

**Republic of Tajikistan**  
**Financial crisis and potential implications on the Tajik economy**  
**Dushanbe, Republic of Tajikistan**

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**Cause and dynamics of the financial crisis**

As we are all aware, the global economy is suffering a severe financial crisis which is affecting global economic growth. The financial crisis has arisen because of expansionary monetary in the United States and in Europe since 2002, which led to a boom in housing prices that then turned in bubble. At the same time, a high level of financial innovation in the U.S. and in Europe resulted in complex unregulated products, many of which proved to be far riskier than their credit ratings indicated.

Developing economies also thrived during 2002–07, for a combination of reasons. First, they entered the decade in good shape because of sound macroeconomic and fiscal management, with low inflation and sustainable fiscal balances, which increased domestic demand. Second, they benefited from an export boom, rising foreign direct investment, and increasing remittances from abroad.

With rapid growth in developing countries came the emergence of vulnerabilities much like those that were appearing in developed countries. The combination of abundant investment capital and rapid growth helped to inflate real estate prices to bubble-like heights in some emerging economies. Many equity markets surged as well, some to levels that suggested irrational exuberance.

However, the annual double-digit increases in housing prices in the U.S. and in other countries proved unsustainable, and the rapidly growing price-rent and price-income ratios clearly had to fall. Defaults on mortgages started to rise in mid-2007, transmitting losses to a whole set of securitized financial products such as mortgage-backed securities. The drop in value of these assets dealt a blow to the balance sheets of many financial institutions. Several major financial institutions either failed or required government bailouts to prevent collapse. The mortgage crisis thus became a full-fledged financial crisis, which in turn has led to a collapse in equity markets worldwide. The bursting of a bubble this large makes a recession inevitable in the United States, Europe, and Japan.

The global economic crisis is also affecting the countries in Europe and Central Asia, many of which are already experiencing a slow-down in growth. Some are facing higher current account deficits, as inflows of foreign direct investment and access to external loans diminishes. Many have seen increases in short-term debt and a decline in foreign reserves.

**Implications for Tajikistan**

The good news is that there will be no direct or immediate effect on the Tajik economy. This is because Tajikistan's banks finance their operations largely from domestic deposits, and have limited exposure to the foreign financial institutions. In the short-run, Tajikistan as an oil importer will also benefit from the steep drop in oil prices, which by mid-

November had fallen 60 percent from the peak values attained in July 2008. Lower import prices for grain and other foodstuffs, building materials, fertilizers and other goods will also help to lower inflation. Higher remittances in the coming months are a real possibility as workers abroad repatriate their accumulated savings.

However, over the next few months, Tajikistan's economy may suffer from several risks. First is a potential fall in remittances. Many Tajik's working in Russia and Kazakhstan are employed in the construction industry, which has enjoyed a boom during the years of high oil prices. Some planned construction projects in Russia have already been delayed or scrapped altogether. A slowdown in construction is likely to result in lower earnings or unemployment of Tajiks working abroad, lower remittances, and the return to the country of migrant workers, putting pressure on public services. Second, the fall in commodity prices may affect the value of Tajik exports, such as cotton. Third, foreign direct investment may decline, affecting plans for large infrastructure projects, such as the Rogun hydropower plant. Fourth, access to concessional financial resources from emerging economies, such as Kazakhstan and China, may fall, increasing the cost of capital for business. A projected reduction in external finance from all sources will likely put pressure on the current account.

### **Policies to limit the negative impact, especially on the poor**

With good policies, Tajikistan can limit the damage to its economy from the international financial crisis. The following are priorities.

- **Maintain a prudent fiscal policy.** Resources will be needed to provide essential health, education, and social protection services to people to ensure that a temporary shock does not result in permanent loss of human capital and social welfare of poorer households. Lower priority expenditures can be deferred.
- **Maintain a sound monetary policy.** Inflationary expectations have declined due to the sharp fall in commodity prices. This may provide room for the central bank to lower interest rates to stimulate investment and growth. Maintaining growth will be especially important, if returning migrants are to be employed productively in Tajikistan. The country also needs to continue to build its foreign reserves to use as a buffer against shocks.
- **Improve the legal basis for the financial sector and strengthen banking supervision at the National Bank of Tajikistan.** Preventing a domestic financial crisis is a priority. Legislation is under preparation, designed to improve the soundness and efficiency of the financial system. This should be enacted as soon as possible. Enhancing supervisory capacity at the central bank is also critical.
- **Take steps to improve Tajikistan's regional and global competitiveness.** Tajikistan still ranks poorly compared to other countries of the region in the ease of doing business. Important actions include advancing with regulatory reform. This involves completing implementation of the laws on licensing and inspections, and continuing work to streamline permitting. It also entails operationalizing the one-stop shop for business registration. Enforcing the rule of law is critical. Investors

will demand a very high risk premium before investing, if they cannot depend on contracts being enforced. Of great importance is to open the aviation sector to more flights, especially from Europe. Currently, potential investors from have too much difficulty reaching Tajikistan to explore potential investment opportunities.

- **Increase the efficiency of large state-owned enterprises.** Barki Tajik still does not generate sufficient revenues to cover its costs, which puts pressure on public finances. Despite improvements in recent years, more needs to be done to implement modern accounting systems and to strengthen management and governance. Public sector entities must also clear their arrears to Barki Tajik and avoid incurring new ones.
- **Strengthen agriculture's contribution to the economy.** Tajikistan needs to diversify its agricultural sector, enhance links of farmers to markets, and promote agro-processing. This will require accelerating the program to issue land-use certificates to farmers, enhancing research and extension services, and improving market information, among other actions.