

UZBEKISTAN COUNTRY ECONOMIC REVIEW UPDATE

1. Official statistics indicate that the overall macroeconomic situation in Uzbekistan remained on an even keel with financial stability in the first half of 2000. Real GDP increased by 3.8 percent compared with the first half of 1999. The growth of GDP is attributed to an increase in industrial production by 6.2 percent. The early spring and absence of frost also boosted agricultural production by 7.1 percent while livestock production grew by 3 percent in the first half of 2000 compared to the same period in 1999. The services sector grew by 9.0 percent compared to the same period last year mainly on account of the increase in wages, salaries and pensions as well as the growth of retail trade activities emanating from the liberalization of the access to foreign exchange for private traders. For the year as a whole, GDP is forecast to grow by 4.3 percent compared to 4.4 percent in 1999.

2. In the first half of 2000, fixed capital investment amounted to Sums 262.9 billion of which 54.2 percent were directed to the development of industrial sectors with the rest going mainly to the agriculture sector. Foreign investments and loans totaled Sums 53.1 billion or approximately 20.2 percent in the total volume of investments. Eighty percent of foreign capital was directed to the transportation, oil refining and chemical industries sectors. However, foreign investment grew by only 2 percent during the period mainly as a result of the low foreign investor sentiment. Foreign investors adopted a wait-and-see attitude ahead of the completion of the macroeconomic reform program.

3. Average monthly inflation during the first six months declined to 1.5 percent compared with 1.9 percent in the January-June period of the previous year due to the imposition of tight fiscal and monetary policies by the authorities as they sought to take the necessary steps to unify the exchange rate. The Government's target for completing this exercise is mid-2001. The decline in inflation had a major positive impact on real wages in the economy. To mitigate the social costs of expediting the macroeconomic reform program, the Government also granted significant wage increases. The average monthly wage rose approximately by 60.2 percent in the first quarter of 2000 compared to the first quarter of 1999. This involved significant wage increases in computer services (108 percent), agriculture (64.6 percent), and transport (41.4 percent). Given these wage increases and the recent increase in fuel prices, it is likely that the inflation target of 20 percent set by the authorities at the beginning of the year will likely be exceeded. Inflation is currently forecast to be 26.2 percent for the whole of 2000.

4. In line with the national development strategy, which adopts a phased approach to market-based reforms, the privatization of medium-and large-scale enterprises and the post-privatization support program continued to be implemented during the year. This program which is in its third stage, has now moved to the privatization of the large-scale enterprises. In 1999, 448 economic entities were subject to ownership changes including 156 privatized enterprises and 141 entities converted into joint stock companies. Overall, privatization revenues totaled Sums 9.1 billion (0.44 percent of GDP). In the first quarter of 2000, the State Property Committee (GKI) reported the privatization of 21 entities and the conversion of 20 entities into joint stock companies, which raised an additional amount of Sums 3.3 billion. It is unlikely that foreign investor interest would return to the pre-1996 levels unless the foreign exchange regime is liberalized and foreign investors are given easier access to foreign exchange, including the free repatriation of profits. The present foreign exchange regime is one of the key factors that has slowed down the Government privatization program.

5. In tandem with the output growth and the increase in economic activities which saw a growth in tax revenues, the state budget ended up in a surplus of Sums 9.8 billion in the first half of 2000, which is approximately 1 percent of GDP. Total revenues in the first half of 2000 amounted to 38.4 percent of GDP while total expenditures amounted to 37.5 percent of GDP. However, the picture is likely to change for the remaining half of the year due to the recent wage increases and the increase in the subsidies for essential food items to mitigate the adverse impact of the fuel price increase as well as the sharp increase in the price of utilities during the second half of the year. For the year as a whole, total revenue is forecast to be 30.6 percent of GDP whereas total expenditures would amount to 31.4 percent of GDP. After taking into account net lending to state-owned enterprises and other entities considered strategic to the national interest, the consolidated balance for the year is forecast to be a deficit amounting to 2.1 percent of GDP. The domestic banking system is anticipated to finance 1.2 percent of this deficit, while the issues of Treasury bills will finance 0.7 percent of the deficit. Privatization proceeds and external borrowings will finance the balance.

6. External trade turnover amounted to \$2.99 billion in the first half of 2000, about 1 percent more than the same period of last year, of which exports made up \$ 1.58 billion and imports \$1.41 billion. Due to the measures adopted by the Government to promote the growth of export-oriented enterprises, exports showed a significant increase during the first six months of 2000. The balance of trade thus amounted to a surplus of \$170 million. Exports exceeded imports by 11.4 percent compared with only 7.3 percent in the first half of 1999. For the year as a whole, exports are forecast to reach \$3.1 billion; 4.8 percent more than in 1999. Imports are also likely to increase over the 1999 level to reach \$2.7 billion in 2000. The merchandise trade balance for the year as a whole would therefore amount to \$0.4 billion or about the same level as the previous year. While the positive trade balance in 1999 was mostly attributable to the import compression by the authorities to defend reserves, the positive trade balance in 2000 is mainly due to the better export performance. Given the natural resource endowment of the country and the narrow export base of largely gold and cotton, greater efforts need to be directed towards diversifying as well as increasing exports.

7. The \$14 million current account deficit (0.1 percent of GDP) in 1999 widened somewhat to \$31 million (0.3 percent of GDP) at the end of June 2000, mainly on account of the increased access to foreign exchange as part of the steps being undertaken to liberalize the foreign exchange market and allow current account convertibility. Gross official reserves declined from \$1.24 billion (5.8 months of imports) at the end of 1999 to \$1.13 billion (5.0 months of imports) at the end of June 2000. Of concern is the sharp increase in outstanding debt which increased from \$4,253 million at the end of 1999 to \$4,718 million at the end of June 2000; an increase of \$465 million. Most of this debt was raised through the presale of gold and cotton. The debt service ratio also showed a sharp increase from 16.9 percent at the end of 1999 to 25.0 percent at the end of June 2000. Outstanding debt in percent of GDP increased from 54.6 percent at the end of 1999 to 59.5 at the end of June 2000. Although the debt indices are within the prudential levels, the rate of their increase in recent years is a cause for concern.

8. Reforms of the agriculture sector lies at the heart of structural reforms being undertaken by the Government because agriculture plays a pivotal role in the overall economy, accounting for about 25 percent of GDP, 40 percent of employment and 60 percent of exports. The Government has its own plan on reforming the agriculture sector. The Government wants to transform from State farms and collective farms that are run like state-owned enterprises into private family-owned farms. However, because it is extremely dependent on agricultural sector revenues to finance budgetary expenditures at present, it wants to achieve this objective only gradually. The reform of the agricultural sector is being carried out step-by-step according to the

Government resolutions issued thus far. Three main forms of farm management are being established in the rural areas: (i) agricultural *shirkats* as large rural cooperative producers especially in cotton and grain growing areas where scale economies can be realized; (ii) private farms (30-200 hectares and not less than 30 farm households), and (iii) *dekhan* farms (individual household farms). In total 1,424 private farms were transformed into *shirkats* in the January-June 2000 period in order to realize scale economies in the production of cotton and grain. On July 1 of the current year, the number of *dekhan* farms engaged in agricultural production reached 404,000. This is an increase of 119,000 *dekhan* farms compared with the situation on 1 July last year and is indicative of the rapid pace of reforms being undertaken in the agriculture sector. Agricultural policy aims at achieving food self-sufficiency through shifting from cotton monoculture to food crops, expanding the supply of agricultural products to export markets and enhancing farm independence.

9. As announced by the Government, liberalization of the foreign exchange and trade regimes is expected to be conducted during 2000-2001. On June 29 and June 30, 2000 the Government introduced a number of changes to the foreign exchange and trade regimes with the aim of liberalizing both access and sale of foreign exchange, establishing a realistic market rate for certain transactions and encouraging informal foreign trade in consumer goods. However, some problems remain, especially regarding access to foreign exchange. These have led to a further depreciation of the curb market exchange rate, effectively reestablishing a system of three exchange rates. The official Sum/\$ rate depreciated by 69.8 percent in the first half 2000, compared to 12.4 percent in the first half of 1999. The depreciation of the Sum against the US dollar on the curb market was 138 percent in 1999, which is 3 times more than in 1998. The curb market rate at the end of September 2000 was about Sum 790=\$1 compared to Sum 750=\$1 at the end of 1999. Partly as a result of the reforms of June 29 and June 30, the difference between the official rate and the curb market rate has been reduced to about 2.5 times compared to about 3.5 times during certain periods of 1999.

10. The planned introduction of current account convertibility must be seen by the authorities as part of a broad-based economic reform program that will comprise price and trade liberalization as well as structural reforms in the agricultural, enterprise and commercial banking sectors. Several of the structural reform measures have already been announced during 2000. Some of these measures such as unification of the official and commercial bank exchange rates, the increase in energy prices, and the setting up of a special commission to draw up rules for the privatization of enterprises in charge of raw cotton and cotton sales, represent steps towards liberalizing the economic system and making it more market-oriented. However, other policy measures, such as Resolution 103 of 24 March 2000 that requires all foreigners to pay for services provided by Uzbek enterprises exclusively in convertible foreign exchange and the 5 percent tax on the purchase of foreign exchange, still result in excessive Government intervention in economic activity and distort markets.

11. The measures introduced on 30 June 2000 are a useful first step towards foreign exchange liberalization. There is the risk; however, that some of the imperfections will discredit the reform process altogether, as unfavorable economic results (such as high inflation and continued exchange rate depreciation) will provide arguments to those who oppose any liberalization of the forex regime. The main reasons for this outcome are the lack of macroeconomic policy tightening in support of the liberalization measures and the continuation of restrictions on access to foreign exchange. Therefore, the key areas where further reforms are needed include the following actions: (i) create a truly market determined exchange rate; (ii) bring inflation under control; (iii) rationalize and enlarge the commercial banks' market for non-

cash foreign exchange; and (iv) take accompanying structural measures to increase exports and foreign direct investment.

12. The Government authorities continue to take gradual but necessary steps to unify the exchange rate. In June 2000, during the visit of the IMF Technical Mission, the Government had stated that it would not seek IMF assistance in completing the macroeconomic reform program as it wanted to implement the reforms at its own pace to minimize the social costs on the population at large. However, the Government requested the IMF to continue providing advice in implementing the macroeconomic reforms over a one year period. Accordingly, the IMF is providing guidance on a continuous basis. An additional opportunity to review the progress in implementing the reforms will arise during the forthcoming Article IV Consultations Mission in November 2000.

13. The recent security incidents have distracted the Government's attention temporarily from the economic reform program. This however, will change as the security situation is expected to be improved.