

Economic Reforms in Uzbekistan: Achievements, Problems, Perspectives**Gabborov Otabek**

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Annotation: Significant changes have taken place since the independence of the Republic of Uzbekistan. There have also been serious formal and informal barriers to the free movement of people and capital across borders. All this has deprived Uzbekistan of the opportunity to fully participate in the international division of labor and to establish competitive industries.

Keywords: Achievements, problems, perspectives, Economic Security, Information Security, Bank of Uzbekistan, Banking System.

Introduction

The Uzbek economic model. As an independent state, Uzbekistan appeared on the world map in 1991. The country launched reforms that were supposed to create a base for running a market economy. In 1996, however the course of the economy was radically shifted towards intensification of state intervention in the economy and the implementation of an import substitution policy. To accelerate industrial development, the state redistributed huge flows of material, financial, monetary and labour resources through:

- Direct allocation of resources, administrative regulation of commodity prices, interest rates and exchange rates;
- High taxes and government expenditures;
- Restricted access to the official exchange rate which is beneficial for currency buyers (usually two to three times different from the market rate);
- Establishment of artificial monopolies by limiting the access to markets for new players and provision of tax, credit and other benefits to certain enterprises or groups of enterprises;
- Direct ('manual') business management; and
- Limitation of imports by tariff and non-tariff barriers.

Table 1. GDP per capita, in USD, nominal growth

	1995	2018	Growth		1995	2018	Growth
China	610	9771	16,0	Moldova	477	3227	6,8
Azerbaijan	397	4721	11,9	Mongolia	632	4122	6,5
Vietnam	277	2567	9,3	India	374	2010	5,4
Armenia	456	4212	9,2	Belarus	1371	6290	4,6
Lithuania	2169	19153	8,8	Russia	2666	11289	4,2

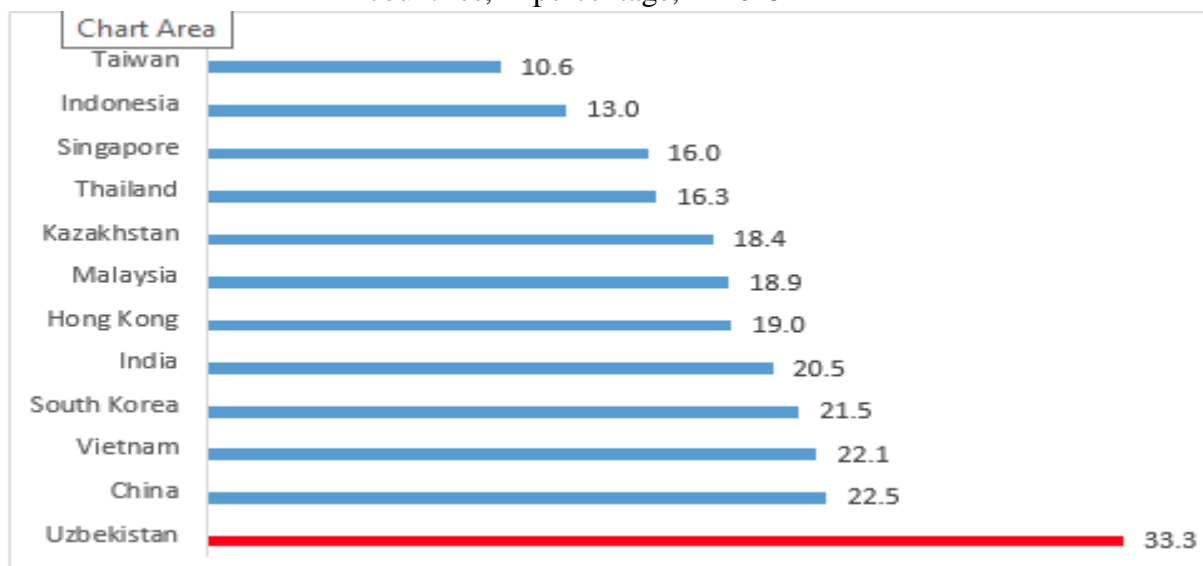
Georgia	578	4717	8,2	Tajikistan	214	827	3,9
Latvia	2322	17861	7,7	Kyrgyzstan	364	1281	3,5
Kazakhstan	1288	9813	7,6	Ukraine	936	3095	3,3
Estonia	3131	23266	7,4	Uzbekistan	586	1532	2,6

Due to the policies pursued, market reforms were curtailed and market mechanisms were partially replaced by command and administrative regulation. Limited competition, high business costs, and insecurity of property rights and deals hampered the creation of competitive manufacturing and other businesses. The incredibly large benefits and high level of monopolism stimulated corruption, rapid unearned incomes and the export of monetary capital.

The artificial cheapening of capital (conversions at the lucrative official exchange rate, cheap loans, and tax exemptions) and expensive labour (due to high payroll taxes) led to utilisation of capital-intensive industries instead of labour-intensive ones, which, amongst other factors, contributed to extremely low employment in the formal sector. As the results of a sociological survey conducted in the summer of 2018 showed (no earlier data is available), with about 18.8 million people employed, employment in the official sector of the economy amounted to 5.3 million people (less than 30 per cent of the workforce), while in the informal sector – also about 5.3 million people (including 1.6 million employed in temporary one-off and seasonal jobs), the number of external labour migrants exceeded 2.6 million people.

A very high level of direct government intervention in the economy has been established. The vast majority of large-scale enterprises and financial institutions are state-owned. Many enterprises are controlled by the state through controlling stakes or so-called ‘golden shares’. The scale of state ownership is impossible to estimate due to the lack of respective statistics, but according to some estimates it exceeds 50 per cent of the country’s total production assets. The state also owns more than 80 per cent of all the assets in the banking sector. At the end of 2018, the expenditures of the consolidated budget of Uzbekistan amounted to 35.2 per cent of GDP in 2018, and considering quasi-fiscal expenditures of state enterprises, the volume of state expenditures amounted to no less than 41.2 per cent of GDP. These two figures are one and half to two times higher than similar figures of successfully developing countries with comparable GDP per capita and even higher than analogous figures of some advanced countries in the world (see Figure 1).

Figure 1. Revenues of the state budget and extra-budgetary funds to the GDP of individual Asian countries, in percentage, in 2015



Time of reforms

Uzbekistan's economy needs fundamental, systemic and consistent reforms and the replacement of the entire system of public institutions. The key task is to create environment for normal operation of effective market mechanisms. Uzbekistan's economic reforms began after the assumption of power by the new president. The following reforms are most important ones from an economic perspective:

Unification of exchange rates, liberalisation of the foreign exchange market and introduction of conversion for current operations (summer – autumn 2017);

Removal of various administrative barriers to cross border flow of goods and people (primarily with the neighbours of Uzbekistan) and reduction of customs charges (2017-18);

Reforms of banking sector and money circulation (2017-18);

Radical tax reform (2019); and

Reduction of various administrative costs of doing business.

Several other important areas have already been outlined for reforms to be launched in 2020: administrative reform, agrarian reform, the restructuring and privatisation of state enterprises, a new stage of banking reform, and more. However, due to the COVID-19 pandemic, the timeframe and scope of these reforms became uncertain. Some of the reforms, both in progress and pending, are described below in more detail.

Liberalisation of foreign economic activity

Up to 2017, the government of Uzbekistan had been implementing the policy of active protectionism, by limiting imports through the absence of free conversion of the national currency, high customs charges and non-tariff barriers. In addition, there were significant formal and informal barriers to the free movement of people and capital across borders. All of this deprived Uzbekistan of opportunities to fully participate in the international division of labour and to establish competitive industries.

As already mentioned, in 2017-18 the government introduced free currency conversion for current transactions, removed a number of administrative barriers to the movement of goods and people and reduced customs charges, which constitute the most important achievements of reforms in Uzbekistan.

However, starting from December 2018, under pressure from industry lobbyists, the government started to restore to some extent the import substitution and protectionism policy: earlier reduced customs charges for a certain range of FEACN codes were increased and new non-tariff barriers to import were introduced. However, zero and low customs tariffs for some categories of goods are combined with rather high tariffs for other categories, which allows to keep the average customs tariff approximately at the level comparable to the average tariffs of the Eurasian Economic Union (EAEU) countries. As a result, in industries with high tariffs and non-tariff barriers, conditions are created for monopolisation of markets by particular companies.

In connection with the COVID-19 pandemic in the spring of 2020, customs charges on a range of essential goods were abolished, the government plans to reduce customs charges on goods for business as well. There is hope that once the pandemic is over, the tendency of liberalisation of foreign economic activity will continue. The government has announced its desire to join the World

Trade Organisation (WTO) as soon as possible. Joining the WTO will inevitably lead to the reduction of many tariff and non-tariff barriers to imports.

Reform of Banking Sector

Up to 2017, the bank-credit sector used to be one of the most regulated sectors of the Uzbek economy. Banks had no commercial independence, their activities, including the establishment of interest rates, were strictly regulated by the Central Bank and alternative credit institutions had very limited presence. The monetary system was fragmented and tight restrictions on cash circulation were in place, generating different values for different types of money.

The deregulation and commercialisation of Uzbekistan's banking sector have taken place over the recent years. The Central Bank has significantly reorganised its activities in terms of control and regulation of commercial banks, regulation of money circulation and currency market. The banks have become more client-oriented, the cost of the banking services significantly reduced, the quality improved and the range of services expanded. The administrative restrictions on the purchase of currency and cash turnover have been removed.

Nevertheless, more than 80 per cent of bank assets are still owned by the state, and the government is actively providing 'soft' and 'bad' loans (imposed by government agencies) through banks primarily to state enterprises. The credit sector competition is still underdeveloped, new players (both domestic and international) have limited access, and the non-banking sector is represented by only a small number of microfinance institutions and pawnshops.

However, the government declares its intention to denationalise the sector, to privatise some part of the assets of state banks, to cease the practice of concessional lending, to increase access of foreign banks to the sector. Several important reforms were planned to be carried out in 2020. However, the coronavirus pandemic is undermining these plans. Preservation of the practice of concessional lending, administrative interference in the issuance and prolongation of loans (which is often almost inevitable in the conditions of an acute economic crisis) is especially dangerous for the planned reforms.

Tax reform

The key problems of the tax system of Uzbekistan, formed in the previous two decades, were as follows:

The overall high tax burden on the economy (mentioned above), especially high payroll taxes, which is burdensome for business;

Very complicated taxation rules which increase the costs of tax administration and create unequal game rules for business (a large number of taxes, different taxation regimes, separate rules for calculating the same taxes for different categories of taxpayers, great deviation from international practice in determining the tax base, a huge number of exceptions, additional rules, benefits, including individual ones, when paying taxes);

Highly uneven distribution of the tax burden between the simplified and general taxation regimes (transition of an enterprise from the simplified to the general taxation regime increased the tax burden several times), as well as between different sectors of the economy; and

Broad application of taxes on gross revenues (turnover), which negatively affect the public division of labour and the formation of long value chains (as the goods move along the chain, the same value was taxed many times, and the longer the chain, the higher the tax burden). These problems became the key reasons for the low level of registered employment of the population, did not allow

to carry out deep processing of raw materials and to create competitive manufacturing by utilising the advantages of economies of scale and narrow specialisation, forced the business to go into the 'shadow economy', to split into parts, and destroyed the competitive environment.

On January 1st 2019, Uzbekistan launched a tax reform process, during which many of the above-mentioned problems were already addressed (partly or completely). The following achievements were particularly important:

Drastic reduction of taxation on labour (by one and half to two times);

Significant reduction of the tax burden on enterprises under the general taxation regime (the most important ones are the reduction of the VAT rate from 20 to 15 per cent, elimination of contributions to the State Targeted Funds from revenues – 3.2 per cent); Significant reduction in the sphere of influence of turnover taxes (before the reform these taxes were paid by almost all enterprises, now medium and large enterprises do not pay them at all, and small enterprises can choose between turnover tax and VAT); and Work has begun on eliminating a huge number of tax privileges and exemptions, equalising tax conditions for all parts of the economy.

Several mistakes in the preparation and initial phase of the reform were corrected by subsequent adjustments in the second half of 2019. In particular, VAT was reduced from 20 to 15 per cent, the refusal to provide tax benefits and exceptions began, and some mechanisms for paying VAT were improved. Nevertheless, relatively high tax administration costs and overall high level of redistribution of revenues through the budget and quasi-budget funds remain. Due to the coronavirus pandemic, some businesses have been given tax holidays and several inefficient budget and quasi-budget expenditures are being reduced. It is hoped that after the pandemic it will be possible to maintain some positive steps towards reducing state participation in the economy.

Administrative Reform

The existing model of state administration in Uzbekistan is characterised by excessive centralisation of decision making, underdevelopment of self-regulation institutions, which leads to 'manual management' of socio-economic and political processes in the country. There is a poor performance of checks and balances, as well as significant informal dependence of the legislative and judicial branches of government on the executive branch.

The main issue of state administration and economic policy in Uzbekistan is that the executive authorities continue to actively use administrative methods of management that are incompatible with the effective functioning of a market economy. Active government intervention is the main factor in high transaction costs for national business and the widespread corruption and, consequently, low competitiveness of domestic products. Accordingly, the main goal of administrative reform is a significant reduction of state participation, as well as modification of functions and methods of state regulation in the economy. Uzbekistan needs a fundamental administrative reform based on consideration of international experience and functional analysis that will result in:

Reconsideration and redistribution of the structure, tasks, functions and responsibilities of central authorities, as well as of administrative bodies at the sectoral level;

Reduction, simplification and optimisation of procedures for public service delivery;

reconsideration of the principles of social sector financing (combined with the reforms of education, health care and pension system);

Fundamental transformation of the public service system; and

Redistribution of functions, powers and financial resources between central and local governments. At the same time, it is necessary to conduct a fundamental reform of the local government itself, including addressing the issues of the separation of powers at the local level and increasing the responsibility of local authorities towards the population. Unfortunately, only some elements of administrative reform have been implemented in Uzbekistan so far. The coronavirus pandemic is inevitably introducing some adjustments into the government's plans to intensify the reforms in 2020.

Regulation of business, protection of property rights, development of competition The Uzbek leadership has done much in the last years for the improvement of business environment and reduction of transaction costs. This is mainly reflected in reduction of the tax, customs and administrative burden, simplification of procedures for export-import transactions and obtaining various permits, and the improvement of the money circulation system and the banking sector. At the same time, the regulatory and legal sphere continues to face many problems related to the lack of transparency, inconsistency and inefficiency of legislation, extremely ineffective judicial and legal protection of property and transactions, and lack of real separation of powers and checks and balances.

Another major issue associated with the imperfection of the regulatory and legal framework is the high level of market monopolisation and unequal business rules. Competition is destroyed by artificial barriers to market access for new enterprises, high tariff and non-tariff barriers to imports, and a wide range of individual and group (for example, for members of industry associations) privileges. Reforms have been extremely slow (mostly just plans for the time being) in the so-called 'natural monopolies' (energy, utilities, transport) and extractive industries sectors. State enterprises dominate and there is practically no competition. Meanwhile, healthy competitive environment can be successfully created in the majority of such industries with the involvement of private investors.

Reforms in the agrarian sector and irrigation systems

Agriculture is one of the major sectors of the Uzbek economy. Almost half of the population of the country lives in rural areas. In 2019, the contribution of the agricultural sector to Uzbekistan's GDP was 25.5 per cent. Nevertheless, agriculture is the sector of economy which is the most regulated by the state. The property rights of major agricultural producers and farmers are poorly protected, methods of regulation of their activities are de facto taken from the Soviet past, and markets for many types of agricultural products, manufacturing resources and services for the sector are underdeveloped. Agriculture desperately needs to be reformed, but no significant changes have taken place so far. A key feature of the agricultural sector of Uzbekistan is the presence of two agricultural crops produced mainly for state needs – cotton and wheat. In the latest years, there has been a certain reduction in the amount of land mandatorily allocated for cotton, primarily in favour of fruit and vegetable production. However, cotton and wheat still constitute about two thirds of all lands allocated for cultivated areas, orchards and vineyards. The existing mechanisms of forming the state order and the pricing system make the cultivation of cotton and wheat unprofitable for a significant part of farmers. In addition, the existing system of land quotas for mandatory crops does not allow farmers to optimise the structure of production, with due regard for soil and climate peculiarities, water availability, staff qualifications, etc. Often, other crops are more profitable to grow on land allocated for cotton and wheat. The system of administrative regulation of the industry also extends to resource markets. Agricultural machinery, fuel lubricants, fertilisers, fodder, seeds, biological and chemical agents for plant protection, etc., are supplied to farmers by state monopoly companies. The prices of some resources are often subsidised. The amount of resources that can be purchased at lower (subsidised) prices is limited. Land owned by farmers is

excluded from economic turnover, the rights to use it cannot be resold, it cannot be used as collateral (to get a loan) or even be legally subleased. Soil fertility is continuously decreasing due to its inefficient use and degradation of land is also taking place. A complex, expensive and technologically poor irrigation system is used to deliver water to agricultural land. At the same time, there are no effective incentives for the efficient use of water by end users, persons and organisations responsible for water infrastructure. The main part of the costs of water delivery to agricultural producers is covered by the state budget. The payments by agricultural producers for water delivery services are not directly linked to the volume of water consumption. Their amount is not sufficient to stimulate economic water consumption. The result is that there is a huge loss of water during its delivery and use. The sector needs a fundamental reform, the main elements of which are as follows: Abandonment of the practice of planned assignments on cotton and wheat production, formation and development of free and competitive markets for these products;

Formation and development of free and competitive markets of resources and services for agricultural producers;

Strengthening ownership rights of land users, provision of the possibility for the resale, sublease or borrowing against the land; and

Introduction of principles of paid water use, public-private partnership mechanisms in irrigation system management.

The strategy for the development of the agricultural sector was adopted at the end of 2019, emphasising the need for fundamental reforms. At the beginning of 2020, the President announced plans to cancel the mandatory state order during the period 2020-23. It is also planned to develop competitive markets for agricultural products, resources and services for the agricultural sector, as well as to create a legal framework for land use. Besides, the draft concept of water sector development, which assumes reformation of the sector, is under discussion. However, in view of the forthcoming removal of the mandatory state order, the question arises about the redistribution of the portions of land which are held by farmers. In recent decades there have been several redistributions of cultivated lands of former collective and state farms. And all these redistributions were carried out completely arbitrarily without any public discussion and approval. This resulted in the current situation when most of the cultivated land is at the disposal of (on the basis of lease agreements) a very small part of rural residents (farmers). The overwhelming majority of rural population has only small plots (dekhkan farms). At the same time, it should be taken into account that some regions have complicated demographic situation, overpopulation and high unemployment in rural areas. Most rural residents consider this distribution of land to be illegitimate. The problem becomes very acute due to the forthcoming cancellation of the state order, which will turn farmers into real owners of most fertile and irrigated agricultural land. One of the options for solving this acute problem is to use the fact that lease agreements state that farmers have no right to freely dispose of lands allocated for cotton and wheat. In fact, this is not their land. And since the state cancels the state order, there is a chance to revise the agreements and redistribute the lands previously allocated for the state order in favour of other rural residents (for example, through auctions). During redistribution of the land, especially when determining the size of land plots to be transferred to new owners, it is necessary to keep in mind a significant number of economic and social circumstances, including: the impact of the size of farms on agricultural productivity, employment and income of rural residents, as well as the interests of adjacent sectors of the economy, the demographic situation in the regions, and so on.

Challenges and prospects of reforms

The country's leadership is still under strong influence of the philosophy and practice of import substitution and protectionism, as well as traditions of 'manual management' of the economy. The importance of separation of government functions from business practices and the need for the government to act as an 'arbitrator' defining the rules of the game for business, rather than being a direct participant in business processes, is not understood. There is no unified team of reformers who clearly and equally understand the goals and directions of reforms and methods of their implementation. On the contrary, the positions of industry and individual lobbyists who defend corporate and private interests are very strong.

Many challenges are related to the very low average level of professionalism, initiative and economic literacy of civil servants. For a long time, a) the existing system of selection and promotion of personnel, b) lack of political competition, and c) low salaries in government bodies (with the exception of law enforcement agencies), caused 'negative selection' of officials, leaving in management positions the unsolicited performers of someone else's will with low qualifications and high degree of inclination to corruption. It is extremely difficult to carry out fundamental reforms with such personnel potential and to expect a significant improvement in the quality of public administration.

Nevertheless, the reforms in the country are going on, even if not always consistently and systematically. If at least some of the necessary reforms are implemented relatively successfully, there is hope for the formation of more or less effective inclusive market institutions, the creation of conditions for sustainable economic development, the formation of a 'middle class' and civil society. In the future, the 'middle class' and civil society will become a social pillar for further economic, legal and political reforms.

In conclusion, the author would like to note that there is an acute objective need for expert and organisational support for reforms in Uzbekistan by international organisations, governments of foreign countries and the international expert community. Without it, it will be quite difficult for the country to build and implement an effective strategy of reforms, which will make it possible to shape a fundamentally new socio-economic system.

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