

### Introduction

Globalization has spread to the remotest corners of the world including Tajikistan. The most tangible effects of the process of globalization on the country were those that occurred in the aftermath of the break-up of the former Soviet Union, when Tajikistan became independent. However, the first phase of the country's involvement in the larger world community did not result in unambiguously positive political and economic outcomes, on the contrary. Nevertheless, the people of Tajikistan have still been able to benefit from the extension of democratic freedoms, access to international mass media and the latest technologies including ICT. Consumers have had access to more and better quality goods.

Globalization is an objective process with a degree of inevitability in which countries such as Tajikistan should participate but in a manner consistent with their interests. Greater integration into the world economy can lead to greater susceptibility to trade and financial shocks, for example, stemming from fluctuations in commodity prices. However, if small countries that are among the least developed remain out of the globalization process, they face problems arising from limited resources and small domestic markets. Globalization brings access to foreign markets and the latest technologies and business methods through integration into global production networks, enabling countries like Tajikistan to improve the range and quality of their products. The removal of trade barriers, along with lower, simplified tax rates and a reduction in administrative interference, improves the business climate for both domestic and foreign producers.

However, the increased pressure of competition through greater imports and foreign investment, while forcing domestic producers to become more efficient and adapt quickly to the changing business environment, also endangers their survival by eroding profit margins. A low level of human development, poor infrastructure and a poor investment climate can limit the ability of countries like Tajikistan to take advantage of the opportunities that globalization makes available. However, the redistribution of resources and incomes following globalization appears to favour countries with higher levels

of income, so that global income inequality is widening at the expense of the poorer countries. Unlike international socialist economic integration, the current process of globalization does not seek to equalize levels of economic and social development between countries.

A loosening of the mechanisms of State regulation, built up over decades, brings with it the danger that nations will be less and less able to grapple with economic and social dislocations. Lower public revenues owing to tariff reductions compound the problem and force expenditure cuts in order to control budget deficits. Regional and multilateral economic integration also lead to a weakening of the economic functions of the State in favour of collective decisions, with an increased role for international organizations such as IMF, World Bank and WTO. For these reasons, Tajikistan like other countries in transition should join the process of globalization gradually, commencing with participation in the process of regional economic integration.

## **A. Globalization and regional integration**

### **1. Integration into the multilateral trading system**

International trade and economic organizations are concerned that regional trade agreements, which are becoming increasingly popular, may undermine the global trading system. Agreements on the creation of free trade zones or free economic zones as part of a process of regional integration can be assumed to lead to a lowering of tariffs and an elimination of non-tariff barriers. For globalization to bring about its desired effects conflicts between regional and global integration need to be resolved constructively and countries that stand to lose the benefits of regional preferences by their participation in multilateral integration need to be compensated. If those preferences cover a wider range of issues regarding cooperation, within the framework of regional unions, as compared with opportunities provided by participation in wider global integration processes, this can complicate multilateral negotiations. In this situation, the step by step cancellation of some parts of the regional preferential system over a period of time becomes important in the transition to a multilateral system.

Tajikistan needs free trade and intends to comply with the obligations of acceding to WTO, when that happens. However, the country will not become a WTO member ahead of those countries with which it has a permanent trade agreement and which, in other respects, continue to adopt protectionist policies. The decision concerning accession to WTO should be made only after Tajikistan

has successfully completed bilateral negotiations with those countries on issues related to their trade regimes. Otherwise, there is a danger that exports to WTO members will be insufficient to offset the loss of existing export markets, while domestic producers will be struggling to cope with the expected sharp increase in imports.

Although accession to WTO seems to be an inevitable step, the former Soviet republics need to make sure that it will increase their economic growth and social development, improve living standards for their people and increase trade. The members of regional groupings such as CIS and EurAsEC should coordinate among themselves and seek to obtain easier terms and conditions for countries in transition wishing to accede to WTO.

Membership of WTO implies elimination of any kind of discrimination in trade relations; full liberalization and expansion of foreign trade; attraction of foreign investment; and integration of national economies into the global economic area. Tajikistan could move to achieve these goals at different speeds. For example, it could move faster to attract foreign investment than to liberalize foreign trade fully but this is an approach that needs to be mutually agreed upon even in the preparatory phase to negotiations. Negotiating partners need to understand the problems and obstacles that Tajikistan faces on its path to socio-economic development, especially the problem of poverty.

## **2. Regional trading arrangements and partnerships**

The creation of mechanisms of economic cooperation that work effectively among the countries in transition located in Central Asia will prepare and facilitate the full inclusion of those countries, including Tajikistan, in the globalization process. The point is that globalization should be anticipated by regionalization or, in other words, the integration of the economies of individual countries within larger regional groupings. In the case of Tajikistan, regionalization is the system of mutually beneficial cooperation between several countries illustrated by, for example, CACO or, more successfully, the EurAsEC. Those countries have declared that the creation of a common economic area, including a common customs area, is their key objective but many tariff and non-tariff barriers remain, preventing the realization of this goal.

At the same time, the advantages that Tajikistan could potentially obtain from EurAsEC are significantly degraded by the absence of Uzbekistan from the grouping. Tajikistan shares a common border with Uzbekistan in the plains to its north and west through which major road and rail transit transport links were

constructed in the Soviet era. With other countries with which it shares a common border, namely Afghanistan, China and Kyrgyzstan, transport links consist of minor roads that are little used. Uzbekistan is also the principal supplier of natural gas to Tajikistan and the economies of both countries are essentially dependent on one system for energy. Both Uzbekistan and Tajikistan are members of CACO but this organization has never regulated relations between its members on the basis of collective commitments, as they have never really been implemented. In addition, between January 1993 and August 2002 Uzbekistan and Tajikistan signed 42 agreements and protocols, of which 39 relate directly to trade and economic cooperation but, unfortunately, the majority of those agreements has not been implemented by both parties.

## **B. Transition assessment**

### **1. Progress in transition and its indicators**

Tajikistan developed very rapidly during the Soviet era, transforming itself from an agricultural province of the former Bukhara Emirate into an industrialized country with mid-level development. In 1960-1990 in particular, strongly capital-intensive development funded largely by the central budget of the former Soviet Union characterized industry and agriculture. The development of hydropower, aluminum and chemicals led to industry contributing 27.3 per cent of GDP in 1990. The mechanization and industrialization of agriculture, particularly in cattle breeding, poultry raising and the production of grains, fodder and irrigated cotton maintained the sector's share in GDP at 36.3 per cent in the same year. Transport infrastructure connecting all settlements in a single network developed quickly as urbanization increased.

Following independence in Tajikistan, economic growth collapsed and inflation accelerated as shortages of consumer goods developed. Bureaucracy and corruption increased, while falling living standards endangered social stability. The breakdown in the centralized system of economic administration made it more difficult for the country to extricate itself from an increasingly more complex situation. The ending of trade and economic links with Russian Federation and other former Soviet republics and free use of the former federal transport infrastructure accompanied the dissolution of the former USSR. Internal conflict and the weakening of the regulatory role of the State, together with the simultaneous implementation of measures to transform the centrally-planned economy to a market-based system, deepened the economic crisis and GDP fell by 58.1 per cent in 1991-1996. Economic recovery began in the

second half of 1997 as macroeconomic stabilization became more evident and GDP expanded by 24.5 per cent in 1997-2002. However, the level of GDP in 2002 was still only equal to 56.9 per cent of its level in 1991.

As a further sign of macroeconomic stabilization in Tajikistan, the rate of inflation fell from a peak of 7,343.1 per cent in 1993 to 3.2 per cent in 1998 although it accelerated again subsequently; it was 36.5 per cent in 2001. The current account and balance of payments deficits have improved, while budget deficits have been largely absent except in 2000, enabling monetary policy to be tightened. A budget surplus was recorded in 2002. However, macroeconomic stabilization cannot be taken for granted, as indicated by the high level of external debt, which amounted to 74.1 per cent of GDP in real terms in 2002, and an increase in the real exchange rate of the domestic currency, the somoni. Further increases in external debt will jeopardize Tajikistan's credit ratings, with negative consequences for the already low levels of FDI inflows.

The slow rate of Tajikistan's recovery from the transition recession reflects the inadequate development of market institutions in the country. Banking activity does not meet the requirements of a market economy and Tajikistan is one of a few former Soviet countries where a secondary securities market has not as yet been created and there is little portfolio investment. If credit could be made available on a competitive basis to all qualified borrowers, entrepreneurship would increase in a short space of time and growth would accelerate. However, the development of the secondary securities market is likely to lag behind owing to unsuccessful privatization, lack of post-privatization support from the State, low per capita incomes and the rent-seeking nature of economic development.

Inadequate economic growth in Tajikistan is also explained by the lack of a competitive environment in the economy. Although anti-monopoly legislation exists on the books, economic activity is divided into spheres of influence exercised by corrupt officials and criminals. Businesses and SMEs, in particular, are suffering and their number has declined from 3,390 in 1995 to 1,181 in 2001 while employment in those firms has fallen from 38,400 to 14,800 in the same period.<sup>1</sup> Restructuring aimed at adjusting to changing domestic and foreign demand patterns has been slow, hampering economic growth in Tajikistan. The main reasons for this are the lack of financial resources

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<sup>1</sup> State Statistical Agency, *Statistical Yearbook of the Republic of Tajikistan*, Dushanbe, 2002, p. 180.

available to the incipient private sector, in part owing to the low credit ratings of the country, and the lack of post-privatization restructuring support. Restructuring in agriculture has made slow progress, especially in the development of private farms but here too, insufficient financial resources as well as the lack of law and order hamper it.

Economic liberalization has found its expression in openness of economy but after an increase in the volumes of exports and imports in the first half of the 1990s, exports have been quite volatile while imports have tended to follow trends in the domestic economy. Exports continue to be dominated by aluminum, cotton and electric power and imports by alumina, natural gas, oil products, electric power, grains and flour. However, there is almost no direct connection between the openness of economy and economic growth, partly owing to the fact that increased imports of alumina and exports of aluminum simply reflect the rehabilitation of the Tajik Aluminum Plant and not liberalization. Another reason for the lack of correlation is the existence of numerous obstacles to foreign trade in Tajikistan and export licensing is first among them. For example, 11 authorization documents, taking 3-5 months to obtain, are needed to export cotton and the bribes needed along the way add considerably to costs, to the extent of making exports unprofitable. The imposition of VAT, even on imports of technologically advanced capital goods, and tariffs at a 5 per cent rate also create financial problems for importers and hamper technical progress and economic growth in the country.

Tajikistan was one of the first among former Soviet countries to eliminate State regulation of prices, markets and foreign trade, a policy for which it has received high marks.<sup>2</sup> What is surprising is that, in contrast to the majority of liberalized economies, the formation of a favourable competitive environment has not occurred in Tajikistan so far. The reason is that from the beginning prices and markets in Tajikistan have been subject to several restrictions, such as licenses, authorizations, unofficial quotas and so on, as well as to restrictive behaviour on the part of law enforcement and local authorities. The authorization of local authorities is necessary even to cross district borders in order to sell foodstuffs, for example. In addition, there are numerous cases of extortion during the transport and sale of goods, so that, for many foodstuffs, transport beyond 200 kilometres becomes unprofitable. Recent presidential decrees have

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<sup>2</sup> See, for example, EBRD, *Transition Report 2000: Employment, Skills and Transition*, 2000, p. 216.

sought to remove some of these unofficial restrictions on the movement of goods but they have been poorly enforced and inspections by tax, customs and other authorities have increased. Altogether, the problems prevent the potential benefits of liberalization from being realized.

## **2. Lessons from privatization**

Measures to eliminate the monopoly of the State on ownership and the development of various ownership patterns, involving both public and private sectors, have been among the most important steps in the liberalization of Tajikistan's economy. Those measures were implemented within the framework of a programme of step by step decentralization and privatization in all sectors of economy during the course of which the share of the private sector in the total number of enterprises almost doubled, from 25.4 per cent in 1991 to 48.9 per cent in 2001.<sup>3</sup> Privatization has been dominated by small firms, which account for nearly 94 per cent of all privately owned enterprises. Privatization of large firms has proceeded more slowly and the corporate form of ownership in privatization has been little used in Tajikistan, accounting for only 1.3 per cent of the total number of privatized enterprises in this period. The extent of privatization has been greatest in trade and consumer services, where in 2002 privatized enterprises were respectively 98 and 92.3 per cent of the total. In contrast, only 5.9 per cent of enterprises in industry and 6.4 per cent in agriculture were in private hands in the same year. The buyout of State-owned enterprises, or of property leased by them, by members of work collectives is uncommon.

The step by step approach to privatization, with immediate privatization of small enterprises and slower privatization of large enterprises, has been fairly successful in Tajikistan. The dominance of the private sector in small business activities is proving to be decisive in revitalizing SMEs. More complicated problems arise with the privatization of large State-owned enterprises, the main problem being the need to improve the economic efficiency of those enterprises prior to their sale.

Privatization has been considered essential for the creation of a market economy. In this regard, a quantitative indicator of the impact of privatization in Tajikistan is the share of the private sector in total employment, which increased

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<sup>3</sup> State Statistical Agency, *op. cit.*, p. 171.

from 19 per cent in 1991 to 42.8 per cent in 2002. Employment in the public sector declined from 59.7 to 28.4 per cent in the same period. However, privatization has not had a significant impact on economic growth and efficiency in Tajikistan as serious mistakes were made during its preparation and implementation. Recommendations of the international financial institutions regarding the methodology, scope and speed of privatization were damaging for a country in Tajikistan's situation and, moreover, those recommendations did not take into account the specific characteristics of the country, following textbook prescriptions instead. The recommendations erred in focusing on the financial aspects of privatization and in exalting private ownership without due regard to the possible benefits of State ownership.

Tajikistan's experience in this regard, along with that of other countries, illustrates the need for strong public and private institutions that can become the foundation for the successful implementation of the process of privatization. In this manner, vital interests of the nation are safeguarded and public control of the privatization process is assured. Lack of a strong institutional element was the reason why the results of privatization have not met the expectations of the general public in Tajikistan.

The lack of post-privatization support has been another factor in the disappointing results from privatization so far. A fund to support businesses after they had passed into private hands was not established in Tajikistan and many enterprises suffered from shortages of working capital in the aftermath of privatization as they had suspended their business activities for various reasons long before they were sold. The enterprises no longer received State subsidies but were unable to obtain bank loans as the financial system was in crisis.

### **3. Fiscal and monetary reforms**

The financial system of Tajikistan is still in the initial stage of its development though institutional reforms in the most important areas of the system have been implemented. A legal framework for the functioning of the system has been created and considerable attention has been given to financial stabilization. However, limited development of the financial sector constrains the use of monetary policy. The absence of a secondary market in treasury bills and weak institutional capacity prevent open market operations being used. To improve the situation, the National Bank of Tajikistan is attempting to develop an interbank market for credit in which it could intervene as needed for the conduct of monetary operations.

In this regard, budgetary reforms are worth noting. Financing of budget deficits is no longer carried out through borrowing from the National Bank of Tajikistan, with adverse consequences for inflation, but by the sale of treasury bills and the efficiency of treasury operations has been improved. The relationship between the budgets of central and local governments has been clarified so that there is a clearer distinction between revenue sources and expenditures of each. Assets of the Social Protection Fund and the Highway Fund have been consolidated into the central budget and off-budget funds are gradually being liquidated.

The overall size of the central budget has been declining in Tajikistan for some years owing to the economic decline after independence as well as civil unrest and problems with reforms. Revenues remain low and despite an approximately five-fold increase in total public revenues per capita in 1995-2002, the ratios of tax and total revenues to GDP were 15.3 and 16.3 per cent respectively in 2002. Tax effort in Tajikistan is clearly poor, as the average ratio of tax revenues to GDP in other CIS countries is around 25 per cent. The reasons for the low level of tax collections include imperfections in tax and customs legislation, which the introduction of the new tax code and VAT reform in 1999 has gone some way to correcting. The poor state of the economy also contributed to the weak performance of businesses whose indebtedness and tax arrears have been rising. The growth of the shadow economy and corruption in tax and customs bodies are other factors keeping tax collections low.

The sale of treasury bills has also not met with much success in Tajikistan although the legal framework for the regulation of the primary market in these bills is in place and a securities commission has been established. Generally, no more than half the total asset value of the bills on sale is taken up by the public at auction, commercial banks having to purchase the remainder.

Low public revenues have resulted in budget constraints and public expenditure on education and health, as well as cultural activities has been inadequate to maintain, let alone improve, standards. Development expenditures have also been declining in recent years, from 17 per cent of GDP in 1997 to 14.8 per cent of GDP in 2002. Those expenditures have been mostly related to infrastructure development and resources have been insufficient to further economic reform and restructuring efforts.

Gradual implementation of measures to increase public revenues has become urgent. Reducing tax rates and customs duties, shifting to direct from indirect taxation and simplifying the tax system to make it understandable to all

may improve compliance, particularly if a system of mandatory tax declarations is introduced. Improving the financial health of enterprises, including through remonetization of economic activities, and bringing the informal economy out of the shadows by restricting cash transactions and “dollarization” are other steps to increase tax collections. Elimination of corruption in taxation and customs bodies and in law enforcement, accompanied by steps to combat smuggling will put a stop to large revenue losses. The granting of tax relief should be reviewed and the practice of unilateral exemption of some companies from taxes should be stopped.

#### **4. Financial sector reform**

Reform of the banking system in Tajikistan has not made much progress and the sector is unable to play the role expected of it in economic development and poverty reduction. Despite the reforms that have been implemented so far, the financial position of the banking system remains weak and vulnerable to external or internal shocks. The operational efficiency of banks is also low. The volume of credit extended by the banking sector is only around 5 per cent of GDP and the aggregate capital of the banking system is approximately US\$ 10 million, clearly inadequate to finance the large development projects that are needed in Tajikistan. The distribution of assets within the banking system also highlights its fragility, as the four largest banks possess nearly 85 per cent of all assets. Smaller and second-tier banks are not in a position to have much impact on the economy.

The main problem in the development of the banking system is the insufficient level of liquidity in the economy. This situation emerged after the implementation of monetary reforms in the mid-1990s that were only partially successful and resulted in the level of monetization of the economy, as measured by the ratio of the broad money supply to GDP, dropping sharply to 5 per cent. Currently, the ratio is around 6.5-7 per cent, resulting in insufficient liquidity in the real sector, a credit squeeze and a decline in effective demand.

There is an acute shortage of financial resources needed to increase the authorized capital of banks, which averaged US\$ 565,400 per bank at the beginning of 2002. In general, around 80 per cent of authorized capital consists of the initial equity capital and little has been built up through the accumulation of profits. Authorized capital requirements were increased to US\$ 1 million in January 2001 by the National Bank of Tajikistan and led to a reduction in the number of banks to 13 by the end of the year. Those requirements are to rise

further to US\$ 3 million by 2004 and the capital adequacy ratio has been raised from 9 to 12 per cent in January 2002. This is a very stringent requirement as even large banks in the country are not always able to reach this ratio.

Insufficiency of assets reflects the low level of deposits, which in turn reflect the growth of the shadow economy and its reliance on cash, as well as the use of non-bank channels by migrants to transfer money to Tajikistan. The share of all deposits in total liabilities in many banks is roughly in the 8-15 per cent range, interbank and central bank liabilities largely accounting for the remainder. The weak balance sheets of domestic banks in Tajikistan prevent them from entering into cooperative arrangements with foreign banks, limiting the development of credit lines and correspondent accounts. Foreign banks are also unable to confirm guarantees extended by banks in Tajikistan. The current situation requires radical change; otherwise it will be impossible to achieve the strategic socio-economic objectives of the country.

## **C. Markets and trade**

### **1. Trade liberalization**

Tajikistan differs from other members of EurAsEC in its liberal trade regime in which non-tariff barriers are completely absent. The weighted average tariff rate is currently around 8 per cent. Over the last decade, foreign trade turnover has increased by a factor of 11. In 1991, total exports amounted to 0.03 per cent of GDP but by 2002 they had increased to 60.8 per cent of GDP. The ratio of imports to GDP increased from 0.03 to 59.3 per cent in the same period. However, the share of raw materials in total exports from Tajikistan is high and aluminum, raw cotton and minerals account for approximately 80 per cent of export earnings. Although the country's power-generation potential is one of the highest among CIS countries, exports of energy as well as machinery and equipment remain insignificant. The share of food in total imports has increased rapidly and is now around 10 per cent.

### **2. Import substitution and export promotion**

Tajikistan does not have an industrial policy providing post-privatization support to businesses producing goods for the domestic market. Consequently, many products are imported, even though most of them could be produced locally. For example, large quantities of poor quality spaghetti are imported from

Iran and Turkey, even though small, privatized enterprises with Italian machines for the production of pasta exist in Dushanbe and Khujand. However, those enterprises have insufficient financial resources either to operate at all or to operate at a high level of capacity utilization. Many other similar examples exist.

Tajikistan does not have a favourable balance of trade and the situation could be radically changed if the country was to follow an import-substitution policy. The first step in such a policy could be based on the implementation of an official post-privatization assistance programme together with financial assistance for SMEs. The second step could involve restructuring enterprises that prior to independence specialized in the production of goods for the entire USSR. The third and final step would involve construction and technical servicing of factories to process Tajikistan's natural resources or to manufacture items of mass consumption.

Developing export-oriented industries is a policy that Tajikistan does not have the resources to pursue in the short term, as it requires large, risky investments to produce goods that are competitive in world markets. A policy to promote exports should seek to expand the production and export of those goods in which Tajikistan has a comparative advantage, such as cotton filament, cotton and silk yarns and aluminum. In all those cases, steps to lower costs and improve capacity utilization will be needed.

#### **D. Impact of globalization on social and human resources development**

In the years preceding independence, legislation on mandatory work and employment guarantees were in place in Tajikistan and employment increased steadily. Nevertheless, the country suffered from surplus labour owing to demographic conditions, which kept productivity low, and to capital-intensive economic development. However, the majority of the population had income and consumption levels above minimal standards and household incomes were largely derived from the earnings of labour. Attention was paid to improving manpower quality through training of qualified workers and specialists and the provision of benefits such as education guarantees, health care, housing and paid leave. In terms of human development, illiteracy was completely eliminated in Tajikistan prior to independence, infectious diseases were eradicated, secondary education was made compulsory, health care was available to all at no charge and vocational and special education were provided. In other words, Tajikistan should have been in a favourable position to take full advantage of globalization but it did not happen.

The economic upheaval following the collapse of the former Soviet Union and during the transition to a market economy caused the social situation in Tajikistan to deteriorate, with adverse consequences for the development of human resources, increasing unemployment and lowered living standards. For a country like Tajikistan, with a high natural rate of population growth, low urbanization and a widespread traditional way of life, the consequences have been serious. During 1991-2002, the labour force increased by 15 per cent but employment decreased by 8.8 per cent. The number of people employed in industry more than halved in the same period, while the number employed in agriculture increased by 38.2 per cent. The number of employed women fell by 43.2 per cent.

Globalization led to de-industrialization in Tajikistan and an increase in the rural labour supply and agricultural productivity suffered. While the share of agriculture in total employment rose from 45 to 66.6 per cent in 1991-2002, real output in the sector fell by 29.2 per cent in the same period. De-industrialization led to a reduction in the employment of technical specialists and an increase in unemployment among people with higher education, causing large-scale emigration of qualified labour. Training of specialists has decreased and the number of graduates from the secondary professional training schools has fallen by 50.3 per cent. Vocational training has also declined and the use of manual, unqualified workers for heavy labour has expanded. Paradoxically, child labour appears to have increased. Working conditions and employees rights have received little protection.

The duration of job search has increased; in 1996, the average duration of job search for an unemployed person was 4.1 months but this had risen to 4.2 months in 2001. Only 4.6 per cent of the unemployed had searched for a job for more than one year in 1996 and in 2002 the figure had increased to 5.6 per cent. Disguised unemployment, part-time employment and underemployment are increasing, so that official data do not provide an accurate estimate of unemployment. To be included among the unemployed, workers have to be officially registered on the labour exchange and to receive unemployment benefits. The official unemployment rate is around 3-3.1 per cent of the labour force but the interim Poverty Reduction Strategy Paper (PRSP) estimates the true figure to be closer to 33 per cent.

There is no systematic attempt by the Government to increase employment in Tajikistan, as activities in this regard are not controlled. Incentives for private initiatives relating to employment have not been developed. The SME

sector receives little support from the Government and privatized small enterprises have been able to contribute little to employment growth. Unemployment in Tajikistan has become chronic causing many people to drop out of the labour force. Emigration to other countries in CIS is another option that has, by some estimates, been taken up by 800,000 to 1 million persons and remittances from migrant workers are now an important part of household income.

The problem of unemployment is made more acute by the low level of unemployment benefits and by poorly developed employment services. Information made available to job seekers, classified by profession, specialty and qualifications, is insufficient and a system to monitor labour market conditions is not operational. In seeking a solution to unemployment, professional and vocational training needs to be emphasized. Job opportunities in industry should be expanded at the expense of agriculture and an attempt should be made to identify future employment trends. Assistance with job placements and job search should be improved. Labour market flexibility should be encouraged, while protecting working conditions.

Other indicators of social and human development have also not benefited from the recent economic stabilization. The incidence of poverty in Tajikistan in 1999 was estimated to be equal to 83.5 per cent. The figure is likely to be much higher in rural areas, where nearly three quarters of the population live. Polarization of the population according to income is also increasing and official data indicate that the expenditures of the richest households are four times the expenditures of the poorest. Expenditure on food comprises 79 per cent of the family budget in the poorest households.

### **E. Key challenges ahead**

Tajikistan has considerable economic potential that could be developed in the future to further social and human development in the country. The immediate task confronting it, however, is recovery from the post-independence decline and restoration of GDP per capita to the level of 1990, which could be achieved in the next 15 years. Reconstruction and restoration of Tajikistan's productive capacity do not mean returning to the former Soviet system of centralized control but should be carried out on the basis of the market structures adopted during the transition period. The new forms of business organization that have since emerged could have an explosive effect on growth, both in industry and agriculture, and lead to a closer match between market demand and output in Tajikistan.

In order for the new businesses in Tajikistan to remain profitable and competitive, they need to become part of the network of international specialization and cooperation. This will clearly depend on increasing the attractiveness of the country as a destination for FDI as significant investment will be needed for the technical rehabilitation, modernization and restructuring of enterprises. At present, the creation of new enterprises is likely to be confined to the SME sector as neither private nor public sectors have the resources to establish large firms.

In the present conditions of capital scarcity, it is important to focus on investments that are likely to have a significant effect on development even in the short term and that offer a rapid payback, without requiring large outlays of capital. One possibility is agricultural processing, which could be quickly and efficiently developed by SMEs. However, this will require improving the access of those firms to working capital of which they have been starved since the mid-1990s. Another priority area for investment is infrastructure construction, rehabilitation and maintenance. Extending the road transport network into rural areas, improving passenger and cargo services, repairing the power grid, telecommunications and water pipes would all be cost effective.

Restructuring of the larger industrial enterprises will require separating their productive activities from the provision of social services such as schools, clinics and so on and placing the latter under the management of appropriate public sector institutions. Some of those enterprises can then be privatized. This is likely to be more effective if centralized control within the enterprises is eliminated and management is decentralized and rationalized. Another aspect of restructuring refers to re-equipping enterprises with technologically advanced capital equipment so that they can switch to the production of goods that meet domestic and external demand. Carrying out the task of restructuring will, however, only be possible if financial resources are available. If they are not, the task will have to be postponed but the privatization of large enterprises could attract the necessary resources through FDI, which would also facilitate access to new technologies and management know-how.

Further development of the economy will subsequently be ensured through self-financing and mainly on the basis of internal capital formation. The restructuring and decentralization of large enterprises will also lead to a decrease in industrial concentration, fostering greater competition and efficiency, and will encourage diversification of output. Simultaneously with the process of rehabilitation of Tajikistan's economic potential, measures to build capacity and develop human resources need to be implemented.

In addition, to make better use of the country's rich natural resources, investment in developing hydropower will be needed. Increased availability of electric power will lead to a doubling of irrigated areas and the achievement of complete food security in Tajikistan. Export revenues will also rise as more electric power is exported. Hydropower development will not only ensure the financial rehabilitation of Tajikistan's economy but will also lead to the accumulation of resources for further investment.

The changes in Tajikistan's development mentioned above will necessarily lead to growth in per capita income and a reduction of poverty. However, the country will still need to take action to reduce income inequality. The aim of reforms is to eliminate deeply rooted phenomena of polarization of incomes and injustice in consumption. Tajikistan not only has an extremely low level of per capita income and consumption but also a very high Gini coefficient. The majority of the population lives below the poverty line, struggling to survive, while at the same time the gap between the incomes of the richest and the poorest families is very wide. The Government has been unable to lessen the shocking differences in living standards, which are largely the result of the unequal distribution of ownership of the country's resources. They also reflect other phenomena such as the non-payment of wages to workers in the cotton industry in 1992-1996, low cotton prices and the inability of all sections of the population to participate in privatization.

Without changes in the distribution of income and consumption, the impact of economic growth on key indicators of living standards will remain low. In Tajikistan today, establishing good governance and fighting corruption in an uncompromising manner are essential if the impact is to be raised to the level desired. In the interim, humanitarian aid and migrant workers' remittances have played a role in narrowing income disparities.

The flow of emigrants from Tajikistan is growing every month and their average earnings are increasing, enabling them to contribute more to their families. The conclusion of agreements between Tajikistan and host countries, based on ILO norms, concerning the terms, conditions and benefits of employment of emigrant workers will not only increase their incomes and protect their rights but also augment their role in financing investment in their home country. However, it does not reduce the responsibility of the Government and domestic employers with regard to increasing per capita income and consumption to socially acceptable levels and providing the population with social security.

In improving the process of reform and correcting its trajectory, the public sector has an important role to play. Unfortunately, the quality of public sector employees has declined significantly from the level of the Soviet era and they need to be re-educated about methods of governance and how to use them effectively. Public employees should have the educational background, experience and skills required of them in their areas of competence and selection processes should be competitive. Personnel training and re-training should also be provided and more posts in local government should be elected.

Serious mistakes were made during the implementation of monetary and banking reforms in Tajikistan and a significant correction is needed. The National Bank of Tajikistan should seek to re-monetize the economy without reigniting inflation. With regard to banking reforms, prudential standards need to be reviewed to be more in line with conditions in the country and the financial potential of companies and the public. It is necessary for the banking system to obtain the confidence and trust of the people so that increased deposits can become the basis for loan expansion. The level of “dollarization” and the use of cash transactions outside the banking system in the economy of Tajikistan also need to be reduced.

In the area of tax policy, further reforms are required to increase tax collections. The number of taxes and the level of taxes and customs duties should be reduced and a single land tax introduced. SMEs should also be subject to a single tax and VAT should be eliminated so that there is a preponderance of direct taxes in the tax system.

Finally, decisive steps should be taken as soon as possible to develop the infrastructure needed for markets to function properly. The lack of that infrastructure during the transition period has been a serious obstacle to the reform process and has prevented full advantage being taken of the opportunities presented by globalization.

## **F. Conclusions**

At the start of the 21<sup>st</sup> century, globalization has become a universal process, affecting all of mankind. Tajikistan has become part of this process, particularly in the period following the collapse of the former Soviet Union. The economy of the country is now more vulnerable to trade and financial shocks, such as commodity price fluctuations. In other words, globalization can have both positive and negative consequences for Tajikistan.

As long as market institutions remain underdeveloped, the growth of basic economic sectors unbalanced, goods production uncompetitive and domestic firms without any protection, the hasty participation of Tajikistan in all the processes of globalization will lead to economic failure. Globalization should happen gradually, beginning with regional economic integration. Integration into the multilateral trading system will follow, in the case of Tajikistan after bilateral negotiations with the countries with which it has trade agreements.

After 1996, macroeconomic stabilization is becoming more of a reality but economic growth remains low. Inflation is not yet firmly under control and the high level of external debt, together with exchange rate weakness indicates that stabilization may not be sustainable. To a great extent, the slow economic growth in Tajikistan is connected with the insufficient development of market institutions. The banking sector, in particular, does not meet the requirements of a market economy. Inadequate economic growth in Tajikistan is also explained by the lack of a competitive environment in the country.

Nevertheless, the liberalization, privatization and other reform measures that have been taken so far have been of great importance to Tajikistan. The step by step approach to privatization, beginning with small businesses, has been successfully implemented. The financial system of Tajikistan is still in the initial phase of its development though institutional reforms in the most important areas have been implemented.

Fiscal and monetary reforms are continuing. Increasing budget revenues through reforming the tax system remains a challenge, as does the elimination of corruption to prevent budget resources from being embezzled. In the monetary sphere steps need to be taken to improve liquidity and access to credit. In its transition to a market economy, Tajikistan faces a number of obstacles to developing foreign trade. Among those are its landlocked situation and geographical remoteness, underdeveloped transport infrastructure, national security problems and the low purchasing power of its population.

Tajikistan has huge potential, which could be developed to promote acceleration of productivity and economic growth and so enable the country to resolve its complex social problems, particularly unemployment and poverty reduction. As a more modest task, achievable in the next 15 years, rehabilitation of the industrial and social potential built up in the past could restore GDP to its 1990 level.