



Business Environment in Tajikistan as Seen by Small and Medium Enterprises

December 2009

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IFC Business Enabling Environment Project
7, Abdullo Komandir Street
Dushanbe, 734001 Tajikistan
www.ifc.org/tajikistan/sme

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FOREWORD AND ACKNOWLEDGEMENTS

IFC, with the support of the Swiss State Secretariat for Economic Affairs (SECO) and the Department for International Development of the United Kingdom (DFID), presents the results of the 3rd survey of the business environment in Tajikistan. The survey has been undertaken by IFC's Tajikistan Business Enabling Environment Project. The objective of this survey was to assess the existing conditions for doing business in Tajikistan in 2007 and to develop recommendations for improving them.

This report is based on the results of a survey of managers of about 1,500 small and medium enterprises (SMEs), conducted in July – October 2008, representing all regions and four key sectors of the economy. Besides small and medium companies, the survey also included the sub-populations of individual entrepreneurs and dehqan farms in Tajikistan. Detailed information on the realities of the business enabling environment that are faced by these three segments of the population is presented here; it is hoped that the empirical data from this survey will be used by various stakeholders to stimulate the business environment and make administrative procedures more efficient and transparent.

During the six years since its launch, the IFC Tajikistan Business Enabling Environment Project has benefited from close interaction with many public and private institutions operating in Tajikistan, as well as a number of international organizations. The project would like to thank the government of Tajikistan, with whom the project signed a Memorandum of Understanding most recently in November 2006. The project would also like to extend gratitude to the Executive Unit under the Office of the President of Tajikistan and the State Committee on Investment and State Property Management, with which it developed a longstanding relationship, and to the Tax Committee, which has been a vital partner during the most recent phases of the project's work.

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IFC SURVEY OF THE BUSINESS ENVIRONMENT IN TAJIKISTAN AS SEEN BY SMEs

Executive Summary

The IFC SME Survey seeks to identify exactly what barriers Tajik small and medium enterprises (SMEs) encounter, in an effort to identify which reforms are most urgent. In this survey, IFC has collected and analyzed the views of 1,500 Tajik SMEs on a number of administrative procedures which they encountered either in establishing or running their businesses in 2007.¹ This report is a follow-up to the first and second surveys of the business environment in Tajikistan conducted by IFC in 2003 and 2006.

The survey collects data on the business environment as seen by respondents from a nationally representative sample of businesses. This report presents the survey findings and incorporates background information on the policy, legal and regulatory frameworks currently in place. Included in the report are recommendations to policymakers, based on analysis of both the regulatory framework and the survey results.

The IFC SME Survey results presented here show several improvements since 2002 in the business environment facing SMEs in Tajikistan, particularly in the frequency of inspections, the time to register a business, and the validity period of the average license.² Implementation of the 2006 Inspections Law saved the SME sector in Tajikistan a total of \$9.3 million over a one-year period.³ This is a strong positive result from legal reform and the government's implementation efforts in inspections.

Other administrative procedures are also ripe for reform and can yield economic benefits in reduced administrative costs for businesses. The average small and medium company in Tajikistan spends 26.7% of profits on the four most common administrative procedures, considering only direct costs (see table 1). This translates to \$18.2 million in direct costs for small and medium companies and for individual entrepreneurs of licensing, permits, certificates, and inspections.⁴ This figure should be seen as only part of the cost of regulation in Tajikistan for individual entrepreneurs and small and medium companies. It excludes, for example, the preparation and filing of tax returns. Also, the analysis above does not consider the amount of employee time dedicated to each procedure or the value of lost profits when a firm remains idle on account of the procedure. Cutting the time and cost of administrative procedures can translate to a direct monetary benefit for firms.

Table 1 - Direct costs of four common administrative procedures impose total burden equal to 26.7% of profits for the average small and medium company

	Licensing	Permits	Inspections	Certification	Total
Individual entrepreneur	1.3%	0.8%	1.2%	0.8%	4.2%
Small and medium company	4.0%	6.2%	10.5%	6.1%	26.7%

Box 1 presents a high-level overview of the main findings of the survey. In many ways, the business environment for small and medium companies, who operate at the larger end of the SME spectrum, remains challenging.

¹ Because 2007 is the reference period for the survey, all calculations of survey findings in dollar figures in this report are performed using the exchange rate as of January 1, 2008, which was 1 USD = 3.465 Tajik somoni.

² The disproportionate impact of regulatory compliance costs on SMEs has been repeatedly documented. See for example, "Policy Framework Paper on Business Licensing Reform and Simplification." The World Bank Group's Investment Climate Advisory Service. 2009.

³ Analysis of survey data and official statistics of direct costs of inspections (official and unofficial payments), but also the indirect costs (labor costs and lost profits). See Chapter 6 for details.

⁴ In several cases, survey data on dehqan farms was too limited to allow for the analysis in tables 0.1 and 0.2, thus dehqan farms have been excluded in this discussion.

Data from the State Statistics Committee indicates very limited growth in their numbers, compared to high growth in the rest of the SME sector (individual entrepreneurs and dehkan farms).

The increase in numbers of businesses in the SME sector is driven by dehkan farms and individual entrepreneurs. From 2002 to 2007, the number of dehkan farms increased by about 16% a year, and the number of individual entrepreneurs increased by 10% a year.

Small and medium companies, by contrast, grew at only 5% a year during this period, and in 2007 represented 5% of all businesses. According to the State Statistics Committee, there were just 334 more small and medium companies registered in Tajikistan at the start of 2008 than at the start of 2006.

Box 1 - The Big Picture: High-Level Findings from the IFC SME Survey

- Individual entrepreneurship is an increasingly popular form for SMEs, and relatively few of them transition to become legal entities (small and medium companies). Small and medium companies face a significantly more difficult regulatory environment.
- Women run 36% of individual entrepreneurs and 16% of small and medium companies. Women are among the owners of just over half of these firms. Only 9% of dehkan farms are run by women, although half of dehkan farm employees are women.
- Investment in fixed assets has fallen among all categories of SMEs since 2002.
- SMEs spent more money on registration in 2007 than in 2005, even though no legal or regulatory changes explain the increase. Registration costs show wide variation among regions of Tajikistan, again with no legal basis.
- Implementation of the 2004 Licensing Law has led to some improvements, most notably an increase in the average validity of an issued license. However, licensing is still a lengthy and expensive process for the small and medium companies who must obtain licenses.
- Permits show many of the same trends as licenses since 2005 in terms of direct and indirect costs, perhaps due to spillover effects from the licensing reform.
- Relatively few Tajik SMEs have a bank account or loan. SMEs overwhelmingly cite unfavorable interest rates as the reason they don't apply for financing.
- The 2006 Inspections Law and its implementation resulted in annual savings to the Tajik SME sector of \$9.3 million, reflecting savings to individual entrepreneurs and dehkan farms offset by an increase in costs to small and medium companies.
- The tax regime for SMEs is complicated, requiring businesses to make five to ten visits each year to the tax authorities. The average small and medium company spent more than three weeks on the process of filing and paying taxes in 2007.
- Import and export procedures are too complicated for most SMEs. Only 24% of small and medium companies import goods, and fewer than 3% export. The figures for individual entrepreneurs and dehkan farms are much smaller.
- More SMEs needed to obtain compulsory certificates in 2007 than in 2005, although the process was less time-consuming.
- For virtually all procedures, SMEs report making unofficial payments less often than in 2005 or 2002. However, Tajikistan still has the highest frequency of informal gifts requested from firms by government officials in the entire Eastern Europe and Central Asia region.

The dynamic growth in individual entrepreneurs, both in terms of number of entrepreneurs and their average revenue, coupled with the low growth of small and medium companies, indicate that the tax system and regulatory regime are not designed and implemented in a way that encourages “graduation” from individual entrepreneurship to legal entity status.

It is vital that policymakers take steps to improve the business environment for small and medium companies, who should represent the backbone of the economy. Indeed, as the average small and medium company is more than twice as likely to invest in fixed assets than the average individual entrepreneur, hires seven times as many employees and contributes significantly more tax revenues, the business environment should encourage its development.

Many administrative procedures are less common in 2007 than in 2005

In a well-functioning regulatory system, regulators maximize state resources and increase effectiveness by focusing their efforts on “high-risk” businesses, rather than requiring all businesses to go through every procedure every year.

For example, inspectors do not need to visit every business every year. They should focus on those most likely to violate health and safety regulations, and on those who are most likely to create serious harm to public health and welfare by non-compliant actions. Permits and licenses, two complementary forms of state control over economic activity, can often be issued for a several year period, rather than requiring businesses to renew their permits and licenses annually.

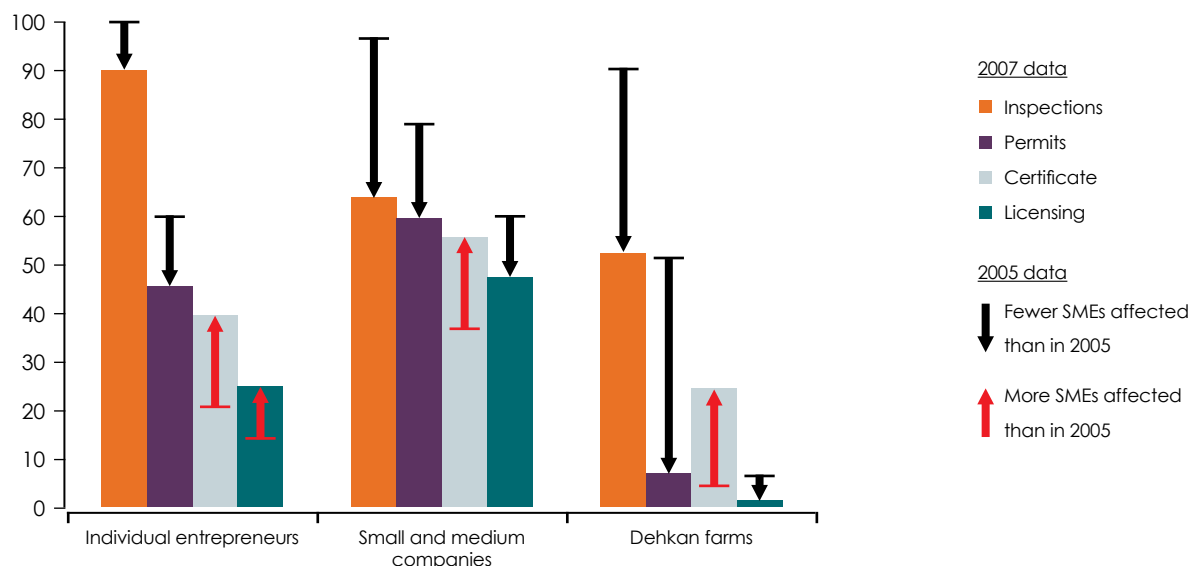
IFC SME Survey results reveal significant improvement in the prevalence of some administrative procedures from 2005 to 2007 (see chart 1). Far fewer SMEs were inspected in 2007 than in 2005, reflecting intense implementation efforts related to the 2006 Inspections Law. The percentage of SMEs who report obtaining a permit also dropped significantly, particularly for dehkan farms.

The government of Tajikistan undertook comprehensive reform of the licensing regime with the 2004 Licensing Law, and fewer small and medium companies and dehkan farms report obtaining a license in 2007 than in 2005. However, progress is mixed, as individual entrepreneurs are now almost twice as likely to need a license.

Unfortunately, across the SME sector, businesses are much more likely to have obtained a compulsory certificate in 2007 than in 2005. Compulsory certificates vary by sector of economic activity, such as veterinary or quarantine certificates from the Sanitary and Epidemiological Service for livestock owners, certificates of origin from the Chamber of Commerce and Industry for exporters, or cotton certificates from TajikStandart for cotton exporters. The certification process often imposes a significant burden on SMEs without producing commensurate benefits.

Chart 1 – Fewer firms were affected by inspections and permits in 2007 than in 2005, but compulsory certification became more common

Percentage of firms who underwent selected procedures in 2007 vs. 2005

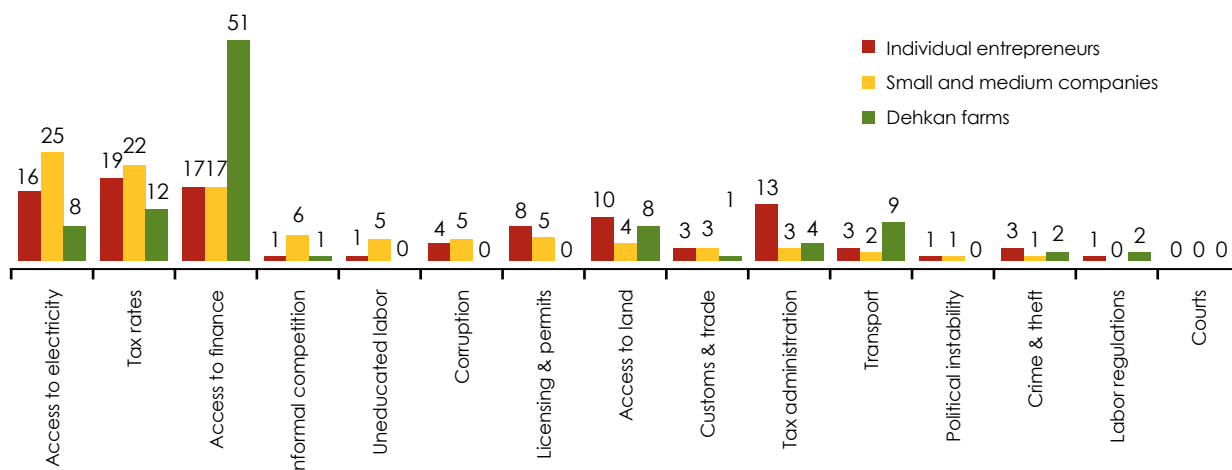


SMEs identify their biggest challenges in running their businesses

To put the different aspects of the business environment in context, the IFC SME Survey asked respondents to identify the single biggest obstacle faced by their business. As the chart below shows, access to finance, tax rates, and access to electricity are the leading obstacles cited by SMEs.

Chart 2 - SMEs identify access to electricity, tax rates, and access to finance as the major obstacles in Tajikistan's business environment

% of survey respondents identifying each of the following as the single biggest obstacle they face



The different members of the SME sector choose different challenges as their most pressing issue. Access to finance is clearly the most important obstacle for dehkan farms. Access to electricity is the major constraint for 1 in 4 small and medium companies. High tax rates are the number one challenge cited by individual entrepreneurs.

Key Recommendations

One purpose of the IFC SME Survey is to identify exactly which areas to reform to lower the regulatory burden, helping Tajik policymakers to establish priorities to encourage entrepreneurs to start new legal entities or grow existing businesses. Development of new legal entities and expansion of existing businesses promotes job creation and poverty reduction. The Survey data provides the foundation for identification of reforms that can most impact the costs of administrative procedures for business. This report puts such reforms in the context of the Tajikistan country situation, including reform efforts already underway or recommended.

The government is building on earlier comprehensive reforms of licensing and inspections by expanding its reform program in 2009 to address business registration, customs reform, tax administration, and permits reform. Other substantial reforms, not within the scope of this survey report, have taken place or are underway in areas as diverse as agricultural policy, land reform, and corporate governance.

The table below summarizes the key recommendations on the topics covered in the IFC SME Survey. Recommendations are covered in detail in each chapter.

Table 2 - IFC key recommendations highlight further transparency in processes, simplification of steps, and full implementation of relevant laws

Registration	
1.	Implement the one-stop shop with a vision for additional reform beyond initial simplification.
2.	Extend the deadline for re-registration of existing businesses, or better, remove this requirement entirely.
3.	Eliminate unnecessary steps in the registration process, which create additional burdens on entrepreneurs without leading to economic benefits.
Licensing	
1.	Look for opportunities to further reduce the number of activities subject to licensing by excluding activities that present limited risk to public safety and health, such as tourism, real estate valuation, cargo transportation, and patent attorneys' activities.
2.	Increase transparency in and simplify the licensing issuance procedure, by: publishing licensing requirements and calculation of licensing fees; introducing, where appropriate, the "silence is consent" and "self-certification" principles via legal amendments; and amending the 2004 Law on Licensing to list the specific reasons for which license applications may be rejected or license revoked.
3.	Extend license validity to an unlimited period, unless periodic review of the license holder's qualifications is necessary.
Permits	
1.	Develop a comprehensive inventory of all permits currently being issued, to guide reform efforts. Work with the private sector to identify which specific permits are the most troublesome.
2.	Eliminate duplicative and unnecessary permits through a "guillotine" process.
3.	Adopt a Law on Permits to clarify and streamline the application and issuance processes of new permits.
Access to Finance	
1.	Implement the recommendations of the Financial Sector Assessment Program.
2.	Encourage private investors to develop a private credit bureau.
3.	Train lawyers and judges on collateral requirements and on their role in the enforcement of loan and lease agreements. It is essential that lenders have confidence in the legal system's ability to enforce loan and lease agreements, otherwise improvements in collateral registries may not translate into increased lending.

4. Improve the legal framework governing the pledge of land use certificates to enable better their use as collateral. Publicize the property registry at the Ministry of Justice among lenders and potential borrowers.

Inspections

1. Inspectorates should come into full compliance with the 2006 Inspections Law requirements by using checklists; sending advance notice to businesses; developing risk categories and risk based inspections procedures; and establishing a suitable record-keeping function to keep track of inspections which have been carried out and their results.
2. The government of Tajikistan should: assist entrepreneurs in the fulfillment of their responsibilities under the Inspections Law; assist inspectorates in the fulfillment of their responsibilities under the Inspections Law; and enforce compliance with the Inspections Law.

Taxation

1. Consider elimination of the road user's tax, which is inherently regressive and disproportionately burdens businesses with a low profit margin.
2. Elaborate and publicize clear rules about the personal income tax for dehkan farmers.
3. Consider whether decreasing the rate of the social tax may be possible without jeopardizing government revenues. The fairly high rate of the social tax encourages tax evasion and may inhibit job creation in the formal sector.
4. Undertake a legal review of the Tax Code in order to reduce ambiguous sections and to limit scope for interpretation. Limit the frequency of amendments to tax legislation to an annual basis, in order to provide a longer-term time horizon for business planning purposes.
5. Provide compliance relief to taxpayers by reducing the number of filings per year per tax, and by simplifying the forms used to file. Filings should ideally only be required annually or, in the instance of VAT, quarterly. Payments ought to be allowed more frequently, to allow businesses to manage their expenses.
6. Review the various simplified regimes with a view to further simplifying the current structure and better aligning the simplified regimes with the general tax regime. The goal should be to facilitate "graduation" of businesses from individual entrepreneurship to legal entity status.

Foreign Trade and Technical Regulation

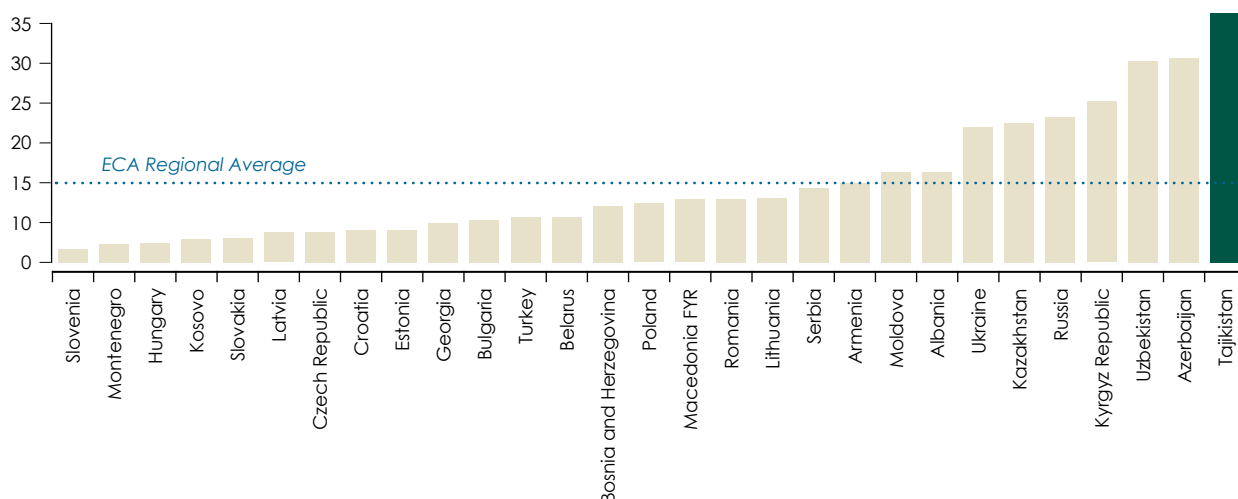
1. Simplify export and import procedures in keeping with the Single Administrative Document and Single Window for customs procedures.
2. Create a "single window" for customs procedures, based on the concept paper developed by government.
3. Implement customs-bonded warehousing. Customs bonded warehouses can be used effectively to allow traders to defer payment of duty/tax on specified goods while they are in storage.
4. Employ consistent valuation methods and other procedures at different border points in Tajikistan. Create a Valuation Dispute Resolution Administrative Tribunal to handle disputes on valuation methods during import.
5. Improve transparency and data exchange by moving to an electronic trade declaration system, using ASYCUDA or another system. Host all data and processing at the Customs Service headquarters, rather than regional offices, to reduce costs and prevent duplication of technical infrastructure.
6. Make certification optional for low risk categories of goods and all services.
7. Develop a roadmap for comprehensive reform of Tajikistan's technical regulation system and TajikStandart. Reform should bring Tajikistan into compliance with WTO requirements. It should also pave the way for other conformity assessment bodies to enter the market.
8. Ensure that mandatory technical regulations, as well as voluntary standards, are in conformity with international standards usually issued by multilateral technical organizations whenever possible.

Unofficial payments, despite improvement, remain high by regional standards

Chapters 2 through 8 will show improvement on many survey questions related to informal payments from 2002 to 2005 to 2007. In other words, Tajik SMEs report being asked for or expected to pay bribes or give gifts in 2007 less often than before. While this is a welcome development, it is too early to conclude that unofficial payments are no longer a problem. Survey data show that 21% of small and medium companies identify corruption as a major obstacle to the operation of their business (only tax rates are identified as a major obstacle more often).

Data from the World Bank’s Enterprise Surveys confirm that corruption is still a major constraint for private businesses in Tajikistan, as demonstrated by the highest frequency of informal gifts requested from firms by government officials (graft index) in the entire Eastern Europe and Central Asia (ECA) region. The Graft Index is the proportion of instances in which firms were either expected or requested to pay a gift or informal payment over the number of total solicitations for public services, licenses or permits for that country.⁵

Chart 3 - Tajikistan has the highest graft index in Europe and Central Asia (ECA)



Data from Enterprise Surveys, here and throughout the report, are presented to allow readers to put the IFC SME Survey data into a regional context.

Likely effects of the global economic crisis

The IFC SME Survey was conducted in July – October 2008, and it asked respondents about the calendar year 2007. The global economic crisis arrived in Tajikistan in late 2008, and thus its effects are not recorded in this survey report. The crisis is likely to produce diverse and generally negative effects on the business environment for SMEs.

It is already clear that remittances for the year 2009 will be substantially lower than in prior years, affecting an important source of funding for both consumer spending and small business investment. Access to finance is likely to become an even higher priority for SMEs, just as domestic banks find it yet more difficult to expand their own sources of financing. The tax authorities are under increasing pressure to deliver revenues into the state budget, even as businesses are themselves finding it hard to stay afloat in the wake of falling demand.

⁵ The Graft Index is defined in Gonzalez, Alvaro S., Ernesto Lopez-Cordova, J. and E. Valladares, Elio, The Incidence of Graft on Developing-Country Firms. World Bank Policy Research Working Paper Series, 2007. The ECA countries were all surveyed in either 2008 or 2009.

If there is a silver lining, it is that tough economic times often generate a tremendous amount of entrepreneurial innovation. Crises also present governments with a window for reform, as constituents look to their leaders to respond decisively to the challenging external environment. The 200 Days of Reform program, launched by the government of Tajikistan in July 2009, is an attempt to sustain and even increase the momentum of reforms that will benefit Tajikistan's private sector. Full implementation of investment climate reforms is one way to help the Tajik economy grow its way out of the global crisis.

Organization of the rest of the report

The SME Overview chapter paints a general picture of Tajikistan's macroeconomic situation, as well as providing a data-driven description of each of the three categories of SMEs in the survey: individual entrepreneurs, small and medium companies, and dehkan farms. Chapters 2 through 8 provide an in-depth look at survey findings on a variety of key topics, and each chapter begins with an explanation of the legal and regulatory framework of the topic. Chapter 9 provides an overview of the survey methodology, and the Methodology Annex that follows presents more detailed information. Finally, the report also has a Survey Data Annex which presents additional findings graphically.



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Tajikistan Business Enabling Environment Project

Abdullo Komandir str. 7
Dushanbe, Tajikistan 734 001
Tel.: (992 48) 701 14 40
Fax: (992 48) 701 14 48

www.ifc.org/tajikistan/sme

