150
Ease of shipment	n/a	2.13/130	n/a	2.17/127
Ease of shipment	n/a	2.12/151	n/a	2.31/133
Logistics services	n/a	2.12/143	n/a	2.33/116
Ease of tracking	n/a	2.04/144	n/a	2.33/131
Timeliness	n/a	2.04/159	n/a	2.95/104
<b>Worldwide Governance Indicators (WGI), score/rank***</b>				
Government effectiveness	–	–	–	–
	0.85/19.7	1.03/13.9	1.12/12.9	–
Regulatory quality	–	–	–	–
	1.02/13.9	1.09/12.0	1.06/12.0	–
Rule of law	–	–	–1.35/8.2	–
	1.06/13.5	1.15/10.6	–	–
Control of corruption	–	–	–1.33/7.7	–
	1.13/11.5	1.15/12.0	–	–
<b>Corruption Perceptions Index (CPI), score/rank****</b>				
	26/136	25/151	21/161	–
<b>Human Development Index (HDI), score/rank</b>				
	0.645/196	0.647/127	0.650/127	–

\* The World Bank's CPIA ratings correspond to a scale between 0.0 (low performance) and 6.0 (high performance).

\*\* The World Bank's LPI scores correspond to a scale between 0.00 (very low) and 5.00 (very high) across 160 countries in 2018.

\*\*\* The World Bank's WGI scores correspond to a scale between –2.50 (weak) and 2.50 (strong), and a percentile rank among 200 countries (ranging from 0 (lowest) to 100 (highest) rank).

\*\*\*\* Transparency International's CPI scores correspond to a scale between 0 (highly corrupt) and 100 (very clean) across 180 countries in 2017.

\*\*\*\*\* The United Nations' Development Program (UNDP) HDI scores correspond to a scale between 0.000 (very low) and 1.000 (very high) across 189 countries in 2017.

Sources: The World Bank's online database (<http://data.worldbank.org/cpia>) and Transparency International.