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Tajikistan: Reinvigorating Growth in Khatlon Oblast

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This report supports a joint World Bank-IFC initiative to review and evaluate economic growth prospects for Khatlon Oblast in order to develop a private sector-driven strategy for accelerating the region's growth over the medium term.

KEY MESSAGES

- Khatlon region offers potentially significant comparative advantages in its ability to produce early season crops, access to abundant water resources, relatively low labor costs, the potential for air freight from three airports in proximity to most production sites, and preferential access to existing markets within the CIS as well as growing access to the south Asian markets.
- There are a number of risks that could seriously impede the growth in Khatlon: realizing the potential of the region is threatened by the nexus of regional insecurity, poor governance and weak institutions.
- Key reform imperatives for stimulating growth in Khatlon include: (i) promoting cities and internal connectivity to build labor skills, realizing scale economies, and diversifying output; (ii) harnessing the potential of agriculture for exports; (iii) reshaping public policies to encourage entrepreneurship and reduce corruption; and (iv) retooling free economic zones to build in internal supply chains and conform to modern management practices.

Context

With almost 2.7 million people in 2011, the oblast of Khatlon is the most populous of the four administrative regions of Tajikistan and contains over one-third of the country's total inhabitants. The population is overwhelmingly rural (83 percent) and is engaged predominantly in primary agriculture, with less than 3 percent employed in the industrial sector. Approximately one-third of all ginneries in Tajikistan are in Khatlon, including three new ones that began operations in 2012. The oblast also accounts for two-thirds of the national raw cotton output and one-half of the cotton fiber production. On the other hand, Khatlon borders Afghanistan and lies on the path of major drug smuggling routes. Its poor, agriculture-based economy is highly dependent on export of labor to Russia, and its population is heavily reliant on remittances from migrant workers; in addition, it routinely faces severe winter energy constraints despite its large energy-generation potential.

Map 1. Khatlon: Railway and Road Links

Source: Central Asia Regional Economic Cooperation, CAREC (ADB).

The Khatlon oblast is geographically remote from the main markets of Western Europe and the Asian side of Russia, and is separated from China by largely impassable terrain. It is, however, favorably well located for the markets of South Asia.

The oblast is predominantly rural but contains two major cities, Kurgan-Tube and Kulyab, and several smaller ones, including Nurek, Sarband, and Dangara. In that context, policies that promote urbanization with the objective of export diversification offer a promising approach that could yield economic benefits for Khatlon's local population as well as for Tajikistan as a whole.

A Strategy for Transforming Development in the Oblast

At the request of Tajikistan's central and regional governments, the World Bank and the International Finance Corporation (IFC) conducted a joint analysis of economic growth prospects in Khatlon oblast, focusing particularly on ways to promote and facilitate private sector development. The report, *"Reinvigorating Growth in the Khatlon Oblast"*, offered a number of observations about the current economic situation in the oblast and potential obstacles to growth, and also provided recommendations to inform future reform efforts.

The diversification potential of Khatlon, together with the sparseness of the current population and economic activity densities, calls for efforts to promote economic agglomeration. In particular, the effects of agglomeration could be magnified if connectivity were to be developed within the two free economic zones being established in the oblast in Dangara and Nizhni Pyanj. These zones could stimulate growth in production and exports by reducing the governance, economic, tax, and regulatory costs of doing business and, through supply chain linkages with the rest of the oblast, help accelerate overall economic growth. Rising production would seek to exploit the transport links with the capital Dushanbe and beyond as well as with northern Afghanistan, which could offer access to the huge South Asian markets.

The main barriers to investment in Khatlon are weak governance, widespread corruption, tenuous property rights, and frequent energy shortages. As a consequence, in the free economic zones, the legal regime, the application of laws on property rights and governance of businesses, leadership and administration, and the supply of infrastructure will have to be of a wholly different order than what is found in the rest of the country. Every effort should be made to ensure that the management and regulatory authority of the zones has the capacity, resources, and ability to be independent and professional, and decisions on entry into the zone should be made on thoroughly objective grounds.

Khatlon offers several comparative advantages: the ability to produce early season crops, access to abundant water resources, low labor costs, the potential for air freight from local airports, and growing access to the South Asian markets.

Agro-processing (fruit and vegetables) and textiles and clothing offer the most promise for development in terms of potential scale of impact and numbers in employment. There is no regional or national strategy for agro-processing. A strategy should consequently be developed to provide a framework for policy and other reforms. The full exploitation of early season crops requires much closer attention to logistics factors.

Although there is abundant air capacity, liberalization in civil aviation will be needed to attract additional private investment. Khatlon's comparative advantage in this area is bolstered by access to three international airports within close proximity to several of the region's production sites. However, the liberalization of air services and the provision of third-freedom rights are necessary to attract private investment, especially if the rapid transport of perishable, high-value agricultural products is to be facilitated.

There will be no progress on developing the participation of the private sector in the oblast without improved safeguards for property rights and contracts. Private investments require complementary public investments in infrastructure and in human capital. Although such private investments may be facilitated by progress in legislation on public-private partnerships (PPPs), experience shows that successful and durable PPP transactions take place only when supporting public institutions are fully credible and private confidence in the security of property rights and the sanctity of contracts is high.

It is also particularly important that Khatlon reform its border procedures and practices with respect to Afghanistan and Uzbekistan. The absence of a system of payment guarantees forces the oblast to use convoys at high fees and generally large logistical and time costs, as these convoys must be formed, transported, and cleared as a group. To realize the full potential of food and agribusiness exports as well as those in new light manufacturing industries, road and freight logistics constraints must be addressed. Also, a number of steps in customs reform and trade facilitation are necessary.

Corruption within the customs system, long government-imposed delays at borders (especially at the Uzbek border), and more or less obligatory inspections, regardless of risk considerations, are impediments to formal and informal trade.

Labor migration within the region into the cities could transform the shape of growth. With the number of labor migrants constantly on the rise, an unofficial unemployment rate at around 30 percent (especially among the youth), and only modest job creation, labor migration from Khatlon is there to stay. Exacerbated by a very low level of investments in the region (including foreign direct investment [FDI]), remittances are by far the largest source of foreign exchange and income when compared to exports, official development assistance, FDI, and public expenditures. What is more, in view of the high fertility rate during the last 20 years and the large share of youth (ages 15–29) that are primarily unemployed or self-employed in agriculture and/or petty trade, labor migration should be treated as a labor market pressure relief strategy. The key policy consideration should therefore be about giving the younger generation employment alternatives rather than focusing on concerns about labor export.

Risks that Could Hold Back Growth in Khatlon

There are a number of risks that could seriously impede development growth in Khatlon. First, narrow political participation as a legacy of the civil war and the resulting fragile polity remains a latent threat. The Khatlon oblast was the focal point of the civil war, which took place during 1992–93 and continued with lower intensity until 1997. The war ended through a national peace agreement with protocols on military unification; progress has been made on the formation of a national army, but fair and equitable political participation and division of power remain highly contentious throughout the country.

Second, the geopolitics of security and the narcotics trade represent serious threats. The importance of the Khatlon oblast as a front line against extremism and the war on drug trafficking grows in light of the planned withdrawal of NATO forces from Afghanistan in 2014. The Afghan-Tajik border—which is 850 miles long—is highly porous. Attaining firm command over the border will require investments, electronics and detection equipment, and improvements in human capacity and skills in all aspects of border control.

Third, heavy bureaucracy, underdeveloped institutions, and pervasive corruption hamper efforts to improve competitiveness and limit growth prospects in the entire country, including Khatlon. Corruption is a product of state capture by a highly centralized, unitary administration that exercises discretion with few checks and balances. A patronage system and clan-based hiring weaken institutions and sap competence in public administration. If Khatlon's institutions are to be strengthened, there must be a substantial effort to build up the demand side of governance.

Fourth, entrepreneurship is constrained by rising informality. Over the past five years, there has been a significant rise in the number of small enterprises or businesses as measured by the number of patents issued. As the number of functioning small and medium-sized enterprises (SMEs) has risen only slightly over this period, it appears that the degree of informality has grown. If entrepreneurship in Khatlon is to prosper, this trend must be arrested.

Fifth, Khatlon can be the energy power battery of the country, but continuing energy shortages restrict growth. Tajikistan has large hydro potential estimated at 264 terawatt hours (TWh) per year, or over half of the hydro potential of the whole of Central Asia. Much of this potential lies in Khatlon, but unfortunately only about 6 percent of this potential is developed. Paradoxically, in a country with abundant hydropower potential and a strong inherited Soviet tradition of engineering in the sector, electricity supplies are notoriously deficient and unreliable. Energy shortages are exacerbated by the privileged access accorded to a large aluminum smelter. With too-low tariffs and large energy losses, the sector runs deficits that have consequences involving inadequate operations, maintenance, and capital spending, and arrears in taxes and payments to suppliers. Both infrastructure improvements and management reforms, including transparency in accounts and financial controls paid for partly by rational tariffs, are essential.

Recommendations

The proposals for reform provided in the World Bank/IFC report make clear that Khatlon's rise in strategic significance has to be matched by responses in public policy and a strong upturn in private investment to strengthen the oblast's economic prospects. A summary of the main reform areas that will need the attention of the authorities is presented in the box below. The report's findings and recommendations, which have been discussed at both the central and regional levels with the strong participation of business and donor communities, will lay the foundation for a new strategy of regional development for Khatlon.

Box 1. Summary of Major Policy Recommendations

Reforms to Attract and Retain Private Investments	Reforms to Boost the Potential of Free Economic Zones	Risk Mitigating Measures
• Focus on institutions and markets. Attention should be given to land use, public services, and infrastructure quality. • Improve safeguards for property rights and contracts. • Rehabilitate roads and feeder roads connecting cities to the hinterland. • Simplify customs and border procedures. • Increase public investments in energy generation to raise energy-efficiency and thermal generation investments. • Stimulate the marketability of land following reform of the land code to unlock the potential of the rural land bank. • Ease urban zoning transactions. • Adopt measures to raise labor skills to facilitate migration to new urban opportunities.	• Clarify the purpose of zones and strengthen zone institutions to improve governance, reduce corruption, strengthen property rights, and reduce energy shortages. • Make the management of the zones independent and professional. • Improve transport and telecom connectivity within the two free economic zones. • Develop a stratetgic, inter-linked approach to infrastructure needs in the zones. • Build stronger links between the zones and the cities in the oblast. • Allow the free movement of labor across the oblast and zones. • Invest in training and skills development. • Create and develop labor migration support infrastructure. • Strengthen local executive capacity in the oblast to manage migration.	• Prepare a medium-term reform program to bolster oblast and raion (region) revenues, reduce volatility in revenues, and attain greater predictability in both transfers from the central budget as well as donor inflows. • Deepen post-conflict reconciliation and broaden representation in government and civil service in support of stability. • Enhance security control at the border with Afghanistan with better equipment and better human capital.

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