UZBEKISTAN: INSTITUTIONAL CONTINUITY HELPS PERFORMANCE

by Jeni Klugman

Introduction

The case of Uzbekistan presents somewhat of a paradox in the study of models of transition. The country has managed to earn quite a poor international reputation as a slow economic reformer. Desai (1997) ranked the republic last out of twelve transition economies on each of the dimensions of economic liberalisation subject to review. The categorisation in de Melo et al. (1996), that was adopted by the recent World Development Report, accorded similarly poor marks to Uzbekistan's performance.[1] International investment and donor support for the largest republic in Central Asia have been correspondingly limited.

Yet the recent review by Fisher et al (1996) shows that Uzbekistan's macroeconomic transition performance – in terms of cumulative output decline and the peak rate of inflation – was actually relatively good. Indeed the republic recorded the lowest output drop among the 26 transition countries studied for the period 1989-1994, at less than 16 percent compared to a group average of over 40 percent. Moreover the maximum annual rate of inflation was less than half that for all transition economics for the same period, and about one quarter of the average for the former Soviet Union and Mongolia. Outside observers – such as the IMF – have tended to emphasize that these outcomes are due to initial conditions and exogenous factors; whereas the Government has stressed the uniqueness of the Uzbek approach to reform. Either way, these observations suggest that Uzbekistan is a case worthy of further review, and better understanding of the nation's approach to reform.

This paper analyses the structural policies that underlie the cautious approach to economic reform that Uzbekistan has pursued during the transition from the planned Soviet regime, casting light on the emerging market model. Section 1 provides background. The economic and social outcomes evident to date suggest less unfavourable outcomes than other transition countries. This is despite a fairly adverse set of initial conditions that were compounded by a series of external shocks. In Section 2 we show how a deliberately gradual and partial approach to reform in the agricultural and enterprise sectors, and continuing state dominance of the financial system and trade, have characterised Uzbekistan in transition. The institutional links and political economy of the independent regime to the chosen transition path are highlighted in Section 3. The final section concludes.

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A general caution about data reliability is warranted, while the scarcity of certain information limits the analysis. This paper focuses on the period up through 1996, with limited references to developments in 1997 as data allow.

1. Background

I have tried to learn from President Karimov his methods of reducing inflation, preventing people from falling into poverty and fighting against crime. He has been able to retain executive power without destroying the old system

Leonid Kuchma, President of Ukraine (reported in Uzbekistan News, 30.6.96)

1.1 *The inheritance – advantages of backwardness?*

This section briefly reviews the initial conditions, drawing attention to the demographic profile, and economic trends in the late Soviet period, including the structure of the economy and the labor market. Uzbekistan is the largest of the Central Asian countries, with a very young and fast growing population. The level of economic development at independence was certainly low in terms of several commonly used indicators: per capita income stood at US$ 860 (second lowest in the Union)[7], the majority of the population lived in rural areas and the rate of population growth was high. The demographic factors associated with 'backwardness' created such potential strains as a rapidly growing labor force and the costs of extending infrastructure and services to rural areas. In these respects Uzbekistan had a socio-economic profile similar to that of a developing country.

Yet is unclear whether the country enjoyed the *advantages* of backwardness. While Fisher et al (1996) found that lower initial per capita income is associated with smaller output declines, Uzbekistan inherited virtually all the inefficiencies and public spending pressures associated with the Soviet regime. The problems of inefficient state production and highly monopolistic market structures, significant overstaffing, stagnating output and repressed inflation were evident (Pomfret, 1995, p. 68). While an obsolete industrial structure did not dominate the largely rural Uzbek economy, industrial enterprises were still very large by the standards of market economies and China and Vietnam, averaging 500-700 employees. The agricultural sector posed serious obstacles to efficiency, including outdated technology and excessive use of subsidised inputs, including water. The Uzbek republic had a significantly negative balance of trade in the late 1980s (amounting to 6.4 percent of GDP in domestic prices and 9 percent in world prices).

At independence, agriculture accounted for about 36 percent of national income, followed by industry (33 percent of output and 14 percent of employment, consisting largely of processing of agricultural raw materials and the production of machinery and chemicals linked to agriculture), and construction (14 percent of output). Relative to middle income country averages, the share of agriculture was greater, services smaller and industry about the same (WDR 1996, Annex table 12). As in other planned economies, the retail and trade services were relatively under-developed. The so-called non-material sphere accounted for about one-fourth of employment, the bulk of which comprised social services, in particular education, while banking and finance represented only 0.3 percent of total employment. This reflected Soviet planning priorities, in particular the emphasis on cotton, and arguably resulted in a lower level of diversification than might have been expected in a country with such varied natural resources. For example, the republic has a rich endowment of natural resources – gold, natural gas and oil, and other minerals – and was the leading producer of natural gas in the former Soviet Union, and the second largest producer of gold.

Planning policies provided favourable terms of trade to cotton relative to other agricultural products motivated by the Soviet desire for self-sufficiency in what was considered to be a strategic commodity (see Khan and Ghai, 1979). From 1935, the procurement price of cotton, relative to production cost, and in terms of international prices, was much higher than for grains.[3] This resulted in a shift in irrigated land away from grain to cotton. In 1990, cotton represented 38 percent of agricultural output, compared to 3 percent for grain and 10 percent for potatoes. Animal husbandry was almost as significant as cotton, accounting for 37 percent of agricultural output in 1990. The republic was heavily dependent on food imports from Russia and Ukraine, particularly grain.

While the number of workers in collective and state farms were similar, somewhat surprising is the even higher share under the category of temporary workers and labour in private plots. Since the scope of the latter was limited, it seems that a significant proportion of workers were regarded as 'temporary' (see Marnie, 1992). This suggests a potentially significant source of surplus labour that was engaged only on a seasonal basis. Indeed, Soviet Central Asia was known as a 'labor surplus' area: the number of working age population exceeded the number of jobs in the official economy. This was in contrast to the western parts of the former Soviet Union that had been affected by 'labor shortages'. There were labor surplus and deficit regions within Uzbekistan: the sparsely populated rural oblasts such as Dzijak were seen to suffer 'shortages' whereas densely populated rural areas of Andijan and Namagan had surplus labor. There were intermittent reports of unemployment in Uzbekistan since the 1970s, although there are no reliable data upon which to judge these reports (Marnie, 1992). In fact unemployment in this context appears to refer to those 'not employed in the official economy' (*nezanyatye*), without any distinction between those actively seeking such employment, as opposed to being content in working in the household sector.

1.2 *Macroeconomic outcomes*

Uzbekistan's economic record in terms of output, inflation and fiscal balance compares favourably to both the rapid, and also the delayed, reformers, of the former Soviet Union. Labour market outcomes are also distinct. Other countries, most notably Belarus and Ukraine, have adopted a gradual approach to reform with disastrous consequences. And neighbouring republics that have been regarded as fast reformers – Kazakstan and Kyrgyzstan – have suffered much larger declines in national income. It is useful to briefly describe and compare these trends by way of background to the structural reforms undertaken.

If we adopt the approach of Fisher et al. (1996), and place the transition experience in terms of stabilisation, it seems that Uzbekistan may have succeeded in avoiding the worst extremes of output collapse and very high inflation often suffered in transition. The average declines in growth in the transition countries through to the year of stabilisation (averaging minus 13 percent in that year), then subsequent recovery, with positive growth from two years after stabilisation. The worst rate of output decline in Uzbekistan, by way of contrast, was in the year prior to stabilisation. The cumulative decline in production amounted to about 18 percent through to the end of 1995, compared to, say 59 percent in fast reforming Kyrgyzstan and a reported massive 80 percent in Ukraine. Uzbekistan's peak of 1,233 percent annual inflation was (remarkably) only about a quarter of the former Russian peak of 4,646 and below the average for all transition economies, including Central and Eastern Europe, of 2,632 percent (Fisher et al 1996).

A strong revenue effort, and the limited extent of tax arrears, stand in sharp contrast to many countries in transition.[4] Total revenue as a share of national income declined somewhat between 1989 and 1992, but far less so than the mean for countries in transition reported by the EBRD (1995, Table 6.5), and by 1995 – at 37 percent of GDP – actually stood above the pre-transition share of 35 percent. It reflects, in part, the extent of direct state involvement in firms, as either full or partial owners, which obviously facilitates revenue collection. The degree of tax compliance also reveals the capacity of the state to enforce rules, in this case its own liabilities, or at least the perception on the part of firm managers that it is able to do so, thereby deterring the accumulation of arrears or evasion. For example, somewhat unusually, in 1995 revenue collections by the Uzbek authorities ran almost one third higher than expected under the IMF programme.

Labour market indicators in Uzbekistan contrast quite sharply to those elsewhere in the former Soviet Union and Central and Eastern Europe. Available evidence suggests that the average real wage have been fairly well maintained relative to other transition countries (see Rutkowski, 1996). Open unemployment has remained at very low levels. In 1996, registered unemployment numbered only about 0.4 percent of the labour force, while estimates of open unemployment were in the range of 4.5 percent of the workforce (UNDP, 1996). Indeed, according to official data, total employment actually expanded over the first half of the decade, by about 2.6 percent, compared to declines of about 7 percent in Russia and Ukraine, and more than 15 percent in Kazakhstan, for example. The net increase has followed a significant rise in agriculture (by almost 20 percent between 1990 and 1995), offsetting falls in other sectors (accounting for smaller shares of the total). Employment in industry shrunk by 21 percent over the same period, and by 6 percent in so-called 'non-material' sectors.

While the slower than expected rise in unemployment is not unique among the former Soviet countries, the rise in number of employed is quite unusual, and even more of a puzzle in Uzbekistan where real wages have been much better maintained. Typically, as in Russia, adjustment in the labour market has been evident on the price (wage) side, even if labour demand has not fallen as much as expected (Commander 1995). There is of course a need to differentiate between official levels of employment and wages, and the reality of wage arrears and forced leave. The official wage data do not take wage arrears into account: although there is a paucity of evidence on the extent of arrears, in a recent survey of households in Karalpakalstan and Khorezm, 60 percent of respondents cited delayed payment of wages as the most significant problem facing the family[5] (Expert Centre, 1996).

The rural economy has been able to absorb labour, particularly as the importance of own-private farms expands. The share of agriculture in total employment increased from 39 to 47 percent between 1990-1993. While the share of private land plots in land area reported in official figures was still only 8 percent in 1994, survey data suggests widespread household access, ranging from 46 percent among urban residents of Tashkent up to over 95 percent of households in rural areas (Coudouel, 1998).

Uzbekistan's cautious approach to reform in the economic sphere has been motivated in large part by underlying social objectives. The regime has sought to avoid, or at least minimise, the economic disruption and social hardship apparent in neighbouring republics. For the regime, a corollary is the desire to avoid political instability. Available measures of income inequality suggest that the Uzbeks may have seen relatively less adverse trends than elsewhere. In 1994, the decile ratio (of the top ten percent of incomes to the lowest) was 6.18 (UNDP, 1995, Table 11), suggesting a degree of inequality far below that in Russia, for example, where the decile ratio is around 12.

The macroeconomic and labour market outcomes evident to date suggest that Uzbekistan has done relatively well in coping with the challenges created by transition. Such an assessment is contrary to what many observers have concluded, but is supported by available data on economic growth and indicators of household well-being. This is not to argue that serious policy distortions have been absent, as we go on to show in the following sections.

2. Structural policies: change and continuity

Uzbekistan decided to follow a relatively cautious and partial approach to reform, at least until an articulated approach to reform could be developed.

Uzbekistan: An Agenda for Reform. World Bank, 1993

The break-up of the Union was associated with a series of major shocks to output, prices and trade. The Uzbek Government sought to cushion the impact through subsidies to households and to firms, but as this approach became fiscally unsustainable, more thoroughgoing liberalization and withdrawal of price subsidies were implemented in late 1994. The initial approach, that sought to maintain thoroughgoing centralised controls, was gradually abandoned from 1994. Up to 1996, the government nonetheless remains extensively involved in the economy through state orders, ownership of the bulk of medium and large enterprises and regulations on the external sector, alongside significant centralisation of decision-making authority. The IMF's (1994) Economic Review concluded, '...(T)here is little effective demarcation between the government, the business and enterprise sector, and the banking system.'

A range of instruments have been deliberately employed to affect the behaviour of economic agents, few of which might be regarded as consistent with the introduction of market mechanisms, so that the overall extent of transition appears limited. So far, the approach to liberalisation has been gradual, and in several senses to date, only partial. A highly interventionist stance is most evident in the persistence of the system of state orders. In institutional terms, core central agencies, in particular the Goskomprognostat which combines the functions of the former planning and statistics ministries, play a critical role. They engage in extensive reporting on economic activity, from the 'effectiveness of cattle and poultry' (amount of milk and eggs respectively), to total profit by branch of industry and by oblast. One indication of the continuing salience of central economic controls in Uzbekistan relative to other former Soviet countries is low arrears on taxation and that, more generally, the maintenance of central revenue collection at reasonable levels.

The evolution of employment by type of ownership between 1993 and 1995 suggests the extent of the shift to private production. Table 1 shows that the 'non-public' sector share of employment has increased to almost 50 percent of the total, if we include collective farms (20 percent), as well as private companies (1.6 percent) and self employment (1.3 percent) in this category. The most striking shift in recent years has been the rise in self-employment, from about one to almost 20 percent in two years. Part of this may reflect a reclassification of 'peasant activity' (which fell over the same period), but even so, there has been a significant expansion of self employment. Employment in the other categories of non-public employment in the more formalised sectors of the economy have increased their relative shares, but typically only by marginal amounts; for example joint stock companies share rose from 1 to 1.2 percent.

Table 1 - TRENDS IN EMPLOYMENT BY TYPE OF OWNERSHIP, 1993-1995

Type of Enterprise	1993	1995
Public	55.8	50.6
Leased	1.7	1.8
Joint Stock	1.0	1.2
Public Organisation	0.3	0.4
Joint Venture	0.2	0.3
Private Company	1.1	1.3
Collective	19.4	19.7
Co-operative	2.5	2.9
'Peasant'	7.9	0.7
Self Employed	1.2	19.1
'Other'	8.4	2.0

Source: Goskomprognostat.

The indices presented in the 1996 World Development Report suggest that the extent of transition in Uzbekistan has been limited, however. Uzbekistan is placed in 'Group 4', together with Ukraine, Belarus, Turkmenistan, Tajikistan and Azerbaijan, who are the poorest performers. For privatisation by type of asset, group 4 ranks at 'little or none' for large and medium sized firms, and for agricultural land. On institutional and social policy reform, this group performs similarly poorly. Uzbekistan's score for overall economic liberalisation is approximately five out of ten, ranking about tenth out of the fifteen former republics. While such indicators may be useful for cross-country comparative work, their value in the present context is questionable. As the authors note, any such index is approximate and judgmental, while the estimates are an amalgam of factors, and the derivation is opaque.[6]

It is perhaps more illuminating if one avoids composite indices and country groupings. This has been the approach of the European Bank of Reconstruction and Development Transition Reports, whose transition indices are country-specific. The 1994 report suggested that price liberalisation was comprehensive, while along with Tajikistan, Turkmenistan and Ukraine, enterprise restructuring and banking reform had been limited (Table 2.1, p.10). Similarly, such indicators as private sector output as a share of GDP, are reported in the World Development Report, more than tripling in Uzbekistan between 1990 and 1995, to over 30 percent (Figure 1.3, page 15). It is apparent that the story is somewhat more complicated than the transition indices tend to reveal, so we turn now to review changes in the structures of incentives and ownership in greater depth.

2.1 *Incentives in the agricultural sector*

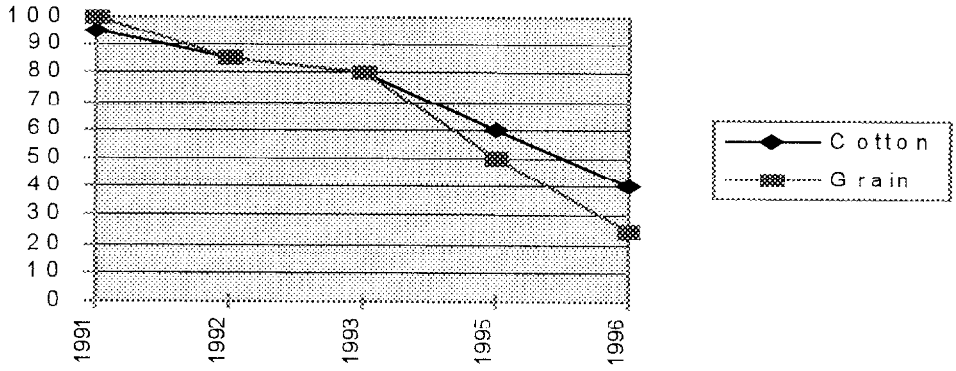
Changes in the external and institutional framework surrounding agriculture have included a severe terms of trade shock, the abolition of the *sovkhozy* and the expansion of individual farming. At the same time, there is extensive state intervention via administrative directives that include production targets (quotas) and state orders for cotton and grain. The decline of agricultural output has nonetheless been much less than that in national income overall, in contrast to other former Soviet republics (World Bank, 1995, p. 3). Employment in agriculture has actually risen, though this might be due more to its role as a residual sector in absorbing excess labor supply.

The World Bank (1995) identified two factors to explain this relatively good performance. First, domestic production of essential agricultural inputs (fertiliser, pesticide and some farm equipment) meant that the trade collapse was less disruptive to farm production than elsewhere in the FSU. The traditional system of supply has continued to provide essential inputs, despite continuing quality problems and occasional shortages. Second, alternative cotton export markets have been found. Nonetheless, the heavy net taxation of the sector has likely stifled Uzbekistan's agricultural producers, as we see below.

There was an adverse terms of trade shock generally against agriculture, and in particular against cotton. The favourable wedge between world prices and the compulsory procurement price of cotton subject to state order was eliminated in a significant shift away from the pro-cotton policy of the Soviet era. Although any estimates are very sensitive to choice of price index and exchange rate the procurement price of cotton in 1994 was clearly only a small fraction of its 1990 level (Khan 1996, p. 80). The area under cotton cultivation has fallen in favour of grain, and cotton output has declined to 32 percent of agricultural output while grain production has increased from the low base of 3 percent to 6 percent of agricultural output. In 1996, the Government announced an increase in procurement prices for cotton to 70 percent of world prices, and to 75 percent for grain; while state orders were reduced to 40 and 25 percent respectively (Figure 1).

Even for crop output that is not subject to compulsory procurement, producers typically face a monopsonistic (former) state purchaser. There are limited marketing alternatives for farmers, particularly for cotton and grain, and the prices earned remain significantly below world market levels. The state-owned ginning organization, *Uzkhlopoprom*, controls all ginning activities in the country; while *Uzbhekproduct* has a monopoly on the processing of grain and bread products. There

Figure 1 - STATE PROCUREMENT OF COTTON AND GRAIN



Source: Khan 1996

are oblast and raion level monopolies on agricultural trade and procurement. There are important differences in the pattern of marketing and control across products: livestock, fruit and vegetables are marketed outside state orders.

The overall constraints on farmers do not appear to be offset by potential advantages in terms of extension services and access to credit. Nor does the government guarantee a minimum price for procured products, which vary according to the world price. Government support takes place through tax exemptions (in particular from the VAT, which is equivalent to about 1.2 percent of GDP) and subsidised irrigation. The bulk of credit goes to agro-processing rather than private producers. Legal restrictions (regarding mortgages and collateral) hinder access to credit. Subsidised credit to agricultural producers ceased in 1995 (World Bank, 1996). On the positive side for farmers, new credit agencies have emerged to finance rural development. Tadbirkorbank, with private shareholders, disburses subsidised loans for the government's Business Fund. In late 1995 Zaminbank was established to support farmers with low interest long-term loans for purchase and mortgages based on land-use (as opposed to property) rights. There is not, however, a legal and institutional framework for local co-operatively owned financial institutions that might be well-placed to assess rural borrowing needs and repayment ability (World Bank, 1996).

The *sovkhozy* were transformed into co-operatives known as shirkat farms (or *kolhozy*), a change that has been attributed to fiscal pressures as well as efficiency reasons. Nearly all state farms have been removed from state control and the assets formally transferred to the workers, so that about 98 percent of agricultural output formally originates outside the state sector. There has been an ongoing tendency of the kolhozy to enter into individual contracts with their members, whereby production is organized by the individual farmers while the parent kolhoz provides some services and inputs, and receives a certain share of revenue. This practice is reportedly becoming widespread in the land under kolhoz jurisdiction (World Bank 1995). Bound by profile restrictions and unable to pledge property rights, however, these units remain responsible for the fulfilment of the overall farm's production quotas and state orders.

While the agricultural sector remains dominated by large production units – out of the 4.5 million hectares of cultivable land, 3.6 million hectares is occupied by collective farms and farm co-operatives – individual farming has been allowed to expand. An estimated 25 percent of total cultivated land is now under private control. By mid 1996 official reports stated that 80 percent of all meat and dairy products came from the non-government sector. There are two main types of direct private control of land:

(i) small household plots, averaging 0.2 hectares have existed since Soviet times though recently expanded; estimating to involve over 2.5 million households and accounting for about 9 percent of total land area in 1994. There has been a significant increase in the number of personal plots, and relaxation of size limits thereon. Such plots were an historically important source of marketed output, especially for perishable products; and

(ii) the right to use land allocated from collectives and state farms, which by the end of 1995 had been given to about 14,250 farmers, and averaged about 60 hectares in size.

The distribution of land leases to households for use (though not sale nor exchange) has had potentially significant distributive effects. Case studies cited by Khan (1995) suggest that the allocation was based on the number of able-bodied workers in the household, but also ownership of productive resources (e.g. cattle). In this sense, the asset allocation is likely to reinforce existing inequalities – since families with many dependants and/or asset poor households are discriminated against in the distribution of land for use. This picture is consistent with locally organised privatisation efforts described by the World Bank, whereby land rights are allocated by local government committees to individuals regarded as potentially good farmers (World Bank, 1995, p.7).

Khan (1996) argued that the reformed system of agriculture amounts to individual household farming, with the kolhoz providing common and technical services and, most importantly, arranging for state procurement of cotton and grain. Still, few farms are independent from administrative controls and planning directives from the State, the system of state orders and lack of marketing alternatives remain dominant factors, while profile restrictions hinder restructuring. The World Bank (1996) concluded that government support for farmers – in the form of extension services and training – has been hard hit by the transition. Many agencies responsible for providing such services have reportedly lost half their staff and lack operating budgets.

2.2 *Enterprise and financial policy*

Policies toward the enterprise sector reveal the strong continuing role of government in the economy apparently motivated, in part, by the desire to minimise potential economic and social disruption. Similarly it appears that financial sector policies are partly an instrument of broader concerns related to enterprise and industrial policy, given a strong residuum of central control and direction.

Official suspicions of new private sector activity are reflected in the many obstacles placed in its way. In legislation, private property rights appear to be subordinate to a list of undefined, general rights and the interests of, *inter alia*, citizens and the state (World Bank, 1993, p. 67). This casts doubt on the boundaries of ownership rights, and indeed restrictions have frequently been imposed by local authorities on the exercise of private property rights. For example, protection of contractual rights is unclear, as are the rights associated with land ownership. More generally, complex licensing, registration and application procedures hinder small-scale economic activity. Private sector access to credit is limited (see Section 2.4 below). Problems faced include preferential treatment of established clients and onerous guarantee and collateral requirements and, since mid 1994, high real rates of interest.

The climate for private sector activity has, nonetheless, markedly improved over time. A Presidential Decree in January 1995 paved the way for the establishment of more than 55 000 individually owned and small scale enterprises. Licensing and registration requirements for business start-ups have been eased. Long term leaseholds of commercial and industrial real estate are transferable, and commercial realty can be sub-divided and shifted to new uses. Perhaps the most vibrant signs of the emerging market are the huge bustling markets in Tashkent and other centres. The government appears to place hope in the creation of off-farm employment in rural areas, based on agro-processing. Another policy theme is the promotion of self-employment through the provision of tax incentives and targeted credit (UNDP, 1995, p. 23).

Alongside regulation and control, there has been extensive state support for existing and new enterprises. The government has set out a programme for economic development that seek to promote the production of consumer goods, the processing of raw materials and minerals, and in retail trade and exports (OECD/ CCET, 1996, p. 71). The Business Fund that was established in mid 1995 illustrates the Government's attitudes toward new private ventures and the role of public support thereto. The extension of subsidised credit is seen as essential to the avoidance of large scale unemployment. The Fund aims to provide credit to new, small-scale private ventures in six 'priority' sectors (agro-processing, farming, tourism, industry and services) that appear to cover most types of economic activity, though the focus is on rural areas. The operational details of the Fund are unclear, as it has private shareholders and also receives budget transfers.

Few enterprises have faced closure or deep restructuring, even though bankruptcy legislation was adopted in mid 1994. By mid 1996, about 200 mainly small trade and retail (less than 100 employees) enterprises had been subject to investigation, of which 83 had been declared bankrupt. It appears that individual creditors have not been willing or able to pursue these cases – in the first instance, the situation of enterprises is reviewed by an 'Economic Viability Committee' chaired by the Deputy Governor of the oblast. No enterprise of more than 500 employees has yet been considered, although there is no legal obstacle to doing so.

The encouragement of foreign investment is seen as an important element in economic restructuring, in particular as a way to raise project finance. The most common form of foreign investment to date has been the joint venture, over 1,000 of which were registered by 1994. The best-known investors in plant include Daiwoo, which has built a large car factory enabling exports to neighbouring markets, and Coca-Cola. However less than 600 had started operations in 1996 given lack of clarity in business law and uncertainty about registration procedures. On the one hand, the government has provided foreign investors and joint ventures with a series of advantages in terms of exemptions from tax and trade regulations, as well as a wide range of guarantees (ibid, p. 74). On the other hand, however, the number of foreign investors licensed to convert their profits into dollars was recently cut from 1,400 to 130, reportedly sending many small and medium firms into financial ruin and creating widespread uncertainty among investors (Dixon, 1997).

2.3 *Patterns of ownership*

Enterprise ownership nonetheless appears to have shifted significantly away from the state. This is reflected in changes in the structure of employment by type of ownership which, given the difficulties surrounding valuation of firms, is perhaps the most reliable indicator of the extent of such shifts. The share of state enterprises and government has declined significantly, from 40 to less than 34 percent as the non-governmental sector has expanded. Nonetheless the new private sector still only accounts for less than 3 percent of total employment, as do joint ventures and enterprises and organizations under mixed ownership.

Under the 1991 law on destatisation and privatisation and subsequent implementing regulations, all state enterprises subject to privatisation are supervised by the state property committee (SPC). However in the industrial sector, the large associations which have assumed the activities of the individual subsectors (e.g. Uzbekbirlashu is responsible for all urban retail trade), enjoy a relatively strong position *vis a vis* the SPC. In a pattern familiar to many transition economies, the approach to privatization was phased. The initial focus was on small-scale enterprises and housing, and has achieved extensive results. By the end of 1995, about 95 percent of the 10,400 small enterprises – retail shops, trade and service establishments – had been privatized, as had about 96 percent of the housing stock.

The method of privatisation chosen typically meant direct transfer or sale to staff.

Phase II includes corporatization and partial privatisation of medium and large-scale enterprise. Between 1993 and 1996 only 19 percent of medium and 17 percent of large-scale enterprises were incorporatised (converted into open or closed stock companies). In fact most of the shares set for sale to the public were not sold. In mid 1996, the Government created a Privatization Investment Fund (PIF) scheme that will promote public participation through issuing a low priced category of shares, although implementation has been delayed. The objective was to sell 30 percent of shares in about 300 large enterprises through auctions. This programme appeared to be successful in that about 50 investment funds and 60 management companies were involved, selling shares to an estimated 36,000 individuals and helping to develop a secondary share market. In terms of the goals of equity and improved corporate governance, there are trade-offs between alternative privatisation methods (WDR 1996, p. 312). While vouchers enable speedy and fair distribution of public assets; sales for cash raise revenue and likely better improve corporate governance; and management-employee buyout, that has been common in Russia and Poland, may be speedy but less satisfactory in terms of equity and governance. The World Bank has described the proposed Uzbek approach through the PIFs as one that will facilitate a fair and transparent privatisation process with broad public participation, access to local capital and skills, and the possibility of attracting foreign investors and skills in the management of the PIFs.

The privatisation programme to date has tended to transfer assets to insiders, managers and employees. While most of the shares that were to be sold to the public were not sold, while employees and managers tended to increase their ownership, a pattern that was also observed in Russia. Thus the benefits have accrued largely to those working in the industrial and trade sectors, representing about 40 percent of total employment. Of course the value of such holdings vary enormously: part ownership of a loss-making enterprise being an obvious case in point.

The pace of enterprise restructuring appears to have been slow, and the extent of change limited. Employment levels have not been adjusted and industrial sector wages remain above average, despite significant declines in industrial output, particularly in manufacturing. There are several obstacles.

- Insider control tends to delay restructuring (WDR, 1996).
- Up through the end of 1994, there were extensive directed credits to enterprises at subsidized rates through the financial system and, since then, through such mechanisms as the so-called Business Fund.
- Capital market institutions are rudimentary and there are serious problems in the financial sector (as described below).
- There are numerous restrictions on the profile and activities of enterprises (for

example, much of asset sale proceeds go to the GKI, reducing the incentives for firms to restructure).

The implementation of the stabilization program in early 1995 appeared to significantly tighten financial discipline on enterprises. Budget subsidies and directed credit through the Central Bank to enterprises were eliminated. Since April 1995, Central Bank credit was only available at the refinance rate, which in mid 1996 stood at 80 percent per annum compared to projected annual inflation of 30-35 percent.

Continuing controls on the productive and external sectors range across state orders for cotton and controls on commodity exports. These appear motivated in part by the lucrative revenue thereby raised. More consistent with a shift to a competitive market economy, perhaps, are the policies that seek to offset the significant concentration of market power, in large part due to the so-called associations in production and retail. The definition of monopoly, that allows direct control of pricing, has been curtailed to enterprises that represent over 65 percent of the relevant market (the threshold was previously 35 percent). The government has taken steps privatised major state-owned trade complexes, which has significantly increased competition and new entry in consumer goods retail in urban and rural areas (World Bank, 1996). However wholesale trade in raw materials and intermediate inputs remain dominated by a single association of 27 wholesale joint-stock companies that implements CIS trade agreements.

2.4 *Financial flows and controls*

Extensive central controls in the financial sector continue to be utilised in ways that distort economic decisions. Limits on the availability of cash, for example, result in price differentiation between cash and non-cash transactions and reduce credit inter-mediation through the financial system. Bank licenses are granted on the basis of non-transparent criteria. The existing legislation for the banking sector dates from 1992, and has become outdated to present needs. Coupled with the repercussions of high inflation and structural weaknesses, central controls have created serious weaknesses in the financial sector. High inflation and the freezing of bank deposits during the currency conversion shook confidence in the system. The World Bank described the sector in mid 1996 as in 'serious distress' (Report Number 15430-UZ).

The financial system is dominated by banks owned by the state that are heir to the largest sectoral banks of the Soviet era: *Promstroibank* (industrial bank); *Phatbank* (cotton bank); and the National Bank, the former foreign trade bank. In late 1995 there were 29 banks, many of which have a specific sectoral focus according to Government priorities. A cautious approach to licensing new banks has meant that private banks do not play any significant role in the intermediation of credit (World Bank, 1996, p.12).

Inter-enterprise arrears have become prevalent, a pattern which has also characterised other former Soviet countries. While arrears on taxation and bank loan payments were limited, there was significant growth in inter enterprise arrears during 1995. Arrears rose as a share of GDP from 2 to 7 percent in the year to January 1996, and as a share of payables from 8 to 27 percent. This phenomenon suggests that several factors are at work: enterprise attempting to maintain production levels despite slack demand for their product; difficulties in access to credit; and expectations of future government support. In response to the arrears problem, the authorities imposed penalties on banks that accumulated arrears on refinancing and interbank borrowing. Similarly, Presidential Decrees in May 1995 and January 1996 penalised enterprise managers who allowed their enterprise accounts to fall into arrears. In fact preliminary data suggests a significant fall in the real value of arrears in the first half of 1996.

The development of investment relationships with external partners has been gradual and to date limited. Direct investments, mainly in existing projects, rose from US$9 million in 1992 to US$50 million in 1996. According to the 1996 WDR, net private capital in Uzbekistan in 1994 amounted to US$52 million, significantly less than (resource-rich) Kazakhstan and Russia. Legislation and decrees have been enacted to facilitate foreign investment, which is seen as a way to overcome technical obsolescence and capital scarcity (Pomfret 1995).

Financial support from the Bretton Woods institutions was slower to arrive in Uzbekistan than in neighboring countries that were perceived to be reforming more rapidly. The first stand-by agreement was successfully negotiated in November 1994 (compared to late 1992 for Kyrgyz Republic). Similarly World Bank adjustment type lending for Uzbekistan began only in 1995, whereas Kazakstan began receiving similar support in 1993. This is clearly related to the adverse perception of the regime's commitment to reform. It also suggests that Uzbekistan's relatively strong balance of payments position lessened potential demand for external loans. Difficult aspects of the policy dialogue have included state orders for cotton, user charges for water and the privatisation programme. By late 1996, relations with the IMF had deteriorated over the failure to meet monetary targets and structural benchmarks, in particular the liberalisation of the foreign exchange market and the stand-by programme was suspended in mid December 1996 (*Transition* 1997, p. 12). In early 1998 it seemed that the IMF did not expect to resume programme support in the near future. Bi-lateral donors were also cautious in proceeding to assist Uzbekistan, as reflected in the very small share of ODA in GDP (only 0.1 percent), compared to much greater involvement in Kyrgystan (amounting to 6 percent of GDP).

2.5 *Trade incentives and controls*

Foreign trade has been subject to strict state control on commodities regarded as strategic, through export registration, licensing requirements and state monopolies with respect to certain products. Indeed, the bulk of trade, particularly in cotton, is carried out through government channels. Interstate trade agreements and trade targets are enforced through the state order system. The Ministry of Foreign Economic Relations is responsible for all centralized foreign exports and imports and the implementation of foreign trade agreements and external trade policy (for example, issuance of licenses and import quotas for state enterprises).

Beyond a range of direct controls, the expansion of trade is hindered by the system of payments. Connolly (1995) describes the latter as characterised by 'arrears, *inconvertibility, and the resort to barter and clearing arrangements to avoid the use* of... hard currency' (p.11). In 1992, barter was the means of payment for about half of both imports and exports (World Bank 1993). Since then, the demise of the ruble zone and the subsequent period of transition to a non-convertible national currency created significant difficulties for trade, to which the government responded with a complex series of controls and *ad hoc* arrangements with the National Bank.

There has been some liberalisation of trade (see Table 8.3, EBRD Transition Report, 1994). The 40 percent tariff on imports from outside the FSU were suspended for a period (January 1994-October 1995), but then reimposed at an average rate of 13 percent (excluding tariffs on motor vehicles, which remain at 40-100 percent). The number of goods subject to export taxes (that range between 5-50 percent) was reduced from 74 to 11 at the end of 1994, and the regime was simplified and further liberalised in April 1996. However export bans were introduced in late 1995 on a selected number of goods, that included various grains, bread and flour, sugar, dry milk, various meats, as well as antiques and venomous snakes (!) This was apparently motivated by a fear of potential food shortages. In addition, there is a 30 percent export foreign exchange surrender requirement. The removal of these restrictions is a condition of IMF support. Finally here we should note that since 1996, at least, a large spread has persisted between the official 'auction'-determined rate of exchange, and that on the street for much of the period. By late 1996, the spread widened to 100 percent, contributing to the suspension of the IMF programme.

3. Institutional continuity and the political economy of the Uzbek regime

> *From roughly 1992 to the present, during the transition from Soviet rule to today's independent Republic, government authorities in Uzbekistan have waged a brutal, relentless and largely effective campaign to wipe out the political opposition. This has taken the form of politically motivated arrests, beatings, harassment, and discriminatory firings from the workplace...*
>
> *Human Rights Watch/ Helsinki, 1996, p.5*

Upon independence, Uzbekistan adopted a form of government described as a Presidential republic. Formally there is a parliament known as the Upper Soviet, comprising 500 members, which appoints the President and Cabinet of Ministers. The National Assembly (Oly Majlis) has 150 members. (Nominal) elections are held every five years. Although the Constitution refers to a separation of powers between the executive, judiciary and the legislature, the powers invested in the President clearly establish his overriding authority.

Indeed the country is unusual among many transition countries in the conspicuous absence of political liberalisation. A widely cited survey of political conditions which evaluates countries along two dimensions – the extent of participation in the political process, and the freedom of individuals to develop views and institutions separate from the state – was used by Murrell (1996) to develop an index of democratic rights. While the vast majority of transition countries had enjoyed a dramatic expansion of political freedom since 1989, the people of Uzbekistan, along with their Tajik and Turkmen neighbours, have suffered a dramatic erosion of such rights, from the Soviet average of 25 at the end of perestroika era in 1989, down to zero in 1994.

Centralisation of decision-making authority is evident throughout the social, economic and political spheres of the country. The hokims (governors) of the twelve oblasts are Presidential appointees, appear to enjoy relatively limited autonomy and typically remain dependent upon central government resources. At the same time, informed observers have noted that the political strength of regional elites is an important element in the nation's stability (Schoeberlein-Engel, 1995, p.17).[7] This is consistent with the empirical finding of a relatively equitable allocation of public resources and access to social services across the country.[8]

The President is clearly a powerful element in Uzbekistan's version of transition. His exhortations to the population are emblazoned on banners throughout the country. He is portrayed, and apparently fairly widely regarded, as a wise and benevolent leader. The 'Karimov factor' is by no means wholly negative. Unprompted, citizens often cite the relatively good outcomes in Uzbekistan, relative to their neighbours. The authoritarianism of the current regime is often justified in terms of the desire to avoid the instability that was experienced during the perestroika era, and the chaos observed in neighbouring state, in particular, Tajikistan, Russia and also Afghanistan. The fear of civil strife is not ungrounded, in the light of experience in the late 1980s. The economic and social elements of conflict clearly exist: economic crisis, youth unemployment and disenchantment and antagonistic ethnic groups – although no leaders have been allowed to emerge that could mobilise such forces into violent conflict.

The Government has gained an unenviable international reputation in the sphere of human, particularly civil, rights. A recent report of Human Rights Watch/ Helsinki concluded that all forms of widespread serious abuse have persisted, including total denial of fundamental civil rights to free speech, association and assembly (Human Rights Watch, May 1996). All media are strictly censored, some newspapers are banned and freedom of speech is severely curtailed. Individuals have been punished for perceived lack of loyalty to the regime, let alone outright opposition. Such punishments have included arbitrary arrests and detentions, 'disappearances', unfair dismissal from employment and intimidation through continued surveillance. The peaceful opposition within Uzbekistan has been virtually liquidated (op cit, p. 5).

4. Concluding remarks

As we have seen the Government of Uzbekistan's approach to liberalisation has been gradual, and in several senses, only partial. Yet perhaps the experience of transition in Uzbekistan reveals another set of 'special circumstances' under which partial liberalisation might succeed in minimising the deterioration of macro economic indicators – in particular output growth and fiscal balances. The 1996 WDR describes the Chinese case as a special case of partial liberalization. In some senses the Uzbek experience is indeed analogous to that of China: the importance of agriculture, and reforms which promoted farm output, as well as the continuing authority of the Party, local network of compliance mechanisms, and suppression of dissent. Price reforms in China appeared to proceed somewhat more slowly from their beginning in 1978 than in Uzbekistan. In both cases, by the end of 1994 about 90 percent of retail prices had been liberalised.

In Uzbekistan, dismantlement of controls on the cotton sector is yet incomplete, and government involvement in the economy remains fairly pervasive. On a number of occasions the state has demonstrated sufficient pragmatism to avert the adverse or worsening outcomes that might otherwise have eventuated. The implementation of apparently sustained stabilisation from late 1994 is an example of the capacity of the state to implement change as required; related examples include the elimination of food subsidies and the reversal of the blow-out in pension expenditures in 1994 and the limitation of inter-enterprise arrears.

However, it is important to recall that many of the continuing controls on the Uzbek economy have likely created significant efficiency and social costs. This is most clear with respect to the system of compulsory state procurement at below market prices, and over much of the period, extensive credit to subsidised industrial enterprises. Whether or not the present approach is sustainable in the medium to long term has not been shown. And not least, while the social costs of transition in terms of income falls and widening inequality appear to have been minimised, the denial of fundamental civil and political rights surely detract from human development in independent Uzbekistan.

Notes

[1] See also Murrel (1996), in particular, table 2 on economic and political liberalization. Any such reviews depend, to a large extent, on subjective judgements about various aspects of the countries' policy stance, and are necessarily approximate, as the authors note. Indeed for two of the four dimensions assessed in the 1996 World Development Report – privatization by type of asset, and institutional and policy reform by reform type – the data is only presented in terms of simple averages for country groups (see pages 14-17).

[2] Note however, that there is no fully satisfactory way to compare per capita incomes of the former Soviet Union with that of most other economies, mainly because of the difficulty in choosing a ruble-dollar conversion that makes sense. (World Bank 1992).

[3] For grains and meat, procurement prices averaged less than one-seventh of international levels, whereas cotton was procured by the state at almost one-third above the international price (op cit).

[4] IMF (1996), Chapter 5, 'Fiscal Challenges of Transition: Progress Made and Problems Remaining', especially Box 8 on the arrears problem.

[5] By way of contrast, unemployment was regarded as the most important problem by only 5 percent of households in the same sample.

[6] The liberalization index is a weighted average of liberalization of domestic transactions (price liberalization and abolition of state trading monopolies), external transactions (elimination of export controls and taxes, substitution of low to moderate import duties for import quotas and high tariffs, current account convertibility), and entry of new firms (privatization and non-state development); the weights being 0.3, 0.3 and 0.4 respectively.

[7] To date, however, prominent politicians including the President (Samarkand) and the Hokim of Namagan, have not sought ethnic mobilization to support the advancement of their regional constituencies.

[8] See World Bank (1995) Intergovernmental Relations in Uzbekistan.

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