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FDI in Tajikistan

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Abstract

Figures show that FDI is now the major force behind economic globalization. With this phenomenon we will look onto Tajikistan, situated in the interesting geostrategic area of Central Asia. Firstly we explain FDI, how it is attracted and what effects it has on the host country. Then we observe which efforts that have been made to attract FDI, how the progress has been and what the outcome looks like in today's Tajikistan. Later on we analyze the situation of FDI in Tajikistan by explaining the development, patterns and effects of FDI.

Keywords: FDI, Tajikistan, Effect, Spillover, Investment

Abbreviations

ADB	Asian Development Bank
CIS	Commonwealth of Independent States
EAEC	Eurasian Economic Community
ECO	Economic Cooperation Organization
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FTZ	Free Trade Zone
GDP	Gross Domestic Product
HDI	Human Development Index
IPA	Investment Promotion Agency
MDG	Millennium Development Goals
MNC	Multinational Corporation
NGO	Non-Governmental Organization
NDS	National Development Strategy
PPP	Power Purchasing Parity
PRS	Poverty Reduction Strategy
R&D	Research & Development
SCO	Shanghai Co-operation Organization
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
USD	United States Dollar
WB	World Bank
WTO	World Trade Organization

Background

Aim

My curiosity in exploring Tajikistan stems from the fact that Central Asia is generally much unknown for many people, like a vast hole on the world map as a Lonely Planet travel guide once wrote. But behind this conception there is a huge economic potential. I want to observe the development in Tajikistan. What has been done? Have expectations been fulfilled? FDI is a very interesting and accurate indicator on whether to spot a country's economic well doing. Tajikistan is, like other Central Asian states, even more interesting for me by only being two decades young as states. Therefore policies here become experimenting and determinant in the country's progress. Consequently I'm curious to know how Tajikistan has managed to attract FDI since independence. What efforts they've undertaken and how it looks like in Tajikistan today. Also what effects there have been by FDI in today's Tajikistan.

Disposition

We start by providing an introduction on FDI and the country Tajikistan. Chapter 2 involves the main theories about what attracts FDI. How countries can appeal FDI and likewise about the effects of FDI. In chapter 3 we show the efforts implemented in Tajikistan since independence. Chapter 4 scrutinizes the outcome of the efforts mentioned in chapter 3. How it actually is in Tajikistan today. The results and how have the development been also about the effects of FDI. The last chapter is a summary and conclusion of the thesis by analyzing the outcome of FDI in Tajikistan. Generally I've tried to divide the chapters in overall economic terms and then direct incentives for FDI, this to make it easier for the reader to grasp the different chapters. During my thesis I noticed that obtaining resources, especially about FDI in Tajikistan, was more difficult than expected. This because Tajikistan is considerably unknown and the use of Cyrillic alphabet in Tajikistan, making most domestic info incomprehensible for me as author.

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1. Introduction

“FDI is a measure of foreign ownership of domestic productive assets such as factories, land and organizations. Foreign direct investments have become the major economic driver of globalization, accounting for over half of all cross-border investments”. (EconomyWatch)

1.1 FDI

FDI is when a firm, often a MNC, develops a firm or invests in a business in another country and has more than ten percent of ownerships to obtain both management and voting rights of the firm. The investment should be in tangible assets, such as land and factories to be defined as FDI. FDI can be divided in two categories, inward and outward investment, depending on the flow of the investment, in which way it's going. In other words the investing country's outward FDI is the receiving country's inward FDI. So total global inward FDI is equal the outward FDI.

The trend in the global market is that the developing world account for an increasing share of the world's inward FDI flows and this trend is expected to continue. (EconomyWatch)

“DEVELOPING countries are attracting more foreign investment than ever before. Since 2000, FDI inflows have rocketed from \$165.5 billion to an estimated \$470.8 billion in 2007 says the World Bank”. (The Economist)

Contrary many beliefs about developing countries. FDI isn't largely focused to low skilled industries. The FDI in high skilled industries, e.g. electronics and machinery in developing countries are almost 25 times larger than in more low skilled ones. Furthermore labors in high skilled industries in these countries earn two to five times more than their low skilled colleagues. (Moran 2002:7)

1.2 Why FDI?

FDI can greatly increase a country's technological levels and thereby income levels. This in turn can result in more jobs which further paves the way for growth in the invested sector and then for the country's whole economy.

Foreign firms invest in other countries because they have some advantages compared to the local firms in the host country. The reason why they need this advantage is that we assume that the local firms have their advantages due to better knowledge of the domestic market. So in need to face this disadvantage foreign firms need to have other advantages as we said.

Alternatives for a firm to exploit their advantages

- Producing at your home market and then export to the foreign market.
- Sell its advantages to the foreign firm.
- Producing and selling in the foreign market, FDI. (Kokko 1992:26)

Other contributions to why FDI occurs explain that there isn't only a single theory behind this phenomenon but that it happens due to a combination of factors such as ownerships, localization and internalization advantages, called the OLI-paradigm. Ownership advantage could be described as the comparative advantages we talked about, patent, brand, R&D, scale of economy superiority. Localization advantages is bound reasons for choosing that specific region or country, often natural resources or other fixed assets. Internalization is briefly that you rather produce yourself than together with some other firm because it is one of your core competencies. (Blomström 2002:168)

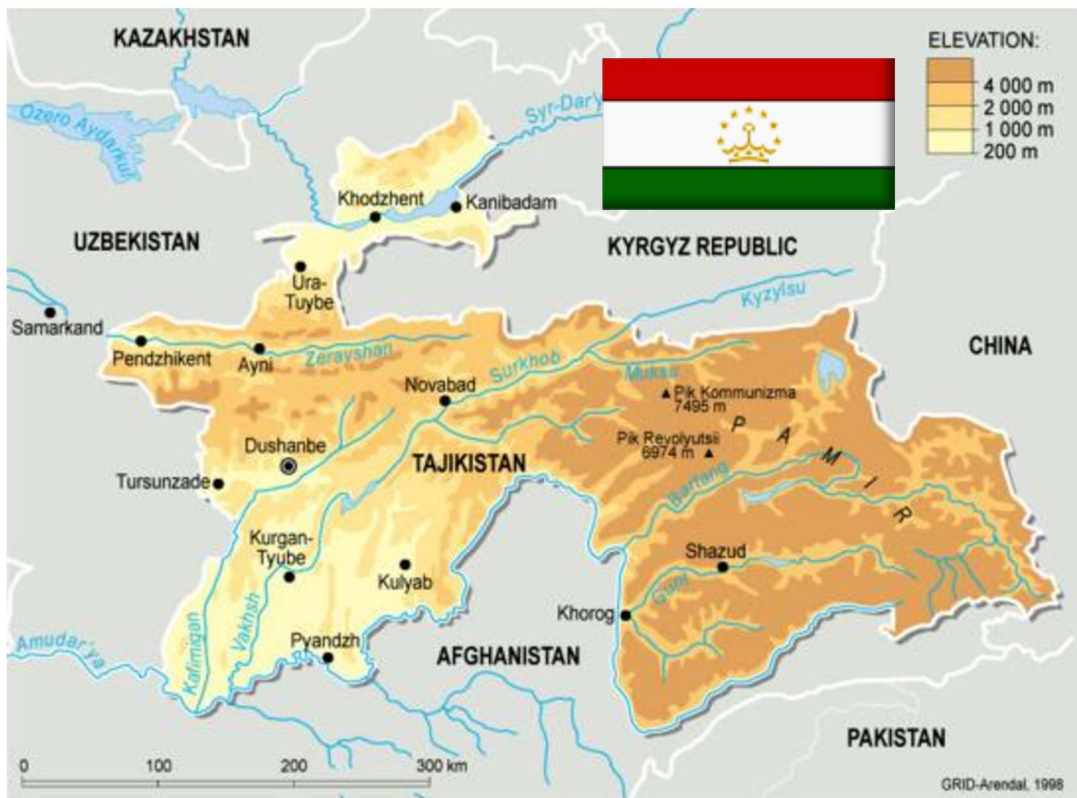
1.3 Tajikistan

Tajikistan is a landlocked country in Central Asia. Bordered to Afghanistan in south, Uzbekistan in west, Kyrgyzstan in north and China in east. Often called “Roof of the World”, 97% of its area is mountainous. It gained independence after the breakup of Soviet Union back in 1991. Shortly thereafter a brutal civil war ravaged the country 1992-1997 which plunged the country into economic recession until late 1990’s. Since then the country has successfully implemented socio-political stability and economic reforms. (FT)

Factsheet

- **Official name:** Republic of Tajikistan
- **Capital:** Dushanbe
- **Area:** 143 100 km²
- **Population:** 8 million
- **Languages:** Tajik (Persian), Russian
- **Main income:** Aluminum, Cotton
- **GDP(PPP)/Capita:** \$2103
- **HDI:** Medium (127 of 187)
- **President:** Emomali Rahmon (Wikipedia)

(MAP)



2. How to attract FDI?

So how does a country attract FDI in best possible way? In which ways can it draw most FDI to host economy? When answering these questions you can reverse the perspective to the MNCs view and see what barriers they face when entering a new country. There is a wide array of measures to take for encouraging FDI. (Moran 2006:22, 28)

2.1 Overall Economy

These generic approaches necessarily aren't needed for obtaining FDI, albeit plays a decisive role in receiving FDI. Hence, they are fundamentals for the country's economy and not necessarily just for a FDI purpose. Thus, implementing these measures will make the country gain whether or not there is FDI. The goal is to create a business-friendly environment.

- **Country characteristics** Market size, country size, natural resources, geographic location. These fundamentals are almost fixed and close to impossible to change.
- **State Apparatus** Due to the risk and uncertainty of investing abroad and the large sunk costs which are required, the MNC first and foremost need stability. War, ethnic tensions, uprisings, revolutions and other uncertain scenarios will scare away investors. A stable political environment is preferable. Secondly is the juridical aspect. MNCs want to be ensured that their rights will be followed and in any case of violation protected by an independent and fair judiciary system. This will also help reducing bribery, corruption and cronyism. (Moran 2006:22, 28)
- **Financial** Low inflation and a reliable exchange rate are greatly beneficial for the host country. An artificially high currency rate hurts the domestic export firms. Hence, the export goods become more expensive than they actually are and therefore less demanded by foreign buyers/importers. Therefore a more accurate and trustworthy exchange rate will distort the market less. (Moran 2006:54) As well a viable domestic banking market which offers competitive rates on loans and credits for local businesses.
- **Infrastructure** For having downward and upward access to firms, resources in other parts of the country worthy infrastructure is a must. Such as railroads and highways. Also energy security for avoiding shortages or blackouts which hurts production. Good and stable access to communication services such as telephone and Internet is a popular request by MNCs. (Moran 2006:28) Some studies show that privatizing infrastructure improves it due to better resource allocation. To summarize, poor infrastructure often hampers FDI.

2.2 FDI

How can a government give the MNC direct, sometimes discriminatory, incentives for convincing them? Last decades of increasing FDI have shown that in most cases FDI improves the host economy and subsequently leads to considerably increased incentives by governments to attract FDI (Blomström 2002:5). Almost on the verge of what looks like a “bidding war” between developing countries. This fallout is excessive overbidding between different governments. In worst case scenarios eventual gains will be cancelled out or even result in net loss for the host country by obtaining the overbidded FDI. (Blomström 2002:13).

Fiscal and Financial Incentives

- Reducing tax burdens, removing in-/direct taxes on both corporate and income level.
- Subsidized loans, receiving cheaper interest rates on credits.
- Write-off losses, possibility of writing off losses in case of not breaking even.
- Export Processing Zones (EPZs) or Free Trade Zones (FTAs) Developing, often remote, areas where network firms supporting the MNC firm locate. Both backward supplier firms and upward buying firms. (Moran 2006:22)

Studies show that these incentives are important only in case foreign investors are satisfied with economic fundamentals. The MNCs use this to distinguish how “welcoming” the host countries are and tend to play off competing developing countries against each other. This implies that these measures are the least effective way to attract FDI. You miss out on much needed and valuable revenue incomes from taxes and the subsidizing only generates costs and distorts domestic economy by discriminating local firms (Rajan 2004:3).

Investment Promotion

How does a country reach out if partly or fully have created a good investing climate? How should you inform the rest of the world of this? The country and its benefits need to be promoted for the investor. The country has to let other countries become aware of their development and offer them reasons to invest in their country. To fill eventual gaps of MNC knowledge or misconceptions about the country it can be fruitful to set up an Investment Promotion Agency.

“Activities that disseminate information about, or attempt to create and image of the investment site and provide investment services for the prospective investors”. (Rajan 2004:1)

Often MNC in the developed world don’t have access to up-to-date and reliable information, statistics and data about the developing countries which they can utilize, hence an admirable solution is an IPA. The IPAs purpose is not to glorify and artificially promote the host country but

instead provide concrete facts and information about diverse issues such as legal and financial terms. These agencies should be employed with high skilled workers who boast direct links with the government for best and most accurate service. (Moran 2006:29)

IPA Services

- **Why invest here?** Explain why the country is attractive for investment through advertising, promoting events and news articles which back up these claims, written by skilled journalists.
- **Analyzing investment decisions.** “One-stop-shop” which can judge and deliver fast and accurate feedback on potential investment plans. Both in expediting approval matters and to obtain information about the specific investment. This to reduce uncertainty and anxieties for risk-averse MNC. (Moran 2006:29)
- **Target potential firms.** Identify specific industries or firms which can benefit from FDI with the help of telephone campaigns or other kinds of surveys and seminars.
- **Improve investing climate.** By taking note of the domestic private markets ideas concerning improvements, suggestions and problems, the IPA can try to identify and improve these. (Rajan 2004:1-2)

An important note is that there isn't any universal rule for IPAs to follow which is applicable for all countries. Countries differ vastly in characteristics and economies as a result there is no tailor-made IPA. Therefore before constructing an IPA there must be careful analyzing of costs and benefits. Smaller, often poorer, countries need to take more notice of this due to less financial power and bureaucratic capability and maybe streamline by mainly reducing trade barriers for convenience. (Rajan 2004:2)

2.3 Effects

What are the effects of FDI? What's the impact of FDI on the host country? A spillover from the MNC to the host country is when the entrance or the presence of the FDI leads to effects or externalities onto the host economy: (Kokko 1992:19)

Spillover

- Increasing efficiency by improving supply flow. This gain decreases with the economic development of the host economy, due to less difference between the home and host country.
- Demonstrating new advantages which the workers can eventually make use of when they work in local firms in the future.
- Break high entrance walls and increase competition. Leads to increased efficiency and productivity. Unambiguously welfare gains.
- Transfer techniques. Could be standardization of products, regulations or quality controls.
- Improve the local managerial efforts by adapting to new circumstances. (Blomström 2002:7)

Advantages MNCs have can be R&D and technology which is in the hand of few major economies. This very much concentrated in the countries of origin of these MNCs. Compare this to their firms, workers or production which is spread much more evenly around the world. Because of having an edge in these areas the bidding countries are in deep need of these. But how can you measure spillovers? It's very ambiguous and difficult due to the abstraction of measurements. Spillovers can be "spilled over" in different ways, voluntary or non-voluntary and through different mediums, hardware or software. (Kokko 1992:22) But commonly spillover effects could be described as when the MNC can't harness or take advantage of all the benefits it's producing in the host country. In that case; how can the host country absorb spillovers?

"Spillover" ways

- The local firm imitates the MNCs technology and uses this for own production and improves productivity.
- When the MNC locates FDI in the host economy it leads to higher competition and therefore domestic firms make their existing technologies more productive in different ways to cope with the new entrant.
- Or the local firms can use make use of new technologies which increases their productivity in that way.

Either way it shows how the host country can reap all of the benefits of FDI. The effects will be even higher in industries or markets where the market competition is low. Thus, by only entering the domestic market, the host country gains partly due to pro-competitive effects. The least effective companies will be forced out of the market. Left is less but more productive firms with lower average costs, prices and therefore higher output due to the imperfect competition and increasing return to scale. Subsequently, welfare in the host economy will increase (Kokko 1992:28)

Spillovers sometimes occur between the MNC and its suppliers or customers. Linkages are when the domestic supplier benefits from spillovers due to cooperation but without really paying the price for the value of it to the MNC.

Linkages

- Assist suppliers to set up production facilities.
- Technical assistance to raise quality of suppliers.
- Provide help for buying raw materials.
- Management assistance.
- Helping suppliers to diversify by finding new customers.

This may be the result of cooperation between MNC and local firms. Linkages are far more likely to take place as the development of the host country increases. The higher skilled labor, the easier they absorb the linkage spillovers. But for being able to absorb these spillovers in best manner the country already need to have some sufficient development itself before receiving FDI. Hence, you cannot hope for the FDI to be put in place and then passively just wait for the benefits to reap. (Rajan 2004:4) (Blomström 2002:174-176).

Spillovers best absorbed when...

- MNCs tightly interact with local firms. Both with supplier, customers and competitors. Here EPZs have a major disadvantage; they are often located distant and isolated from large industrial clusters in the host economy.
- Improving host country characteristics such as human capital, technological development. Higher skilled labor can absorb the new technology better.
- No major difference between MNC and local firms. So the local firms have adequate ability to absorb the spillovers. "Speaking the same language".
- Increasing competition on the market.
- Motivate local firms to learn and absorb.
- Local policies also involve local firms and not only MNCs.

Spillover effects aren't something that happens automatically but depends on several variables. The best way to maximize spillover effects is to enhance the macroeconomic business environment and not only by focusing on the MNCs.

"The greatest contribution of FDI comes, instead, through integrated packages – technologies, business techniques, management skills, human relations policies and marketing capabilities – that place host country plants on the frontier of industry best practices, and keep them there. This outcome is most likely when the subsidiaries are tightly integrated into the parent multinational's strategy to reinforce its competitive standing in international markets. The parent firm then has self-interest in positioning the plants along the cutting edge, and in continuously upgrading local operations." (Moran 2002:162)

Negative effects

We mostly have gone through the idea of positive effects or scenarios where the spillovers have gained the host country. However in many cases these gains are absent and in even in some cases there are negative effects. Especially when FDI is invested in extractive industries, thus concerning natural resources.

Studies show that FDI in these sectors are the ones most prone to bribery and corruption. Accordingly, these natural resources in many cases become a curse rather than a blessing. Inflicting tensions commonly resulting in wars, dictatorships and social tensions. This of course makes the foreign investors much more anxious about investing. They subsequently consider massive sunk costs from the beginning which in the future hopefully are covered and compensated by large revenues. Thus, creating more concern with the terms and enforcements of the FDI contract. This makes the foreign investors demand higher legal protection. And both sides become more prone to moral hazard with soaring mistrust yielding less efficient investment. (Moran 2002:76)

Too much focus on natural resources or new larger findings of them can undeliberately result in the "Dutch Disease". Implying that the extractive industry gains on the behalf of the manufacturing sector. Due to larger inflow of hard currency into the host country, by the surge of natural resources, it makes the country's currency stronger compared to other countries. This eventually leads to that the export commodities of the host country becomes relative more expensive than before and therefore less after sought and imported by other countries.

3. Efforts made by Tajikistan to attract FDI

To further enhance and develop economic reforms and national development Tajikistan initiated a long term plan, NDS, in 2005 for setting the agenda for the country's progress.

3.1 Overall Economy

This overall plan is a foundation which the country's various sectors, institutions and partners focus on and try to progress within. Parallel with NDS goes PRS, which is a short-medium term strategy, within the frame of the NDS. (UNDP:4)

NDS (2006-2015)

Is the basic foundation for which the Tajik government has outlined for different state institutions, public and private sector, different development actors, partners and various agencies to follow. National development and economic reforms should be in accordance to the NDS priorities and goals. The goal of the NDS is *"to strengthen social and political stability and to achieve the economic prosperity and social well-being of the people of Tajikistan in an environment shaped by the supremacy of the principles of a market economy, freedom, human dignity and equal opportunities for each person to realize his or her potential"*. (UNDP:10)

It will be largely in accordance to the United Nations Millennium Development Goals, UN MDGs. The strategy is divided in three blocks:

1. **Function** Improve conditions for institutional and functional environment of the state by strengthening public & private sector, investment environment, regional and global cooperation.
2. **Production** Spurring economic growth by increasing collaboration of public and private sectors and increase in private investments. Especially by focusing on sectors such as, agricultural, energy, infrastructure. Economic growth leads to further employments, higher consumption and income, reduction of poverty which is one of MDGs main goals.
3. **Social** Expanding basic social services such as the education, health system, access to clean water and sanitary. While also improving social issues like gender equality and environmental sustainability. (UNDP:12,24,33)

Below are important **reforms** done in Tajikistan in accordance to the country's national development and important for the economic progress.

External Debts When Tajikistan gained independence 1991 the country started out with no external debt. As the civil war plunged the country into chaos and poor state apparatus couldn't manage the country, Tajikistan started to accumulate large amounts of debts (mostly obtained from Russia, Uzbekistan and Turkey). This culminated in 2000 when the external debt attained 128% of GDP. First attempts were partly successful when during mid-1990's Tajikistan started debt rescheduling negotiations with the main credit givers to improve their debt service. However it wasn't until 2000 Tajikistan could reverse the trend and start to shrink the ratio of external debt to GDP. The government was successful in implementing stricter rules on obtaining credits. Major rescheduling programs, debt-for-asset and debt cancellation were enforced vis-à-vis the main creditors, especially Russia. This together with economic growth decreased the external debt burden significantly. (IMF:56)

Taxes Tajikistan implemented a new tax code in 2005 to replace the old one. The main aim of this revised tax code is to improve the tax system and lower the incentives for tax avoidance, as well as to lower the costs of collecting taxes and to make the system more efficient. Corporate profit taxes were reduced from 30% to 25 %. Increased possibilities for tax holidays, abolishment of corporate property taxes and simplified tax system for smaller businesses. Personal income taxes were streamlined and now only dealt with upon three categories. Unified tax for agricultural industries is now enforced and the state has implemented new procedures for credit givers for better getting their loans back in case of bankruptcy. (IMF:15)

Financial There has been some bank reform in Tajikistan mainly involving restructuring the four major banks. The banking sector wasn't competitive and the major banks had found their niches which made them convenient and non-competitive. Together with International Financial Institutions (IFIs) reforms have been installed and the major obstacle non-profitable loans were reduced. Further assistance was to improve loan quality and easier mobilization of domestic saving between banks. (UN :9-10) Also stricter basic regulations as minimum capital requirement for existing banks was set to 1,5 million USD and three million USD for new banks in 2002. Tougher capital requirements were enforced 2005 for new banks, which were raised to five million USD. (IMF:33)

Energy When incorporated in the Soviet Union due to its strategic location Soviet built two major hydropower stations, Roghun and Sangtudeh dams. But their constructions were halted due to the breakup of Soviet. Reconstruction is underway and the Sangtudeh power stations are soon to be

inaugurated with the help of Iran and Russia. The Tajik energy sector is run by monopolist BorqiTojik. They deliver electricity to Tajikistan on prices below cost recovery. Particular groups of the society such as the military, disables, pensioners were granted even cheaper electricity and some even for free. The government only helped BorqiTojik with a slight part and the company itself carried most of this subsidy burden itself. Much needed profits for further investment were lost. Shortages and rationing was common. (UN:7-9) In 2003 the government introduced reforms for the energy sector. The “special” beneficiaries of the electricity tariffs were eliminated for more efficient allocation of usage. Instead different seasonal tariffs were introduced which took into account historical consumption for more precise targeting. Energy Compensation Mechanism was initiated. Local governors collect information about households’ incomes and then examine who are eligible for this state handout to ease the burden for the poorest in society. (IMF:27-30)

Cotton The cotton sector is a key source of income for Tajikistan. The output levels during Soviet times were way more than it was a decade after independence. Thus, large scope for improvements. 1996 the state-owned monopoly was split into several private firms. More international investors became keen towards the Tajik cotton market and out of 22 major firms eight were bought by foreign investors. The cotton trade is now facilitated at Dushanbe Cotton Exchange. This exchange platform has improved trade significantly through accurate price indications, negotiations forums, quality control and being the common place to find buyers and sellers. (UN:8)

Regional Cooperation The demise of Soviet, civil war and the chaos that broke out severely damaged Tajikistan’s external relations. Trade more or less disappeared. Tajikistan’s geographical location further aggravated the situation.

“Tajikistan is a triple-locked economy: land-locked with no commercial access to sea, even by river; mountain locked by one of the world’s highest mountain-ass – he Trans Alay Range in the north and the Pamirs in the south east; and distance locked”.(IMF:42)

Due to these unfavorable conditions the Tajik government has since 2000 made significant progress by actively encouraging regional cooperation. Tajikistan is today member of several major preferential trade agreements such as Euro-Asian Community (EAEC), Shanghai Cooperation Organization (SCO), Economic Cooperation Organization (ECO) and Commonwealth of Independent States (CIS). Trade liberalization and harmonization of trade policies are the core goals. Tajikistan is also underway of accessing the World Trade Organization. (IMF:42-46)

3.2 FDI

FDI is high priority for the Tajik Government. Prioritized due to its vital role in the country's development. Particularly encouraging FDI in new industries and existing ones. Hopefully resulting in diversifying exports therefore becoming less dependable on few natural resources such as aluminum and cotton.

Below we will examine the legal framework for FDI in Tajikistan. Tajik commercial laws concerning foreign investment have steadily been improved since independence but are still below international standards. The main law is "Law on Foreign Investments" which been adjusted several times. Various issues regarding FDI (UN:15-18):

- **Nationalization** Protects foreign investors and their investment against nationalization or expropriation. Exceptions could be natural disasters or other cases of emergencies.
- **Repatriation** Corporates are allowed to send profits back to their country of origin.
- **Fiscal** The more FDI, the more tax breaks. More investment privileges and corporate tax benefits are given to foreign firms which invest more. Stepwise increasing.
- **Settlement of Disputes** First settled in Tajik courts and then if necessarily in international courts.
- **Intellectual Property Rights** Tajikistan has ratified laws regarding this area in 1994 when joining World Intellectual Property Organization.
- **Foreign Exchange Arrangements** Free currency exchange. Converting, transferring funds is done in a market oriented system.
- **Land** Foreign firms and/or persons are forbidden to own land.
- **Trade Policy** Significant progress which initiated in late 1990's when tariffs were harmonized with other former Soviet states. For protection of main export goods there are higher import tariffs. Tajikistan applied for WTO membership 2001 and there have been steps forward for membership.

Procedures and implementation of FDI

- **Entry Process** To start a firm or an investment in Tajikistan you need to register it at various state institutions. There after the Ministry of Finance and Ministry of Justice will screen the investment based on the Law of Investment. The decision-making and entry process is very centralized and time consuming. Nothing goes by without getting approval from the president's office.
- **Custom Procedures** This area has improved significantly. With the cooperation and assistance from Asian Development Bank, ADB, Tajikistan has simplified custom procedures and significantly streamlined them so trade facilitation becomes more efficient.
- **Other administrative procedures** Like other former Soviet states or CIS countries, the overall administrative system and procedures are very non transparent, slow and many times repeating. Procedures for opening a plant, tax reporting or obtaining permits/licenses are time consuming. Corruption is common and bribing occurs frequently among underpaid custom officers. This had led the Tajik government to put up a task force in 2002 dealing with these issues and to speed up matters so being able to reach the country strategic goals in the NDS. (UN :19)
- **Implementation** Due to the government awareness of the corruption problems seriousness which mainly derives from the imbalances of economic distortions, they have in accordance with the World Bank, WB, put focus on several reforms such as: efficient public expenditure management, administrative reform, improving government transparency, eliminating excessive legislation and inefficiency in agricultural industry, ensuring efficient state audit agency. (UN :20, 22)

Investment Promotion

In 2006 Tajikistan decided to reform their state executive bodies which led to a new structure among their various state agencies. One of the new bodies that were created is the State Committee on Investment and State Property Management, SCISPM, Tajikistan's official investment promotion agency.

SCISPM

This new state agency was created in late 2006 following a series of reforms and reconstruction among state bodies. It lies under the directory of Consultative Council which goes under the President's responsibility. It overtook the responsibilities of the president's office executive

administration concerning aid coordination, ministry of finance issues related to foreign investment and the whole responsibility of former agency of anti-monopoly and support for entrepreneurship.

Objectives

- Creating favorable investment climate.
- Increasing investment flows to Tajikistan.
- Foreign aid coordination.
- Support for entrepreneurship development.
- Better ratings for Tajikistan concerning investment.
- Promotion of regional cooperation. (SCISPM)

Better rating for the country means improved position on the World Bank's annual ranking "Doing a business". The ranking is determined by looking on business regulations and enforcements across five different indicators (WB): International Trade, Access to Credit, Taxation, Construction permits, Starting a Business. (TAFF)

Besides this dedication on investment promotion the Tajik government initiated an investment development program "*Improving entrepreneurial environment – 200 days of reforms*". This plan is within the frame of SCISPMs mission and also to the overall economic guidelines of the country. The overall goal is to improve Tajikistan business environment specially towards attracting foreign investors. Special focus has been on making it easier for entrepreneurs to open up business in Tajikistan, a "one-stop-shop" approach instead of registering business at various time consuming state authorities. The *reforms* are enlisted below:

- Registering business only needed by submitting application to the SCISPM.
- Closing a business procedures have been streamlined by reforms in the laws concerning bankruptcy.
- Minority shareholders rights have increased by reforms in laws protecting them.
- Improvement in licensing in the construction sector. (TjSwiss)

4. Development, patterns and effects of FDI

How does it look like in Tajikistan today? What is the outcome of the overall development and the various FDI incentives? The effects of FDI? First we look at the general development and then more specific on the outcome and effects related to FDI. This together with a range of data will provide an overview of the current investment climate in today's Tajikistan.

4.1 Overall Economy

When analyzing Tajikistan one must understand the background. Tajikistan has had a tumultuous past two decades to say the least. Firstly, the demise of Soviet, resulting in 14 new states, including Tajikistan. With independence accompanied breakdown of economic links with outside world, when center of Tajik policies moved from Moscow to Dushanbe. In addition the fragile Central Asian neighborhood and poor relations with neighbors, namely Uzbekistan, led to sever economic disruption. Unfortunately for Tajikistan the transition period thereafter didn't turn out as peaceful as in other CIS countries and a devastating civil war broke out 1992-1997.

Furthermore the country suffers from unfavorable geographic location, triple-locked dilemma, and the poor country characteristics. Also the country is split in two parts for most of the year due to a mountain range. When segregated, southern and northern Tajikistan to trade with each other they need to pass Uzbekistan, a hostile neighbor, often charging Tajik traders with antagonistic tariffs. With these dire conditions the Tajik government understands the role of reforms. After the civil war, stability and reforms dragged the economy out of recession into growth. But the postwar recovery has stalled. Corruption is widespread and undermines the judiciary as well as the whole state apparatus, scaring FDI when the rule of law isn't abided. Additionally restoring and building decent infrastructure would largely benefit Tajikistan. Saving unnecessary tariffs and corruption at border stations with Uzbekistan and thus by connecting the two parts of the country for further economic integration.

Tajikistan ranks 128th of 187 countries in the latest Human Development Index. (HDI) Tajikistan faces numerous challenges along the way reaching the UN MDGs. The UN states that Tajikistan won't be able to fulfill the majority of goals by 2015. (UNDPTJ:8)

Despite being a potential major energy producer Tajikistan still endures severe winter shortages leaving most areas outside Dushanbe with little or no electricity for most of the season.

Figure 4.1 [HDI ranking]

2008	2009	2010	2011
122 of 177	127 of 182	112 of 169	127 of 187

“As early as 1776, Adam Smith observed that the inland regions of Africa and Asia were the least developed areas of the world, and he underlined the constraints associated with transit trade to and from maritime ports.” (UNCTAD2)

Officially Tajikistan has well written laws and emphasizes legal business aspects but the reality differs. Implementation is poorly enforced and courts are often tightly knotted with powerful government officials. The international community has encouraged Tajikistan to improve its rule of law but problems with interpretation remains and few are acquainted with the rights of business owners. The judiciary is unable to fairly judge the responsibilities and interests of business owners. Disputes are often solved by some high positioned in the power structure. Results from international settlements are rarely accepted nor for bilateral commitments signed with trade partners. Due to poor recognition of these agreements many cases are settled by a case to case judgment. (USDS)

Corruption is another major obstacle. The country always position at the bottom in different rankings with major issues needed to be resolved. Bribes are common and widespread. Obtaining a higher positioned job occasionally requires bribing the chief. Buying a government position isn’t uncommon. With corruption so widespread, officials barely do anything against it. Corruption is almost used as a method of silencing critics. May perhaps explain why major efforts to reduce corruption have failed. Ironically some of these organizations are in particular corrupt themselves.

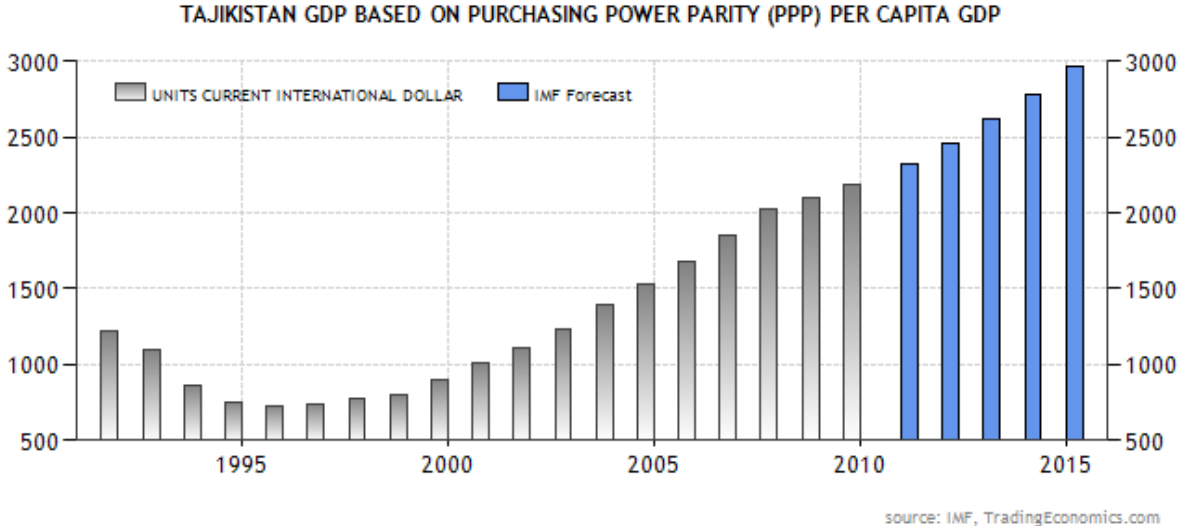
The corruption has hurt the educational system very hard. Today’s generation is far less ill equipped to handle modern equipment and provide good standards of service. Higher educational degrees in the academic world have become less trustworthy and nepotism is widespread. Together with massive brain drain and migration, to mostly Russia, international organizations and NGOs in Tajikistan have difficulties in recruiting competent staff personnel.

Besides cotton and aluminum, main sources of income, over one million Tajiks work abroad mainly in Russia. Sending back remittances accounting for half of Tajikistan’s income, making it a vital but unpredictable source of income. (ECS:16)

In some areas the development has worsened. The country’s main construction project, the Roghun Dam, started being built back in the Soviet Union times is set to be constructed with only domestic

income. With the poor state of Tajik economy this has led to more or less forcible agreements by the state to seize or allocate a significant share of the labor incomes for the Roghun Dam. Those objecting may face losing their jobs. Furthermore the shares that the workers “voluntary” buy have no secondary market, making the shares highly insecure.

Figure 4.2



On a positive note the country has managed peace, political- and macroeconomic stability since late 1990's resulting significant overall economic development. Annual GDP/capita growth is almost nine percent. The Tajik government actively engages in numerous international and national reforms for improving investment climate, state administration, regional cooperation and macroeconomic stability. (ECS:8) Even during the global crisis zenith in 2009 the economy grew with 3.9% and forecasts confirm steadfast growth. The Tajik government is keen on developing its economy by attracting foreign investors. There is huge interest in opening up and drawing investors but the implementation of these plans haven't been executed as anticipated.

4.2 FDI

Foreign direct investment often goes in accordance with the general economy outlook of a country. Tajikistan boasts significant natural resources but at the same time counteract attracting FDI due to structural problems. Tajikistan needs to improve its bleak overall business climate to attract more FDI.

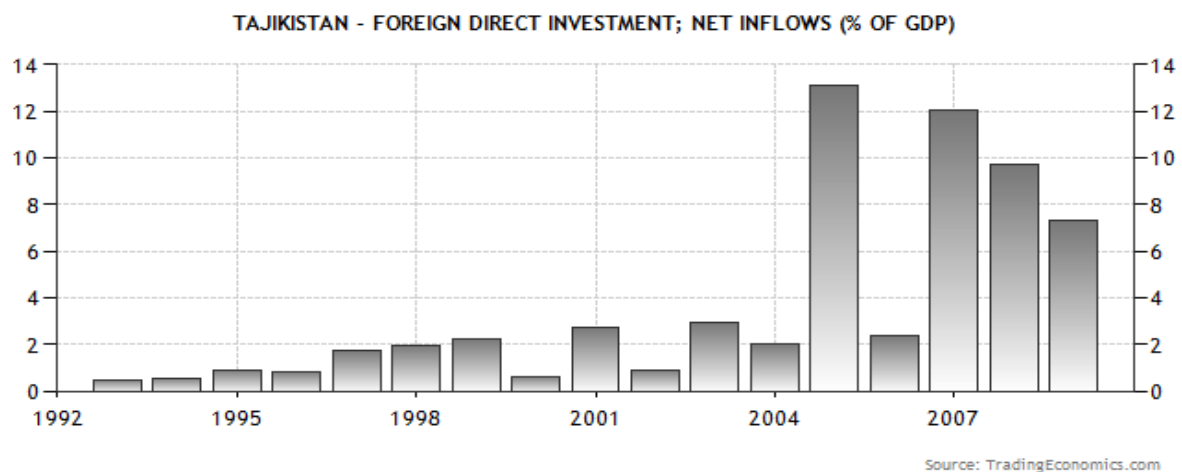
Figure 4.3 [FDI inflows]

1995-2004	2005-2007	2008	2009	2010
\$46 m	\$251 m	\$376 m	\$16 m	\$45 m

Annual average for 1995-2004 and 2005-2007

Uncertainty in the economic outlook makes the foreign investors respond in similar way. The volatile FDI inflows can be explained when larger investments are done, for example construction of a hydro power station, it results in a high figure that specific year, when usually receiving low inflows of FDI otherwise. Another gloomy note is that there hasn't been a steady flow into a specific targeted sector as targeted. The only pattern is that the service sector receives the most FDI, mostly the chemical and pharmaceutical businesses. (WB:65)

Figure 4.4



A major problem is heavy government influence. Obtaining FDI by geopolitical interests rather than general consensus. Explaining why powerful, surrounding countries as Russia, China and Iran the last years have made large inroads to Tajikistan.

A sign of openness for FDI is the emergence of a "single-business" registration system in 2009. This system assists both domestic and foreign firms in starting businesses in Tajikistan. Investors pay a fee to the Tax Committee which responds within five days. This reduces excessive red tape and

bureaucracy for risk averse investors while increases transparency. Other measures such as improving minority shareholders rights has improved Tajikistan’s ranking in the World Banks “Doing Business” chart, elevating from 152 in 2011 to 147 in 2012.

Figure 4.5 [Doing Business Ranking]

2008	2009	2010	2011	2012
153	159	152	152	147

However in other areas the conditions have stalled or in some cases even declined. One example is the forcible payments by locals workers for the construction of the Roghun Dam as previously mentioned. Furthermore by the poor services offered by the official state sponsored investment promotion agency, SCISPM. Companies still endure time-consuming processes involving several state agencies rather than only one agency. Undermining the aim of the SCISPM. In addition there still aren’t any proper criteria’s which the agency works from and monitor the different incoming proposals. Worse, there have been very little if any marketing concerning firms and sectors that might be potentially suited in Tajikistan. The research remains underdeveloped and there hasn’t been any systematic and structured way of obtaining this targeted information.

Also the privatization process has only been conducted to smaller firms. Large enterprises are still monopolies and closely affiliated with the governing elite. There are by law no limits on foreign participation but nontransparent decisions make the conditions unfavorable for foreign investors’ vis-à-vis powerful state shareholders, deterring FDI. (USDS) Shortcomings are lack of marketing prior to the investments and not knowing who the real decision makers are in different businesses, resulting in mistrust. (WB: 68)

Officially there is no discrimination towards foreign investors in Tajikistan but due to the corrupt environment and the suspicious attitude retained from the Soviet legacy, tax officials often act aggressively towards foreign investors profiting “excessive”. Hence, punishing the best performing in an unfair way. Thus, inducing foreign investors preferring joint ventures or collaboration with the governing elite.

The suspicious trait against foreigners makes the government especially reluctant offering foreign investors contracts concerning developing natural resource fields. Often everything below ground is considered state property. But efforts have been made to opening up this “secrecy” and offering the chance to develop mine fields for example. Further there are ongoing talks about inaugurating Free

Trade Zones. These FTZs would offer great tax and custom reductions. The inauguration is underway and the current decrees for minimum investments for different sectors are: manufacturing \$500 000, trading \$50 000 and services \$10 000. The zones will be located close to border areas, more convenient for trade. (USDS)

Obtaining credit is dire. Rates are high, starting from 25% along with excessive restrictions. Together with high inflation “forces” foreign firms to look abroad than relying on Tajik credit for FDI. The undeveloped banking sector generally has good standards and laws but are often not followed or enforced. Further many of the large banks have too many underperforming credits and the absence of a functioning securities market makes credits very unreliable and vulnerable. (WB:7)

FDI in Tajikistan for the first three quarters of 2009 by **country and sector**:

Figure 4.6

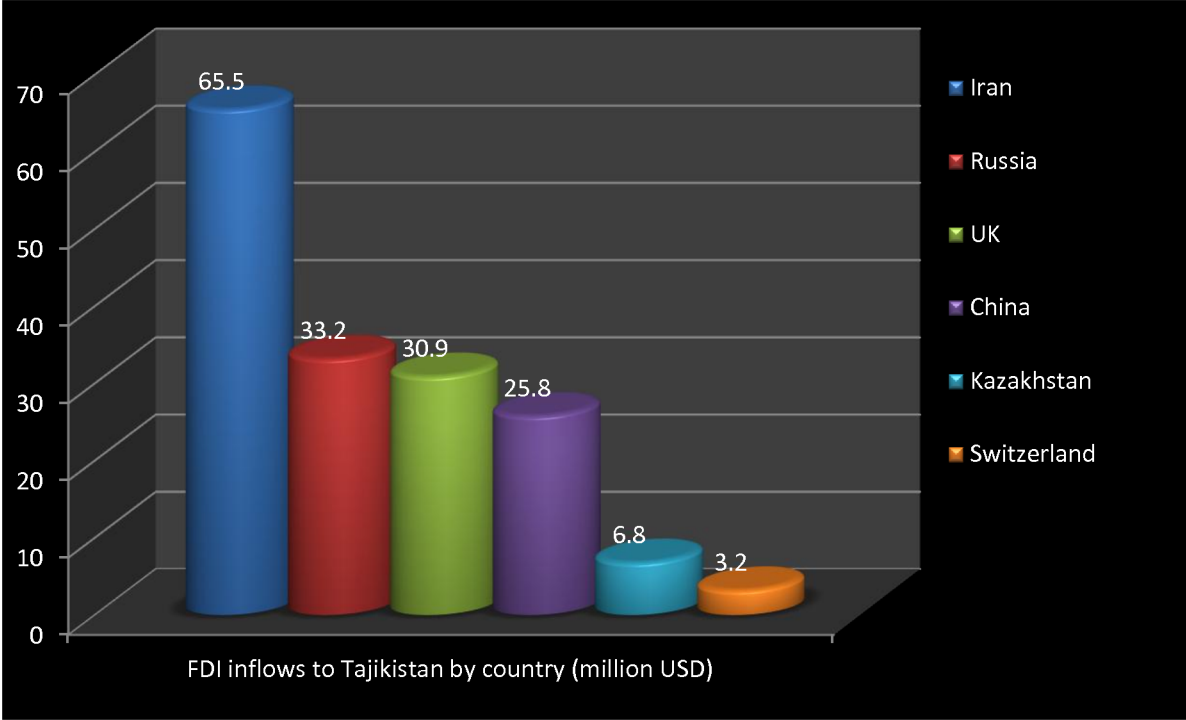
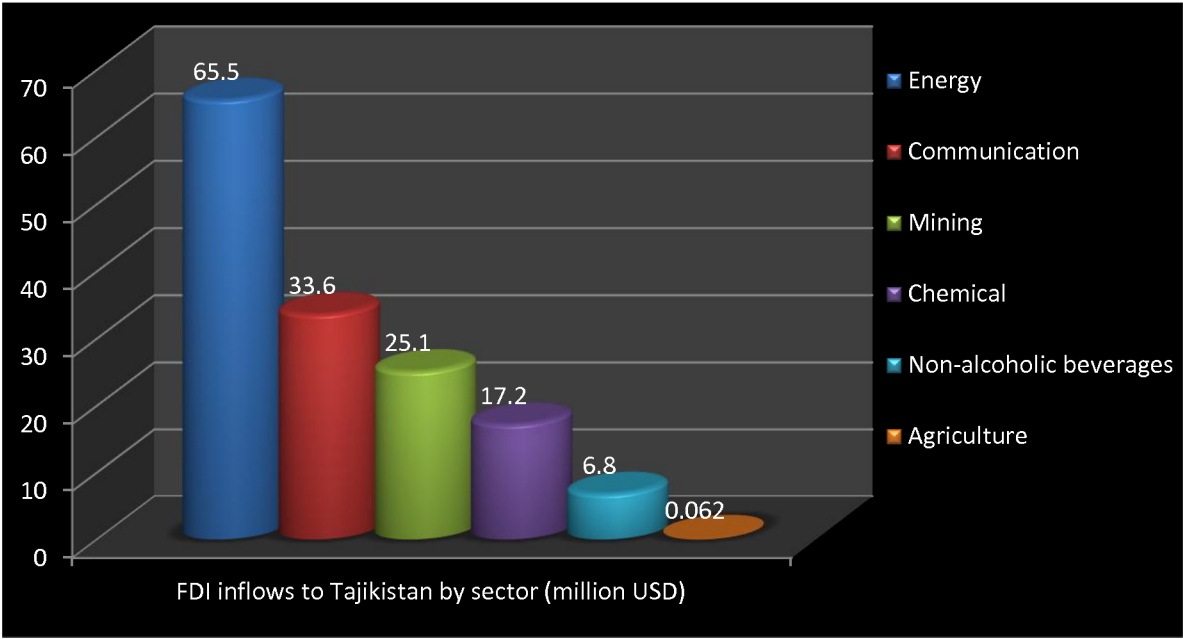


Figure 4.7



Important note, these stats do not include state-led investments such as Chinese-financed transport projects and Iranian hydropower stations.

4.3 Effects

Mostly, the FDI in Central Asia is invested into natural resource sectors. In Kazakhstan, Turkmenistan and Uzbekistan it's almost entirely devoted to the oil & gas sector. In Tajikistan, as the investment figures shows, it's also the energy sector, albeit hydropower, which is the most attractive sector.

"FDI projects in extractive industries are very narrow in the scope of activity, thereby limiting economic spillovers and the transfer of skill to local residents and yielding few welfare multipliers. Further, the concentrated investments reflect the commercial opportunities in the natural resources sector, but indicate little intent to develop the Central Asian economies' human resources or confidence in the business climate". (Universal)

This together with government involvement and distortion makes the investments nowhere near what the spillovers otherwise could've been. Further, this wretched transmission for investments creates a missed opportunity for sustainable development. For not slipping into the natural resource curse there needs to be guaranteed enforcements of laws concerning natural resource endowments and extraction together with fair agreements for the actors involved.

For example, Kazakhstan recently transferred the oversight and control of the country's mineral and subsoil resources from a central state organ to more specific organs devoted their specific missions. Together with introducing reforms by strengthening law enforcement contracts and opening up for FDI created a surge in investments from abroad. This is needed for introducing new technologies and further absorbing the new technological knowhow and spillover from the FDI.

By understanding the importance of FDI the Tajik government has focused on this area as a key area for economic development. Albeit behind the hopeful and optimistic agendas and goals during the last decades one would've expected more positive effects from the FDI than it has generated. This has largely to do with the fact that the investments have been limited to the primary sector which hasn't allowed significant effect of any transfer of spillover. Gains have been few and mostly consisted of little monetary increases for the host country.

“Over the past twenty years, FDI's track record in Central Asia illustrates the need to strengthen good governance, transparency, stability and the fair application of the rule of law. Only with these political-structural components satisfied will the long-term benefits of FDI be realized and the peoples of Central Asia will reap the benefits of a free and open market”. (Universal)

4.3.1 Example: The Textile Sector

When still incorporated into Soviet the textile industry was thriving in today's Tajikistan. But due to the civil war it crippled the industry. But slowly it's propping up again. Most of the cotton exported is not processed inside Tajikistan, leaving plenty of room for vertical integration development. Tajikistan suffers from unfavorable infrastructure and geographical conditions such as; unnecessary checkpoints, bribery, mountainous landscape, the northern area of Fergana valley is cut off winter time due to mountain ranges. Also the Anzob tunnel which connects the northern with the southern part of the country is blocked due to flood, heavy snowfalls, avalanches instead traders are required using very expensive and delayed routes through Uzbekistan. Consequently implying that it's much more economic favorable with a domestic vertical integration of the textile industry.

This integration would reap the benefits of cheap labor in Tajikistan and higher tax revenues for the state. Lately China's dominance in the textile industry shows that countries processing the whole vertical integration domestically are more resistant against competition and price shifts than countries without. Today there are several investors in Tajikistan. Giavoni, an American-Tajik joint venture, has opened their third plant in northern Tajikistan, almost fully vertically integrated and employing more than 3000 workers. (WB: 74-76) The conditions for the textile industry in Tajikistan

are very promising; large production of cotton and cheap labor mostly concentrated in a industrial base in the Fergana Valley.

Obstacles are that their fellow Uzbek rivals are subsidized by their government which provides them an advantage and that contracts between cotton producers and garment producers in Tajikistan are set by fixed prices updated every three months. The contracts scare away many foreign investors by not being up to date and accurate.

By liberalizing foreign investors would come across Tajikistan as a more suitable location for their textile industry. (WB: 77-78) Other areas for improvement are the labor force productivity which is below competing countries such as Chinas. This can be increased by importing or building new machineries and by raising the laborers competencies through education. There has been an institute put up in Khujand, the second largest city, in the Fergana Valley to increase the labor productivity and to improve the managerial capabilities of future executives. Subsequently for attracting foreign investors there need to be less power shortages. It hurts the industry and is a big disadvantage.

Another disadvantage the Tajik textile industry has compared to neighboring countries or vis-à-vis domestic sectors is that it has no business association representing it. The lack of business association makes communication, coordination between the sector and the government suffers. A business association could be beneficial so that managers from the textile industry can monitor and follow the latest changes in issues concerning their industry for best development. Also guaranteeing less misunderstanding between the two parts. Briefly the textile industry is largely underdeveloped in Tajikistan but has a great potential if directed right.

5. Summary and Conclusion

It's the overall economic situation which decided how attractive Tajikistan is for FDI. This can explain the volatile and non-sustainable progress of FDI in Tajikistan. With sustainable growth and improving macroeconomic indicators the country would be a much more attractive place for foreign investors. Tajikistan has been very encouraging in understanding the role of the FDI for spurring economic development. Big words and large agendas have been put to pen. These efforts resemble more good thoughts than wholeheartedly efforts. Also the follow-up hasn't been promising. An investment promotion agency has been set up but rarely achieving its purpose. There is still heaps of time-consuming, unnecessary bureaucracy, government manipulated decision-making and suspicious attitude towards foreign investors. This sheds light on the "openness" and on how foreign investors are welcomed. However efforts such as easiness of starting a business, one-stop-shop procedure of FDI, streamlining taxes and strengthening legislations for FDI have all improved Tajikistan's FDI climate. Investments have increased since the 1990's and regional cooperation has increased.

Another aspect is in which sector the government wants the FDI. The government is very keen on promoting the energy sector, particularly hydropower the crown jewel of the country's natural recourses. However, lacking common strategy in finding potential investors and screening the home market for potential contributors. Thus matchmaking is inevident. Forcing MNCs carry a heavy burden for market research. Explaining why countries like Iran, Russia and China obtain large multibillion deals closely affiliated with government officials.

Tajikistan shouldn't only focus on attracting FDI. More focus is needed on how to keep the FDI and absorb the spillovers in best way. This by examining the current and future FDIs by solid following-up. Improve the current FDIs condition to be able to reap future FDI. Learning by doing. Additionally, to best benefit the spillovers and linkages. Tajikistan is in great need of spillovers. Mismanagement sees spillovers being wasted into extractive industries in the natural recourse sector. The few positive spillovers hardly benefits Tajikistan more than a monetary surplus. Instead the FDI should be integrated into the Tajik economy for spurring the domestic market. New technologies, know-how and other spillovers could be a catalyst if integrated and absorbed. Not through the newly introduced and remote EPZs. These won't be able to improve Tajik economy more than an eye catching brochure for foreign investors. Instead, like the garment industry, tightly stitched with Tajik firms for best possible spillover and benefits absorption. Consequently Tajiks, themselves can create similar firms which in turn make the market more competitive.

Despite a first tumultuous decade with independence and civil war Tajikistan has thereafter been successful in bringing political and economic stability. There have been promising efforts in developing the economic climate of the country. The importance of FDI has been understood and strategies have been set in place in order to attract it. But behind these agendas and strategies there are issues like poor judiciary and infrastructure, nepotism, corruption which doesn't let Tajikistan to take advantage of its resources in attracting FDI. The overall economy which is the single most important factor in attracting FDI have slowed down or in some cases stalled, thus hurting FDI in Tajikistan. There is a gap in what the country has set for goals for the general economy and FDI to what it has achieved.

Thus, the FDI prospects are overshadowed by Tajikistan's overall business climate. This has to raise awareness among Tajik officials in trying to market the benefits of investing in Tajikistan and to fill gaps of eventual misconceptions about the country. With all due respect Tajikistan is one of the most remote, smaller and unknown countries of the world.

Hence, reforms are needed for attracting more FDI to improve the country's economic situation and thus reaching their long term strategic goals. But there needs to be more hard fought efforts and work than just words or thoughts. As well as evaluation afterwards for decisive and sustainable results. Make-up reforms can't change Tajikistan gloomy conditions. Only strategic and enduring endeavor will improve Tajikistan's economy. With great untapped potentials in natural resources, labor force, history and proximity to regional powers this can set the stage for an economic surge in the coming decades for Tajikistan.

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