INTERNATIONAL MONETARY FUND

IMF Country Report No. 21/201

REPUBLIC OF TAJIKISTAN

SELECTED ISSUES

September 2021

This Selected Issues paper on the Republic of Tajikistan was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on December 26, 2019.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
PO Box 92780 • Washington, D.C. 20090
Telephone: (202) 623-7430 • Fax: (202) 623-7201
E-mail: publications@imf.org Web: http://www.imf.org
Price: $18.00 per printed copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF TAJIKISTAN

SELECTED ISSUES

December 26, 2019

Approved By
Middle East and Central Asia Department

Prepared by Nailya Menlasheva, Yuri Sobolev and Farid Talishli.

CONTENTS

FIGURES

TABLES

FISCAL RISKS FROM STATE-OWNED ENTERPRISES AND REFORMS IN TAJIKISTAN[1]

A. Introduction

1. The State-Owned Enterprise (SOE) sector in Tajikistan is large and systemically important.[2] The sector employs around 24 percent of the labor force and accounts for approximately 17 percent of GDP. Assets of this sector are estimated around 48 percent of GDP (EU, 2017). SOEs operate in many sectors of the economy, from energy and infrastructure to communal services, communications, banking, transport, trade, and insurance.[3] The three largest SOEs as measured by assets — the energy company Barki Tojik (BT), Tajik Railways, and the Tajik Aluminum Company (TALCO) — hold over 80 percent of all SOE assets (EU, 2017). Other large SOEs include Tajiktransgaz and Tajik Air.

2. Tajikistan launched a privatization program in 1991. Around 12,000 small- and medium-scale state enterprises were privatized or liquidated. However, the largest SOEs, especially those implementing important social functions or suffering substantial losses, continued under state ownership. As of 2017, 931 SOEs were active with the remainder listed in the Tax Committee's register as under re-registration or liquidation.

B. Losses and Fiscal Risks from the largest SOEs

3. The SOE sector is inefficient and loss-making, and BT accounts for almost all of its losses. While information on the largest SOEs has been collected regularly by the SOE Monitoring Department of the Ministry of Finance, the consistency and reliability of the data may be questionable. The largest SOEs are inefficient and loss-making. Cumulative losses amounted to 3.7 percent of GDP in 2018.[4] Despite an improving financial situation, BT accounts for almost all of the losses of this sector owing to below cost recovery tariffs as well as the revaluation of its FX denominated borrowing from the government and commercial banks. The large state-owned aluminum company, TALCO, is also loss-making. Most of the other SOEs show only modest profitability.[5]

---

[1] Prepared by Nailya Menlasheva and Yuri Sobolev.

[2] State-owned enterprises (SOEs) are those in which the state exerts significant control through full, majority, or significant ownership owned by the central or local governments (Sturesson, McIntyre, and Jones 2015).

[3] An EU study conducted in 2015 "Safeguarding against Fiscal and State-owned enterprise risk" identified 1016 SOEs. The majority are under central government ownership, while about 20 percent are under municipal ownership.

[4] These results are based on data from the SOE Monitoring Department of the Ministry of Finance. Data coverage extends to the 24 largest SOEs.

[5] See also, "An assessment of state-owned enterprises in Tajikistan"; Selected Issues Paper, IMF 2017.

Table 1. Tajikistan: Summary of Financial Position and Performance of 13 Large Non-Financial SOEs

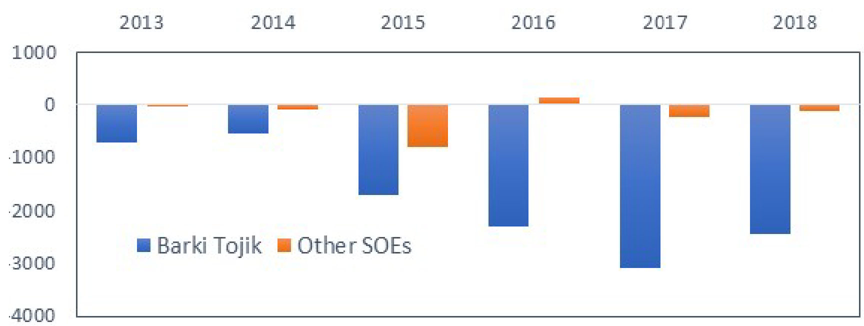
(Percent of GDP)

	2012	2013	2014	2015	2016	2017	2018
Current assets	13.86	13.37	10.09	9.11	9.87	9.31	11.35
Total assets	42.76	40.96	44.81	45.50	43.45	40.40	41.93
Current liabilities	14.22	17.27	16.98	18.24	22.62	23.61	27.24
Total liabilities	25.60	27.84	28.08	35.31	38.52	42.25	47.89
Shareholder's equity	17.16	13.12	16.73	10.19	4.93	n.a.	n.a.
Revenues	11.78	9.79	8.18	9.44	8.25	7.70	8.04
Net profit	-0.90	-1.78	-1.36	-5.20	-3.93	-5.42	-3.71

Source: SOE Monitoring Department.

Figure 1. Tajikistan: Losses by Barki Tojik and other SOEs

(Millions of TJS)



4. BT has significant arrears to the government on FX denominated loans. The government on-lends concessional FX loans and grants from multilateral and bilateral agencies to BT on non-concessional terms. These loans are denominated in FX and are intended to develop the energy infrastructure. However, these debts are not serviced fully, resulting in BT arrears to the government. At end-2018, the outstanding amount of government loans to BT was 17 percent of GDP. The government has continued to service the external debt.

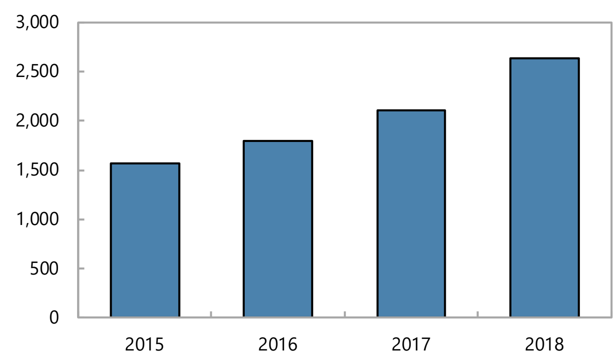
5. BT is also in arrears to domestic banks and energy suppliers, posing significant financial sector and fiscal risks. BT has commercial FX denominated loans from domestic banks and power purchase agreements with domestic energy suppliers. Owing to its financial situation, it has accumulated arrears on both. The cumulative liabilities of BT to banks and suppliers were 6½ percent of GDP at end-2018. The exposure to BT has the potential to weaken bank balance sheets in Tajikistan, with associated fiscal risks.

6. Non-guaranteed borrowing by other SOEs also poses sizable fiscal risks. Tajiktransgaz has signed a loan agreement for $300 million (3½ percent of 2019 GDP) to finance the construction of a gas pipeline (Line D of the Central Asia-China Gas Pipeline). TALCO is loss-making and in significant arrears to BT. Recently TALCO has signed an MOU aiming to borrow $545 million (6½ percent of 2019 GDP) from Chinese companies to finance the modernization of its plant. The agreement is expected to be finalized in 2020. Given the financial situation of the SOEs, these loans may become contingent liabilities for the government.

C. SOE Reform Efforts in Tajikistan

7. The BT financial recovery program is an ongoing multi-year multi-faceted reform effort to improve its operational efficiency and financial situation. There is recognition in government that BT's situation is unsustainable. The authorities have implemented annual electricity tariff increases of about 17 percent since 2016 to improve its financial situation and reduce subsidies to residential consumers. They have also issued a decree to unbundle its operations into generation, transmission and distribution. An Electricity Regulatory Department has been established under the Antimonopoly Agency. There is progress in improving the collection rates. A new tariff methodology has also been approved that would allow the setting of tariffs in line with full cost recovery. Further annual tariff increases are planned (17 percent till 2022, 8 percent between 2023- 2025) that will move BT closer to full cost recovery and eliminate cross-subsidization of consumers. Despite these improvements, arrears to commercial banks and energy suppliers have continued to rise. The planned reform of BT with WB and ADB assistance envisages clearance of arrears to suppliers and commercial banks and restructuring of the debt to government, although details remain to be fleshed out. Improvements to inventory management and collections as well as rising export revenues are expected to strengthen BT's financial position over the medium-term.

Figure 2. Tajikistan: Barki Tojik Proceeds from Energy Sales
(Millions of TJS)



Source: Audited financial statements.

8. An SOE monitoring department was established at the Ministry of Finance in 2010, and reform efforts have continued since the conclusion of the last Fund Program in 2012. The reforms have been supported by IMF Technical Assistance and donor efforts and are aimed to improve SOEs oversight, transparency, and performance. These reforms include:

- *Gradual expansion in the monitoring powers of the SOE monitoring department* from 10 to the 24 largest SOEs. The department is constantly building its capacity and participating in relevant training. Recently, this list of the 24 most economically significant SOEs has been updated and is awaiting approval.[6]

- *Inclusion of the Statement of Fiscal Risks (SFR) in the state budget document*. The monitoring unit has promoted transparency in the sector. The 2016 and 2017 statements defined the main channels of fiscal risks, summarized the financial position and financial performance of largest SOEs, explored fiscal relations between SOEs and central government, described quasi-fiscal activities, subsidies, explicit and implicit contingent liabilities of the central government as well as those of the SOEs (IMF 2017). Preparation of the 2018 and subsequent SFRs is facing delays.
- *Approval of a Strategy to Manage Fiscal Risks stemming from SOEs (September 2016)*. Steps have been taken to operationalize this strategy, including the adoption of an Action Plan (July 2017) to improve the governance and transparency of SOEs. However, implementation has been slow.
- *Preparation of a new SOE law*. Key improvements in the new SOE law are aimed at promoting SOE profitability and financial sustainability and thereby reducing SOE fiscal risks, increasing transparency and accountability by following international standards of governance (including explicit financial performance requirements and availability of information), and improving definitions to make them consistent with the Government Finance Statistics Manual 2014 and other laws. The draft has passed the internal coordination process within the government and is awaiting final approval.
- *Approval of a government decree (May 2019) to establish a Fiscal Risks Coordination Council on the management of SOE fiscal risks*. Key responsibilities assigned to the council include approval and implementation of the action plan to operationalize the SOE Fiscal Risk Management Strategy.

D. What More is Needed?

9. It will be important to continue the reform of BT. The program designed with WB and ADB assistance should be implemented. In addition to planned annual increases in energy tariffs, there is a need for government to restructure BT's existing loans and arrears to make them concessional in line with the initial donor terms. Repayment of commercial banks and suppliers will reduce BT's debt burden. This will need to be accompanied by improvements in collection and future increases in tariffs to ensure full cost-recovery over the medium-term. Targeted social safety nets will be needed to mitigate the impact of these tariff increases on vulnerable segments of the population. In addition, over the longer-term, drawing on the Georgia experience (Annex), it will be important to ensure continued efforts to deregulate the sector and improve its transparency and management.

10. The SOEMD faces challenges to manage the fiscal risks from SOEs. These include:

[6] Roghun is included in the updated list of SOEs to be monitored by the SOEMD.

- ***Accounting, auditing, transparency and disclosure***. Full implementation of International Financial Reporting Standards (IFRS) by all large SOEs is yet to be put in place. Financial difficulties prevent many SOEs from conducting regular audits. It is not uncommon for even the largest SOEs to receive an adverse audit opinion. This underscores potentially severe issues related to internal controls of the quality of the financial statements. It also represents a risk for the state as the ultimate owner.

- ***Data constraints***. The data provided by SOEs on their financial performance is limited. There are significant inconsistencies between audited reports and those submitted to the MOF by some large SOEs. There is no unit within the government that has full and comprehensive information of the size of SOE sector or its financial situation.

- ***Staffing and capacity issues***. The current staffing of the SOEMD is limited to 8 people, who share the functions of on-site inspections, participation in courts, oversight, monitoring, and fiscal risk evaluation. Bank bailouts have broadened the tasks of SOEMD, which requires staff capacity building or outsourcing support for comprehensive monitoring and risk assessment.

11. Stepped up implementation of reforms will help improve transparency and financial discipline in SOEs. The new SOE law to improve financial oversight, governance and accountability of SOEs should be approved in line with IMF TA recommendations. The revised list of SOEs should be approved to include all economically significant SOEs. The preparation and inclusion of the SFR in the budget documents should continue. Capacity and staffing of the SOEMD should also be improved. Regular audit reports would be needed to conduct proper analysis and decision making. Without regular comprehensive audits it is hard to reconcile the contradictions in government behavior as owner, regulator, and provider of social services. The authorities should prepare and publish accrual-based consolidated financial statements for general government.

12. Borrowing by SOEs should be carefully considered and included within the government's overall medium-term debt envelope and strategy. As a first step, comprehensive recording and reporting of all public debt (including non-guaranteed SOE debt) is needed to better understand and contain debt vulnerabilities. Large infrastructure investments and investments that are aimed at public policy goals (e.g. maintaining domestic employment, health etc.) should be undertaken by the government as part of its fiscal policy and financed through government borrowing. Commercial borrowing by SOEs should be underpinned by strong corporate governance and proven commercial viability.

13. More ambitious SOE reforms will be needed to create a dynamic economy. Many developing countries have introduced reforms to improve the SOEs' performance by establishing better institutional frameworks for managing them, allowing SOE management more autonomy in their business operations, and strengthening ex-post monitoring and incentive mechanisms (Annex). The large and unprofitable SOE sector in Tajikistan likely holds back economic growth and there is a need for ambitious reforms to improve its operational and managerial efficiency.

Annex I. International Experience with Reforms of State-Owned Enterprises

SOE reforms have long been the focus of developed and developing countries alike. Many developing countries have introduced reforms to improve the SOEs' performance by establishing better institutional frameworks responsible for managing them, allowing SOE management more autonomy in their business operations, and strengthening ex post monitoring and incentive mechanisms. Some of the key SOE reforms included separation of administrative and business operations where the latter were entrusted to a board of directors who were responsible for reporting SOE performance to the shareholders. A large number of SOEs have since been publicly listed and their governing structures now include both private and foreign firms as minority or majority shareholders such that the government is no longer involved in most SOEs' day-today operations (ADB 2017). The results from these reforms, however, have been somewhat mixed. In many countries, the lack of political commitment to SOE reforms along with the prevalent overarching role of the government in SOE management and unspecified performance mandates still pose significant challenges for improving SOE performance.

Georgia

In 1991, the Georgian economy went into a deep recession accompanied by an economic crisis, political unrest, and internal conflict. The power sector suffered the most where countrywide blackouts became a common occurrence in Georgia.

Key reforms. After stabilization in 1995, Georgia began to reform the power sector in two phases (ADB, 2015). Phase 1 reforms included creation of a regulatory body and diversification for independent generation, transmission and distribution entities; privatization of the power sector; tariff reform across different customer types; and establishment of a wholesale electricity market. Phase 2 included further deregulation and privatization; rehabilitation of state-owned generation, distribution, and transmission assets; and the replacement of Georgian Wholesale Electricity Market by the Electricity System Commercial Operator which is responsible for balancing electricity trade as well as guaranteed capacity (WB, 2004). Recently, the authorities have embarked on further energy market reform based on EU principles.

Results. The improvements in the system brought by the reforms and added investments have ensure full electricity access in the country. Georgia has made significant progress in enhancing transparency, economic efficiency, regulation, and sector management. Lessons learned from the Georgia experience demonstrate the importance of fair regulations for transparent competition; guaranteeing the full independence of the regulator; and ensuring no political interference in regulatory enforcement (ADB 2015).

Malaysia

Malaysia enacted SOE reforms in the aftermath of the Asian crisis (ADB, 2017). In 2004, the government embarked on a transformation program for Government Linked Companies (GLCs). The program had realistic and performance-based objectives in line with international benchmarks.

Key reforms. The program introduced key performance indicators (KPIs), as well as performance-based contracts and compensation, along with a change in the composition of GLC boards and senior management. It addressed the root causes of underperformance in SOEs, upgraded their legal and operational framework, and infused newer management. Management were given a clear mandate and time frame to improve performance.

Results. These reforms helped instill a performance-based culture, and improved SOE management through better utilization of capital and other resources, which translated into higher revenues, profitability, and shareholder returns. The GLCs also expanded globally during this time.

Kazakhstan

The 2008 financial crisis revealed many problems in SOE sector where those companies were severely hit by the scarcity of capital.

Key reforms. The government created a system of state asset management and established two domestic sovereign wealth funds: National Fund of Kazakhstan and Sovereign Wealth Fund Samruk-Kazyna. This defined the relationship between the government and SOEs as a form of cooperation, where the government delegated some of its functions to the market and largely acted through stimulation and regulation. SOE management was expected to switch to a customer-oriented model grounded in market categories such as profitability, competition, transparency, business initiatives, and equal access to capital (Nurgozhayeva 2017). The new method of state management implied active involvement of private companies into the activities traditionally carried out by the state sector.

In January 2017, price regulation was abolished, except "natural monopolies" as railway transport, electric power, gas supply and airport services. New tools of antitrust response were introduced. The government updated the 2007 Model Code of Corporate Governance in November 2016 to take into account OECD and G20 standards of corporate governance. Samruk-Kazyna recently issued a Corporate Governance Code to be applied in all companies of the group where state ownership exceeds 50 percent. Each of the national managing holdings as well as other state-owned firms also adopted corporate governance codes (OECD, 2018).

Results. OECD's reports that financial reporting and auditing practices in the SOE sector have improved. External auditors in national managing holdings and national holdings are appointed by the boards of directors, the activities of which are also audited. Companies' annual reports are comprehensive and often follow international standards. The State Property Committee receives performance reports from all companies on a quarterly basis. According to the World Bank (2018), the current situation in the sector remains the same as SOEs tend to be large and lack incentives to continue to improve the quality and efficiency of their services and products—while often keeping tariffs and prices below cost recovery levels.

References

Asian Development Bank Institute, 2015. “Assessment of power sector reforms in Georgia”, Country Report.

Asian Development Bank Institute, 2017. “Efficient Management of State-Owned Enterprises: Challenges and Opportunities”, Policy brief, (Tokyo, Asian Development Bank)

European Union, 2017. “Safeguard against Fiscal and State-owned Enterprise Risks” Project, Final report, EuropeAid/133863/C/SER/TJ.

OECD, 2018. Reforming Kazakhstan: Progress, Challenges and Opportunities.

R. Nurgozhayeva, 2017. “State Ownership in Terms of Transition: Curse or Blessing”, Cornell International Law Journal.

World Bank Group, 2004. “Revisiting reform in energy sector, lessons from Georgia”, World Bank Working Paper #21, (Washington, World Bank Group).

World Bank Group, 2018, “A new growth model for building a secure middle class”, Kazakhstan Systematic Country Diagnostic.

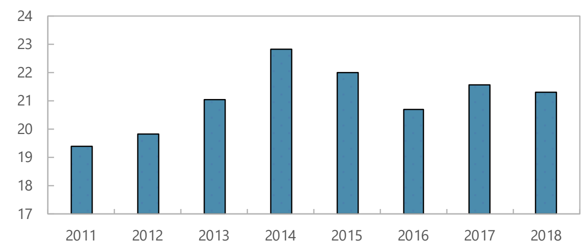
TAJIKISTAN'S TAX INCENTIVES REGIME[1]

A. The Main Characteristics of Tajikistan's Tax Regime and Tax Policy

1. **Despite significant progress made by Tajikistan in increasing tax revenues as a share of GDP, they started shrinking during the last four years.** Tax revenues increased from 13 percent of GDP in 2000 to 22.8 percent in 2014, reflecting reforms in tax policy and tax administration as well as streamlining of tax rates. Tax procedures were also simplified and number of taxes were reduced from 21 to 10. However, beginning from 2015 tax revenues as a share of GDP declined to 21.3 percent in 2018.

Tajikistan: Tax Revenues

(Percent of GDP)



Source: National authorities and IMF staff estimates

2. **The effective tax rate (ETR) in Tajikistan is much higher than other CCA countries (Tables 1 and 2)[2].** The average ETR on profits reported by businesses in Tajikistan is almost 7 and 2 times that in Georgia and Kyrgyz Republic respectively. The effective corporate income tax (CIT) rate is higher relative to neighbors. Moreover, a large portion of the ETR in Tajikistan is related to other taxes: road user tax (RUT) for example. Although the RUT rate is 1 percent, it is charged on the firms' turnover. This makes it roughly equivalent to a 17 percent tax on reported profit (Table 2). Social tax (28.5 percent) paid by employers is also the highest in the CCA

Table 1. Effective Tax Rates in the CCA and LICs

(Percent, Latest Available Year)

	Total Business Tax Rate[1]	Number of Payments	Time to Prepare, File, and Pay (Hours)
TJK	67.3	6	224
ARM	18.5	14	262
AZE	40.8	6	159
GEO	9.9	5	220
KAZ	29.4	7	182
KGZ	29	51	225
UZB	32.1	10	181
LIC Average[2]	52.1	38	271

Table 2. Contribution to Effective Tax Rates in the CCA and LICs

(Percent of Profit, Latest Year Available)

	ARM	AZE	GEO	KAZ	KGZ	TJK	UZB
Corporate Income Tax	17.6	14.0	7.8	16.2	6.4	17.7	6.3
Property Tax	0.3	2.0	2.1	1.4	2.8	...	...
Land & Real Estate Tax	0.5	0.0	0.0	0.0	0.1	3.9	1.9
Vehicle & Road Tax	0.0	...	...	0.0	...	17.0	...
Environmental Tax	0.0	...	...	0.1	...	...	0.0
Social & Pension Funds	...	24.8	...	11.2	16.9	28.4	17.4
Tax on Interest	...	0.3	...	...	0.3	0.3	0.3
Other	...	...	...	0.5	2.5	...	6.2
Total	18.5	41.1	9.9	29.4	29.0	67.3	32.1

Source: World Bank.

[1] Total tax rate measures the amount of taxes and mandatory contributions payable by businesses after accounting for allowable deductions and exemptions as a share of commercial profits.

[2] LIC = Low Income Countries, as defined in the IMF World Economic Outlook (WEO)

---

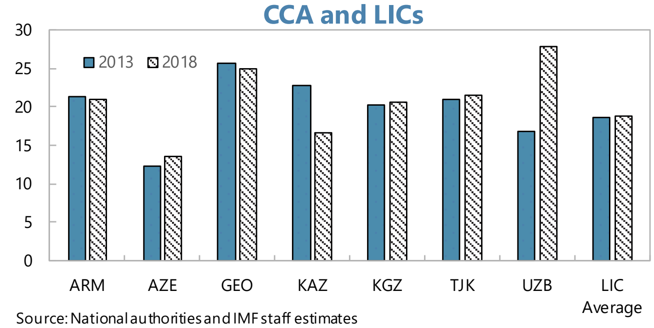
[1] Prepared by Farid Talishli.

[2] The ETR is defined as a ratio of paid taxes to reported profit. A high ETR may also reflect underreported profit.

(Doing Business 2019). Other taxes charged to businesses make tax compliance costly and time consuming.

3. Notwithstanding the higher ETR, total tax collection as a share of GDP in Tajikistan is comparable to neighboring countries and other LICs. This may indicate that tax compliance rate in Tajikistan is weaker relative to neighbors. Another reason may be the tax incentives (discussed below) granted to some sectors of economy which reduce the tax base. For example, although Tajikistan has the highest effective CIT rate in the CCA (17.7 percent, Table 2), CIT related tax revenue is comparable with the Kyrgyz Republic where the effective CIT rate is only 6.4 percent (Figure 1).

Total Tax Revenue as a share of GDP in CCA and LICs



Source: National authorities and IMF staff estimates
Note: Total tax revenue includes social contribution for all countries and LIC average.

Figure 1. Tax Revenue Across the CCA 1/

Source: Pricewaterhouse Coopers and IMF staff estimates.
1/ For purposes of comparability, for taxes with multiple tax rates, we take those tax rates that are the most widely applicable.

4. Tajikistan applies multiple tax rates for several taxes that complicates tax administration. In Tajikistan, as in some CCA countries, many of the taxes have multiple rates (Table 3). Unlike Armenia and Azerbaijan, where only the personal income taxes are progressive and are applied for higher income brackets, most taxes in Tajikistan are differentiated by type of activity and residency. For example, the CIT has three rates 13, 15, and 23 percent for goods, services, and nonresidents respectively. The RUT has dual rate: 0.25 percent for trade and procurement and 1 percent for other activities. The PIT applies a lower rate to residents. The VAT has multiple rates: 0, 5, and 18 percent.[3]

Table 3. Tax Rates in the CCA and LICs

(Percent, latest year available)

	CIT Rate	PIT Rate	VAT Rate[1]
TJK[2]	13; 23; 25	13; 25	0; 5; 18
ARM[3]	0; 23; 28; 36	36	20
AZE[4]	0; 14; 25	25	18
GEO	15	20	18
KAZ	20	10	12
KGZ	10	10	12
TKM[5]	8; 20	10	15
UZB[6]	15	12; 20	15
LIC Average[7]	27	30	16

Source: Pricewaterhouse Coopers and IMF staff calculations.
[1] CIT = Corporate Income Tax, PIT = Personal Income Tax, VAT = Value Added Tax.
[2]For CIT rates: 13% for goods producers, 25% for non-residents, 23% for all else. For PIT rates: 13% for residents, 25% for non-residents.
[3]For CIT Rates: 0% for taxable income below 55000ARD, 23% from 55000-150000, 28% from 150000-2mln, 36% above 2mln.
[4]For CIT Rates: 0% for taxable income below 8000AZM and 14% exceeding 8000AZM for non-oil public sector, 14% for taxable income below 2500AZM and 25% +350AZN if exceeding 2500 for oil, gas, and public sector.
[5]For CIT rates: 8% for domestic corporations, 20% for foreign corporations.
[6]For PIT rates: 12% for residents, 20% for non-residents.
[7]LIC = Low Income Countries, as defined in the IMF World Economic Outlook (WEO).

B. Tax Incentives in Tajikistan

5. Tajikistan grants numerous VAT, CIT, PIT, and customs duty exemptions/ incentives to different sectors of the economy (Table 4). The current tax system provides a CIT holiday to businesses making new investments, including in the tourism and cotton processing sectors. This tax holiday is generous — for instance, a 5-year corporate income tax holiday is available to investments over just USD 0.5 million. In addition, several tax incentives are available to businesses that are involved in various sectors e.g. i) the construction of hydropower stations, ii) import of raw materials to make final goods iii) poultry farms and enterprises on production of feed for birds and animals, iv) the tourism sector, v) securities market participants, and vi) production sharing agreements. Firms that operate in the four free economic zones in Tajikistan also benefit from reduced taxes and custom fees. In addition, there is a simplified tax for small businesses, and a unified tax for agricultural producers. These grant exemptions from PIT (for small businesses), CIT, RUT, VAT, and land tax (for agricultural producers). These generous tax incentives are profit-based rather than cost-based.[4] Tajikistan also allows cost-based incentives

[3] The 5 percent VAT rate reflects reduced VAT granted to a few sectors (see further discussion). Tax payers with turnover below the threshold of TJS 1 mln (approximately USD 100,000) are subject to a simplified tax regime. Tajikistan's VAT refund system is weak, potentially adding costs to producers.

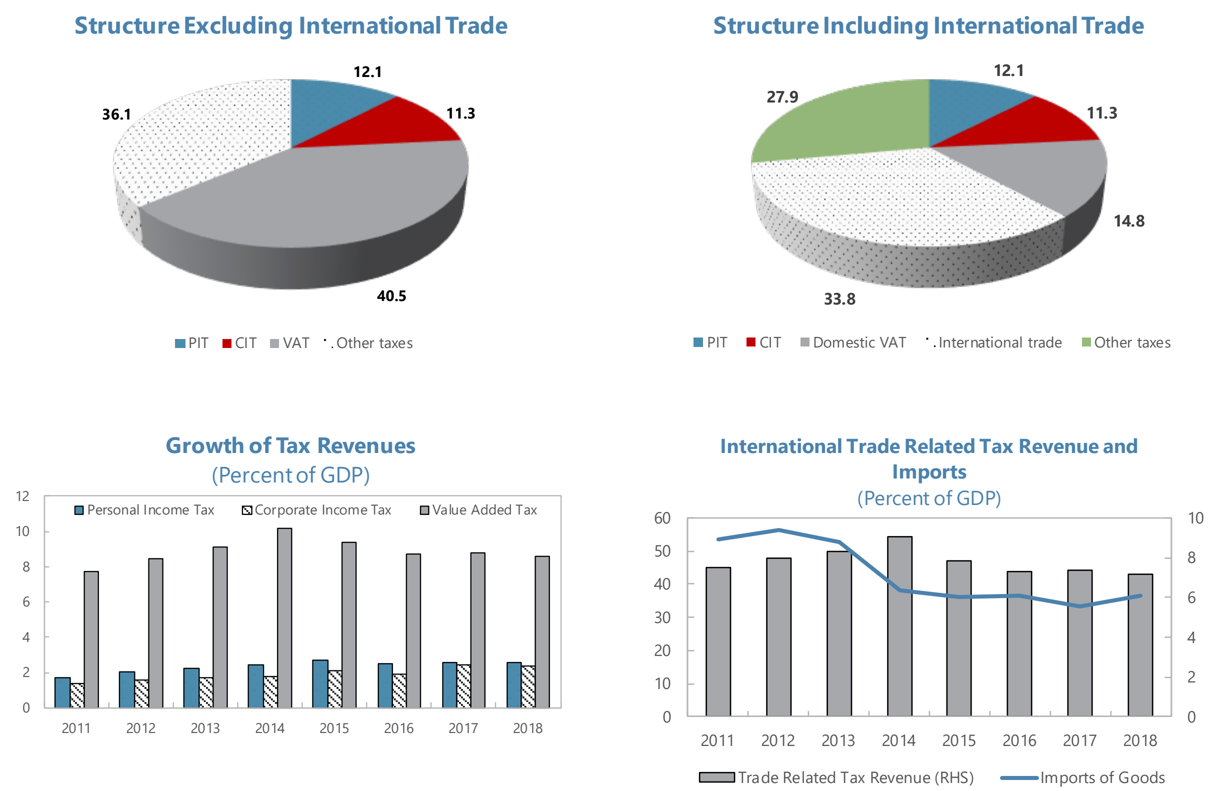
[4] Profit-based incentives reduce tax rates on taxable income or waive tax altogether to increase profitability. Cost-based incentives decrease the cost of capital and can help boost investment (e.g., investment allowances, tax credits, and accelerated depreciation).

such as accelerated depreciation, but these may not be used as widely by businesses as they are less favorable than exemptions.

6. Albeit their objective is to promote industrialization, most incentives are not linked to investment and are vulnerable to abuse. For instance, tax incentives and holidays for new firms could invite tax avoidance by disguising existing investment as new. Sectoral tax incentives do not appear to be linked to new investment. Import VAT and custom duty exemptions granted to importers of raw materials are too broad and may be diverted to unintended recipients to create opportunities for rent-seeking – these could be handled better through a stronger system for VAT refunds whereby firms receive credits for inputs. Special economic zones could lead to leakage of untaxed goods into the domestic market.

7. Tax incentives are likely to have eroded the tax base in Tajikistan. Tax revenues as a share of GDP in 2018 decreased by 1.5 percent relative to 2014. The CIT rate was lowered by 1 percent in 2017. Moreover, there was a significant decline in VAT collection as a share of GDP in recent years. This is likely related to an increase in the VAT threshold in 2017 and additional exemptions on VAT (e.g. tourism and poultry farming sectors). Import taxes also declined — import increased sharply in 2018, but trade related taxes declined (Figure 2). Like other LICs,

Figure 2. Tajikistan: Structure of Tax Revenue in 2018 and Trade Related Taxes



Source: National authorities and IMF staff estimates

Tajikistan heavily relies on import related tax revenues.[5] Granting tax exemptions erodes the already thin domestically-source tax base making Tajikistan's fiscal stance less resilient to external shocks.

Table 4. Tajikistan: Profit-Based Tax Incentives

	CIT	VAT	Import VAT	Excises	Road tax	Property tax	Vehicle tax	Social tax	Custom duties	Registration fee
Investors										
2 year exemption for investments USD 200,000-500,000	X									
3 year exemption for investments USD 500,000-2,000,000	X									
4 year exemption for investments USD 2,000,000-5,000,000	X									
5 year exemption for investments exceeds USD 5,000,000	X									
Financial sector										
5 year exemption for professional participants of stock exchange market	X									
5 year exemption for professional participants, emitters, and investors in security market	X	X								
Companies of at least 50% disabled employees	X									
Precious metals, stones, jewelry, aluminum, metal scrap, and cotton		X								
Industrial, agricultural, and medical equipment			X							
Goods for government investment projects, and important projects (as defined by the government)			X							
Goods for the production of aluminum			X							
Production sharing agreements	X	X		X						
Poultry farms and combined feed producers	X	X			X	X				
Construction of the hydroelectric power plant	X	X	X	X	X	X	X	X	X	X
Tourism (5 years exemption)	X		X							
Processing of row cotton (5-12 years exemptions)	X		X	X					X	
Manufacturing and technological equipment									X	
5 years exemption for import of raw skins, wool, and raw silk			X						X	
Construction, wholesale, and retail enterprises		5%								
Manufacturing enterprises			5%							
Wheat and wheat products			10%							
Aluminum production			X							
School closing production		X	X						X	
Import of raw materials to produce a final goods			X						X	
New cars									50%	
Handicraft industry	X	X	X	X	X	X	X	X	X	X
Livestock for meet, milk, and wool production			X						X	

Source: Ministry of Finance of Tajikistan and Deloitte *Tax and Investment Guide Tajikistan*

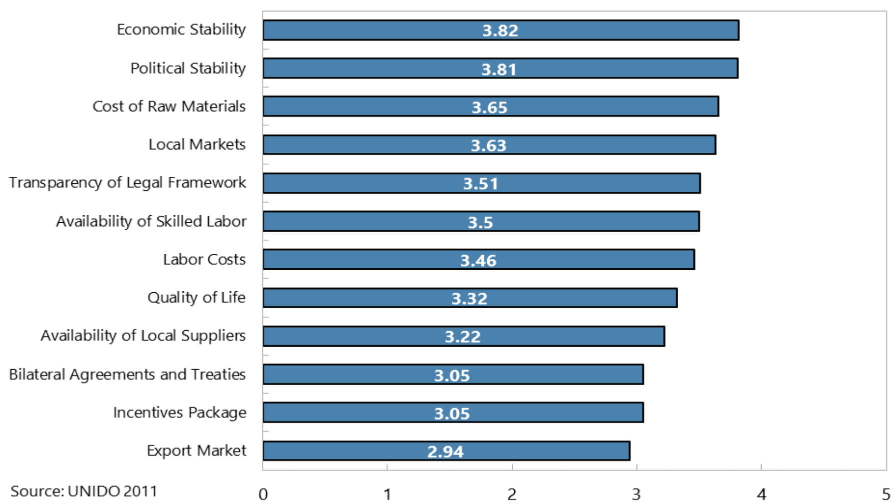
[5] In 2018 trade related tax revenues consisted 30 percent of total tax revenues.

C. International Experience with Tax Incentives

8. Cross-country studies show that tax incentives in LICs usually create complexities and lead to an erosion of the tax base. Many LICs try to offset weak institutional capacity, poor infrastructure, and macroeconomic instability by offering tax incentives to boost economic growth. However, these efforts are ineffective, inefficient, and associated with abuse and corruption (Kinda 2014, IMF 2015). Tax reforms conducted in LICs that included among other measures simplifying tax regimes, curbing exemptions, and improving tax administration contributed to tax revenues growth. For example, in Mauritania, VAT collection net of refunds increased by 2.5 percentage point of GDP during tax reforms 2009-2013 (IMF, 2019)[6].

9. An international investment survey suggests that tax incentives are not the most important consideration for business investment. The investment decision rather depends on whether the tax system is stable, predictable, less discretionary, and transparent. An investment survey conducted by the United Nations Industrial Development Organization suggests that tax incentives rank 11th out of 12 in importance in investors' decisions. This survey suggests that investments in LICs would have been made with or without tax incentives. Economic and political stability as well as the business environment were important factors affecting investment decisions.[7]

Relative Preferences from Investor Location Survey, 2010
(Relative rank)

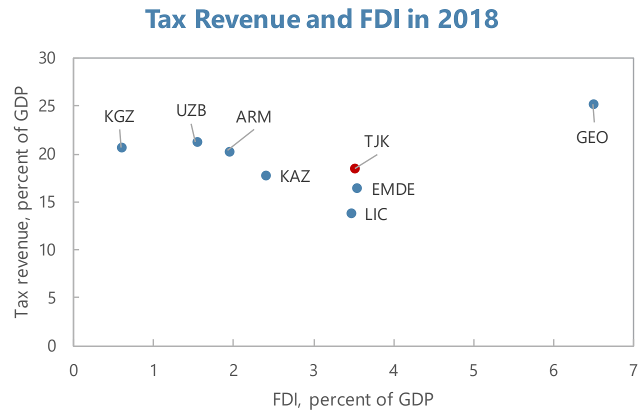


Source: UNIDO 2011

10. Empirical evidence also suggests that tax incentives do not have a sizable effect on investment in the long term. Evidence for 40 Latin American, Caribbean, and African countries suggests that tax incentives did not increase total investments or economic growth. In countries where FDI was growing, it fully displaced domestic investments (Klemm and Van Parys, 2009). In contrast, structural reforms to improve the business environment and simplify tax policy and administration helped boost FDI (e.g. Georgia).

[6] Reforms included simplification of tax system, the removal of exemptions, differential taxation on nonresidents to limit profit-shifting by multinational companies.

[7] Empirical evidence finds that taxes matter for investment in advanced and developed countries (De Mooij and Ederveen, 2008).



Source: National authorities and IMF staff estimates

11. International experience suggests using cost-based tax incentives over profit-based ones to boost investment. Table 5 summarizes the advantages and disadvantages of commonly used tax incentives around the world. For example, applying accelerated depreciation schemes lowers the cost of capital and makes a greater number of investments more profitable at the margin, thus generating investments that would not otherwise have been made (IMF, 2015). Profit-based tax incentives (e.g. lower corporate tax rate or tax holidays), generally, reduce tax rates applicable to taxable income, which leads to lower government revenues and makes profitable investment even more profitable. However, profit-based incentives do not make unprofitable investments profitable.

Table 5. Tajikistan: Advantages and Disadvantages of Various Types of Tax Incentives

Advantages	**Disadvantages**
1. Lower Corporate Income Tax Rate	
- Simple to administer - Revenue costs are transparent	- Large benefits go to existing high-return firms. - May result in tax avoidance, high tax enterprises shifting profits to low tax ones by transfer pricing - Act as windfall to existing investments - Unlike specific benefits, may not be tax spared by home countries
2. Tax Holidays	
- Simple to administer - Allows taxpayers to avoid contact with tax administrators - Same as lower CIT rates except may be tax spared	- Attracts short term projects - Incentivizes tax avoidance through extension of holidays by disguising existing investment as new investment - Creates competitive distortions between old and new firms - Revenue costs are not transparent unless tax return filing is required reducing administrative benefits

Table 5. Tajikistan: Advantages and Disadvantages of Various Types of Tax Incentives (concluded)	
3. Investment Allowances and Tax Credits	
- Can be targeted to certain types of investments with highest positive spillovers - Revenue costs are transparent	- Distorts choice of capital assets in favor of short-lived ones, since a further allowance is available each time as asset is replaced - Qualified businesses may attempt to abuse the system by selling and purchasing the same assets to claim multiple allowances - Create administrative burden - Discriminates against investments with delayed returns if loss carry-forward provisions are inadequate
4. Accelerated Depreciation	
- All of the benefits of investment allowance and credits - Does not discriminate against long-lived assets - Moves the CIT closer to consumption-based tax by reducing the distortion against investment under regular CIT	- Some administrative burden - Discriminates against investments with delayed returns if loss carry-forward provisions are inadequate
5. Exemptions from Indirect Taxes (VAT, Import Tariffs, etc.)	
- Allows taxpayers to avoid contact with tax administrators	- VAT exemptions may be of little benefit. Under regular VAT, tax on inputs is already creditable; output may still get taxed at a later stage. - Prone to abuse. Easy to divert exempt purchases to unintended recipients - Weakens the administration of the VAT
6. Export Processing Zones	
- Allows taxpayers to avoid contact with tax administrators	- Distorts locational decisions - Typically results in substantial leakage of untaxed goods into the domestic market, eroding the tax base
Source: Botman, D., Klemm, A., Baqir, R., 2008, "Investment Incentives and Effective Tax Rates in the Philippines: Comparison with Neighboring Countries," IMF Working Paper 08/207.	

D. Tax Incentives Reform Recommendations

12. Tajikistan needs to transition to a new economic model to ensure inclusive and sustainable economic growth. So far, growth has been driven by public investment and remittances. However, this has made Tajikistan vulnerable to external shocks, with low domestic private investment and job creation. International experience suggests that private investment is positively associated with good physical and social infrastructure, macroeconomic stability, a stable and predictable tax system, and rule of law. Tax incentives are not very effective in boosting private investment. In Tajikistan, boosting investment will require measures to improve the business environment and maintain macro-financial stability.

13. In Tajikistan, reforms to broaden the tax base and alleviate the tax burden would improve the business environment while maintaining strong revenue performance. Tajikistan's ETR is the highest in the CCA, although collections are in line with other countries. In order to maintain fiscal sustainability, it will be important to broaden the tax base, followed by a gradual rationalization of the high tax rates. Revenue collections would need to increase to support fiscal consolidation as in Mauritania, Uganda, and Rwanda. The existing inefficient tax incentives could be phased out over time. Alleviation of tax burden and phasing out of tax incentives would create a fairer and more equitable tax system with less incentive for rent-seeking activities. Dropping nuisance taxes, eliminating where relevant multiple rates for the same taxes, and simplifying tax payment and compliance procedures can decrease the tax burden on businesses, create incentives for small and medium firms to grow, expand the tax base, and improve compliance.

14. Tax incentives should be made more cost-based, transparent, and non-discretionary. Over time, profit-based or other tax incentives should be phased out so that businesses rely more on cost-based tax incentives (including accelerated depreciation) to boost private investment. If new tax incentives are granted, they should adhere to international best practices. Tax incentives should be carefully designed and should be granted based on rules rather than discretion. Good governance, including transparency, is very important to improve the efficiency of tax incentives and diminish opportunities for rent seeking and corruption. Tax incentives should be included into the Tax code and consolidated under the Ministry of Finance, while the approval process may involve several players. Estimated fiscal cost of tax incentives should be part of the tax expenditure report. It is important to establish a proper reporting system for firms benefiting from tax incentives.

15. The reform of tax incentives should begin in the near-term. A more detailed analysis of the costs and benefits of the existing tax incentives, including special economic zones, would help in assessing their effectiveness and designing a reform strategy. Businesses affected by the reforms will need time to adjust so while reforms should be pre-announced in a credible way, implementation may proceed more gradually.

References

Dobrescu G, Nelmes J, Yu J, 2011, "Nepal's Tax Regime", Selected Issues Paper, IMF, Country Report No. 11/319 (Washington: International Monetary Fund).

Chen Q, Ostojic D, Shukurov B, 2013, "Tax policy in the Kyrgyz Republic", Selected Issues Paper, IMF, Country Report SM/13/132 (Washington: International Monetary Fund).

Tajikistan, Country Economic Memorandum, 2018, "Nurturing growth and Addressing Policy Challenges", No 130045-TJ (Washington: World Bank).

Krelove R, Caner S, Dehan T, 2012, "Federal Democratic Republic of Ethiopia: Tax incentives, tax expenditures, and transfer pricing", 2012, (Washington: International Monetary Fund).

Keen M, Perry V, Mooij R, Clark S, 2015, "Options for low income countries' effective and efficient use of tax incentives for investment", FO/DIS/15/165, 2015, (Washington: International Monetary Fund).

Akitoby B, 2018, Raising revenue: Five country cases illustrate how best to improve tax collection

Akitoby B, Honda J, Miyamoto H, Primus K, Sy M, 2019, "Case studies in Tax Revenue Mobilization in Low-Income Countries", IMF Working Paper, WP/19/104, (Washington: International Monetary Fund).

Deloitte, Tax and investment guide Tajikistan: reach, relevance and reliability

Howell H Zee, Janet G. Stotsky, Eduardo Ley, 2002, "Tax incentives for business investment: a primer for policy makers in developing countries". World Development, Vol 30, No9.

Kinda T, 2014, "The Quest for Non-Resource-Based FDI: Do Taxes Matter?", IMF Working Paper, WP/14/15, (Washington, International Monetary Fund).

Klemm A, Van Parys S, 2009, "Empirical Evidence on the Effect of Tax Incentives", IMF Working Paper, WP/09/136, (Washington, International Monetary Fund).

De Mooij R, Ederveen S 2008, "Corporate Tax Elasticities A Reader's Guide to Empirical Findings," Working Papers 0822, Oxford University Centre for Business Taxation.

Botman, D., Klemm, A., Baqir, R., 2008, "Investment Incentives and Effective Tax Rates in the Philippines: Comparison with Neighboring Countries," IMF Working Paper 08/207, (Washington, International Monetary Fund).