

Global financial crisis: Challenges for employment, modernization, and sustainable growth in Uzbekistan

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Economic performance in Uzbekistan, 2004–2008

Accelerating economic growth and exports

Since 2004, economic growth rates in Uzbekistan have been high. According to official statistics, in 2004–2008 gross domestic product (GDP) growth averaged 8.0% a year. The main factors were economic liberalization, primarily the introduction of current account convertibility, agricultural reforms, and a favorable external market environment, including economic growth in the main trading partners.

A distinct feature of this period is that the high GDP growth rate was achieved not only by traditional commodity sectors such as agriculture, but also by high-tech industries creating substantial value added and enhancing the country's competitiveness. Already contributing to sustainable economic development are emerging industries producing finished products, which are competitive in world markets and less prone to the volatility of world commodity markets.

Table 1: Key macroeconomic indicators

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 ^a
GDP	103.8	104.2	104.0	104.2	107.4	107.0	107.5	109.5	109.0	108.0
Industrial output	105.9	107.6	108.3	106.0	109.4	107.2	110.8	112.1	112.7	109.3
Agriculture output	103.1	104.2	106.0	107.3	108.9	105.4	106.7	106.1	104.5	105.0
Export of goods and services	100.9	97.1	94.3	124.6	130.3	111.5	118.1	140.7	127.8	109.9
Investment in capital assets	101.0	104	103.8	104.5	105.2	107.0	109.1	122.9	128.3	118.0
Central bank refinancing rate (%)	32.3	26.8	34.5	27.1	18.8	16.0	14.0	14.0	14.0	14.0
Inflation (%)	28.2	26.6	21.6	3.8	3.7	7.8	6.8	6.8	7.8	7.9

a. Preliminary.

Source: State Statistics Committee of Uzbekistan.

At the same time, high international prices for key export commodities increased the economy's vulnerability to external shocks.

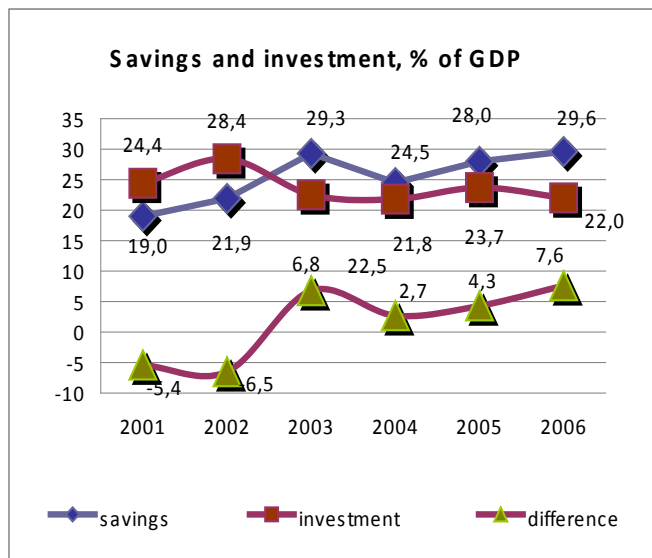
Accumulating income (savings)

Investment policy facilitated the advancement of structural reforms, modernization of the economy, and foreign investment. Investment recorded annual growth of 7–9% in priority investment projects.

Benefits and preferences created to encourage investment increased the share of company equity, foreign direct investment, and loans in the general composition of investments. However, since 2002 total savings were higher than investments, partially due to the growth in total currency reserves. This

excess of private savings presents an opportunity to both increase overall investment and enhance the contribution of the private sector to growth. The private-sector savings surplus indicates that the problem of financing growth in Uzbekistan is not due to lack of savings, but to the failure to mobilize savings for investment purposes. Critically lacking are the mechanisms to convert savings into productive investments. Effective mechanisms need to be developed.

Figure 1



Source: State Statistics Committee of Uzbekistan.

The Fund for the Reconstruction and Development of the Republic of Uzbekistan was established in 2006 with the objectives of ensuring the macroeconomic stabilization and utilization of financial resources generated as a result of favorable world prices for the financing of strategically important investment projects in the basic sectors of the economy.

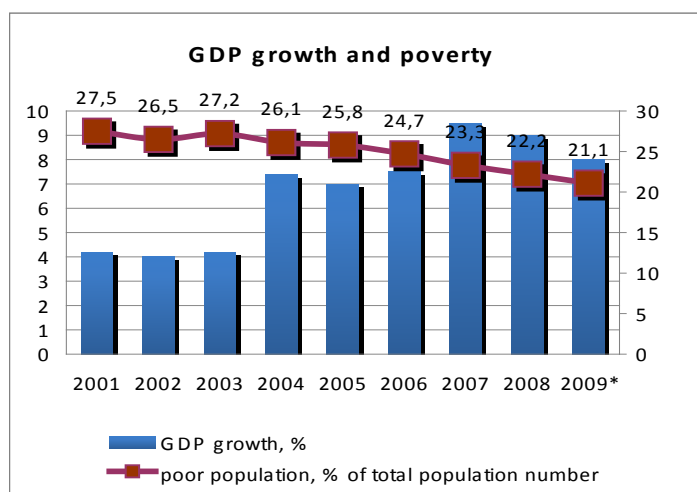
The main challenge in investment policy is not just the search for additional sources of financing but also to create a portfolio of effective investment projects and a good regulatory environment such that they can be implemented without excessive bureaucratic procedures.

The availability of material and human resources in the investment process will be an important factor for such successful investment activities, requiring additional efforts both in expanding the production of construction materials and for training highly qualified engineers and construction staff.

Slow and uneven poverty reduction

Based on the findings of the Household Budget Survey in 2001, the World Bank carried out a living standards assessment, the results of which showed that in 2001 the poverty level in the country was 27.5%, or 6.8 million people below the poverty line out of a population of 27.5 million. Analysis of Survey data for 2001–2007 shows a steady but limited trend of poverty reduction, from 27.5% to 23.6%.

Figure 2



Data for 2008 and 2009 are preliminary.

Source: "The Welfare Improvement Strategy of Uzbekistan. Full strategy paper for 2008–2010." 2007. Tashkent.

The pace of poverty reduction is more rapid in urban areas (from 22.5% to 17.6%), and the gap between urban and rural areas is growing: in 2001 it was 8%, and by 2007 it had reached 9.5%. In 2007, 73.1% of the poor were living in rural areas.¹ This demonstrates that the benefits of growth were bypassing the rural population.

The Government addresses unemployment through targeted employment programs, job creation, support to small enterprises, and measures to increase self-employment opportunities. However, the labor intensity of economic growth remains relatively low. In these circumstances, in 2007 the Government adopted the Welfare Improvement Strategy for 2008–2010, to be implemented using the resources accumulated during previous periods. The launch of this Strategy coincided with the start of the global financial crisis.

Crisis of 2008–2009: Implications

The global financial crisis has affected Uzbekistan's economy indirectly, mostly through its major trade and economic partners. The indirect impact was mainly due to the limited integration of the national financial sector in the global financial market and to the country's low external borrowing.

The main channels of contagion from the global economic crisis run through foreign trade and remittances.

Foreign trade

Foreseeing the possibility of external shocks, since 2008 Uzbekistan has increased its share of energy in the export structure. This allowed it to sustain export volumes at the precrisis level. At the same time, Uzbekistan was unable to avoid a certain reduction of the share of finished products. This affected employment in labor-intensive sectors, such as automobiles, textiles, and fruits and vegetables.

¹ In 2007, the rural population constituted 63.8% of the total.

Figure 3: Foreign trade, \$ million

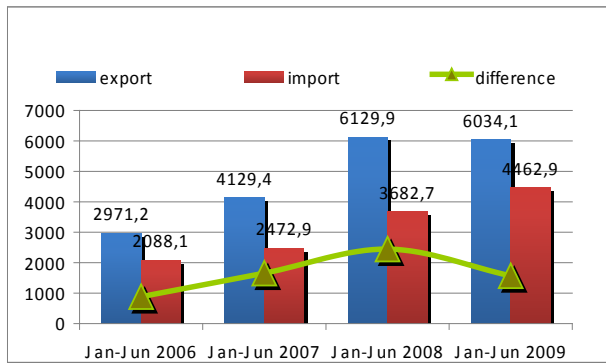
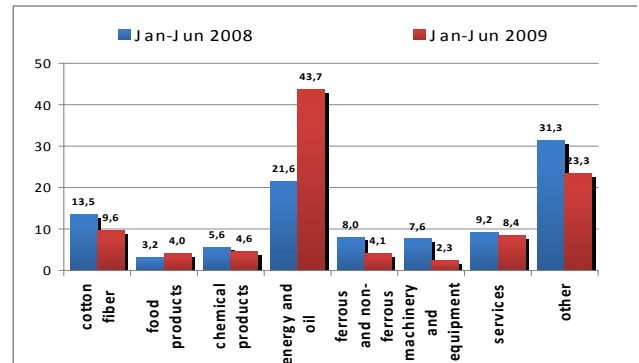


Figure 4: Structure of export, %



Source: State Statistics Committee of Uzbekistan.

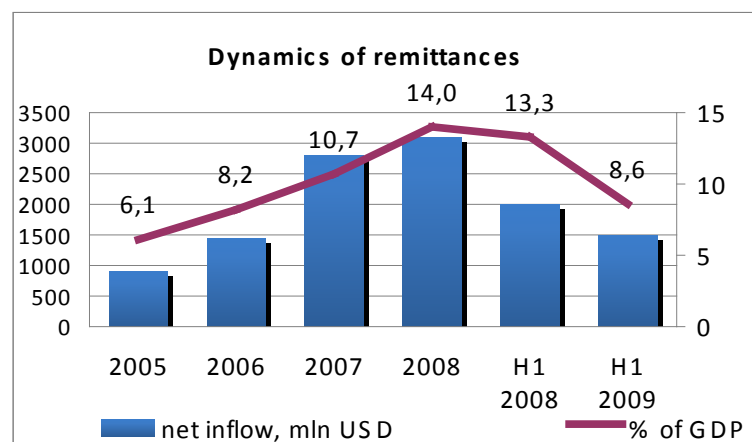
The prices for the main export commodities including cotton, copper, and uranium (but excluding gas) fell in 2008. Taking into account the fact that since 1 January 2009, the export price of gas for Uzbekistan has been determined on a formula correlated with the gas price in Europe and the world price for oil, the export price for gas increased in the first half of 2009. Compared to 2008, the gas price from Uzbekistan doubled at a time when export demand increased from the Russian Federation. The increased revenues helped offset decreases in some other export items.

Shrinking world demand had obvious implications, and in particular led to some decrease of export gains by economic entities and investors, affecting their income and profitability. Moreover, in 2007–2008, Uzbekistan was affected by the world food crisis, which led to a growth of prices for the majority of food products, both locally produced and imported. This also led to the reduction of consumption and reduction in private investments.

Remittances

Over the past 7 years, Uzbekistan has benefited from remittance inflows of labor migrants, mainly from the Russian Federation. As a result of the global financial crisis, economic activity in the country is shrinking (particularly in real estate and construction). Labor migrants from Uzbekistan, as well as from other Central Asian countries, are now losing their jobs. Some of the migrants have started returning home, as the demand for labor has dropped dramatically while the number of workers has not. It is expected that remittances will decrease by at least 30% due to the devaluation of the Russian ruble.

Figure 5

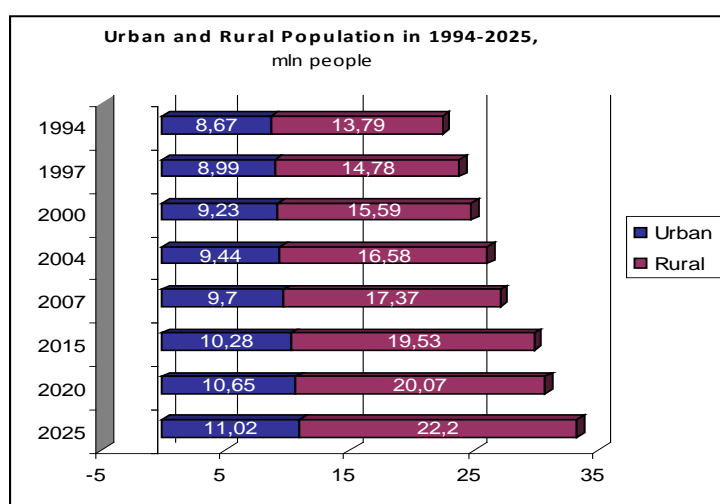


Sources: Calculated from data of the Central Bank of Russia; IMF data, “The Impact of remittances on the economy of Uzbekistan,” Policy Brief, CER, 2007.

The overall volume of remittances should stabilize during 2010, as more migrants travel to the Russian Federation to find jobs and substitute for the shrinking remittances from other family members. Migrants are likely to seek other niches in the Russian Federation since job opportunities at home are still limited. This is partly related to structural reforms in agriculture (most of the migrants are from rural areas), including the enlargement of farms.² As a result of such enlargement, only 105,000 farms remain out of 220,000 farms. In 3 months (October–December 2008), more than 115,000 farmers (more than 500,000 people including dependents) lost plots of land, which they had obtained during the previous phase of agrarian reform. The consequences of these structural reforms in agriculture are twofold: on the one hand it is expected that agricultural productivity will increase, while on the other an excessive supply of labor in rural areas will be seen.

According to CER estimates (CER 2009), productivity increases in agriculture could reduce employment in the sector from 3 million to 2 million people. In the medium term, Uzbekistan will face the challenge of a huge labor surplus in rural areas, reaching approximately 7 million people by 2025, which may lead to an increase in unemployment, and further decreases in the incomes and living standards of rural households. This increasing supply of labor in rural areas would generate major internal (rural–urban) and external migration.

Figure 6



Source: CER calculations based on data of the State Statistics Committee of Uzbekistan.

Government response measures

Responding to the need to sustain economic growth, employment, and social stability, the Government outlined a large-scale anti-crisis package in four presidential decrees at the end of 2008. The total value of the rescue package is 3.9% of GDP or US\$1.35 billion.³ The rescue package is for 4 years (2009–2012). The Government also announced a set of measures aimed at accelerated modernization of national industries for 2009–2014, with ambitious investment commitments totaling US\$42 billion. This type of industrial policy mainly seeks to preserve and diversify the sources of budget revenues.

The main objective of the Government was to sustain employment and income levels. For this reason a set of measures was adopted for supporting exporters and stimulating internal demand.

² When two or three small or medium-sized private farms were merged to establish one private farm with more land.

³ According to Avesta research calculations. This does not include the huge amount of investments aimed at modernization of national industries.

Supporting exporters

The following measures were used:

- Tax privileges for exporters of finished textile products
- Temporary reduction of amortization payments
- Debt restructuring for enterprises that underwent technical modernization within the last 2 years via bank credits
- Reduced lending rate for working assets
- Limited growth of price for natural gas, electricity, and water in 2009 to no more than 6–8%.

Not all measures could be rapidly implemented, and not all enterprises have fully benefited from them. However, these measures have fulfilled their key objectives:

- Existing external markets were preserved
- Although the volumes of export of manufactured products were reduced, a sharp drop in export volume has been avoided. The growth of exports was 2.8% in the first half of 2009.

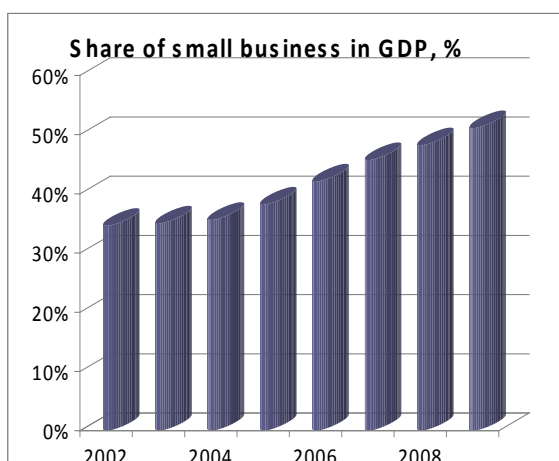
Stimulating internal demand

Stimulating private entrepreneurship

The share of the business sector in GDP is 50%, and generates incomes for 73% of the employed population. Private property dominates all spheres of the economy, except transport. Sectors that employ the majority of the low-income population (retail trade and agriculture) are privately owned. Hence, the development of this sector is of particular importance for reducing the negative social implications of the global financial crisis. Anti-crisis measures are aimed at stimulating rapid creation of enterprises, especially in industry, and include:

- Reduced single tax payment for small industrial enterprises from 8% to 7%
- Rapidly reduced (up to 10 times) costs of services for doing business: registration, cadastral, architecture, etc.
- Dividends made tax exempt for founders of small enterprises.

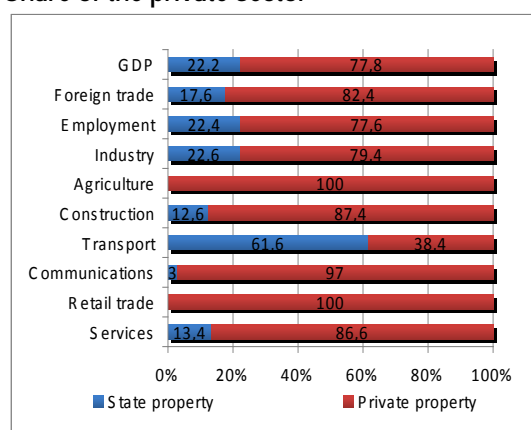
Figure 7



Source: State Statistics Committee of Uzbekistan.

Figure 8

Share of the private sector



Source: Adapted from the materials of the International conference on “The global financial economic crisis, ways and measures to overcome it in the conditions of Uzbekistan”, Tashkent, 22 May 2009.

Promoting strong investment activity

The Government regards maintaining high investment activity as the key factor to ensure the creation of new jobs. Investments are stimulated through a reduced tax burden on the corporate sector and population, providing considerable privileges and stimulus for foreign investors, and more active use of privileged investment loans of the Fund for the Reconstruction and Development of the Republic of Uzbekistan for strategic projects. Owing to such a strategy, Uzbekistan, despite the crisis, did not experience lower investment activity, unlike the majority of developed and developing markets. In the first half of 2009:

- The inflow of investment in the economy increased compared to precrisis 2007
- The inflow of foreign investment increased (more than 70% of investment is FDI).

Figure 9

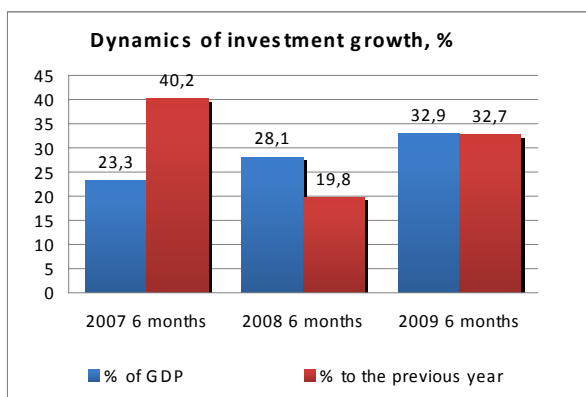
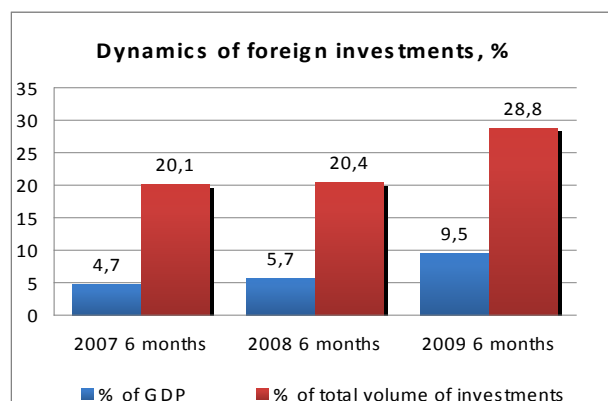


Figure 10



Source: Calculated based on data from the State Statistics Committee of Uzbekistan.

To stimulate investment activity, the capacity of the banking sector was strengthened, as follows.

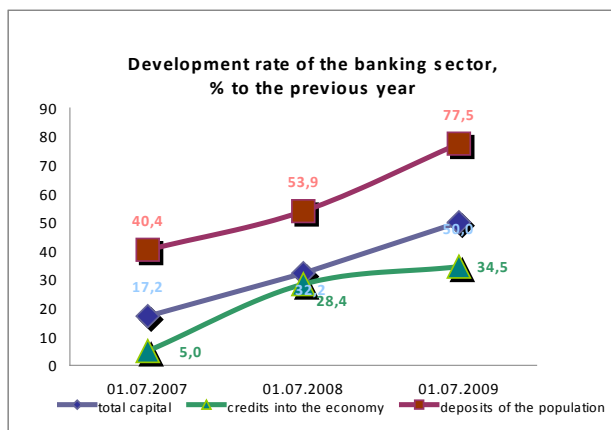
Increasing share capital of five strategic banks, serving the key sectors of the economy. As a result, credit to the economy has been scaled up.

Sustaining liquidity. The current amount of commercial banks' assets currently exceeds the amount of deposits from the population and economic actors by 2.4 times.

Strengthening credit support to private entrepreneurship. This was mainly through the activity of Microcreditbank, which was created in 2006. Creation of credit unions and microcredit organizations was also accelerated.

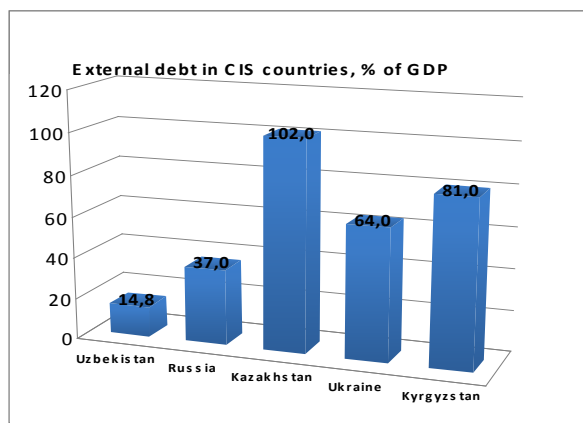
Discontinuing the practice of not using short-term external loans. The banking system retained its sustainability due to a low level of external debt obligations. Uzbekistan had always followed the principle of rejecting short-term external borrowings.

Figure 11



Source: Based on author's calculations using official data of the Central Bank of Uzbekistan.

Figure 12



Source: Adapted from the materials of the International conference on "The global financial economic crisis, ways and measures to overcome it in the conditions of Uzbekistan", Tashkent, 22 May 2009.

Considerable expansion of industrial and social infrastructure

Measures in this area included the following.

Expanding construction of educational facilities. Colleges, academic lyceums, schools, sport facilities, etc. were included.

Accelerating construction of infrastructure facilities and houses in rural areas. A specialized bank for rural construction was created for supporting these activities, as well as a number of repair and construction companies in each district. The year 2009 was proclaimed the year of support to rural areas.

Boosting road and rail. Construction of 1,501 km of national highway was initiated, and the electrification of railroads was accelerated.

Industrial cooperation. A localization program is being implemented, which aims at stimulating production of commodities from local raw materials with active use of household labor. In 2009, it is planned to intensify the activities within the framework of this program by 3.5–4 times in sectors that create the largest multiplier effect for increasing internal demand and job creation (machinery building, electro-technical, light and food industry, and production of construction materials).

Optimizing agricultural crops. This assumes reduced areas under cotton and increasing production of oilseeds and vegetables, which yield crops twice a year. This would allow the rural population to considerably increase their incomes.

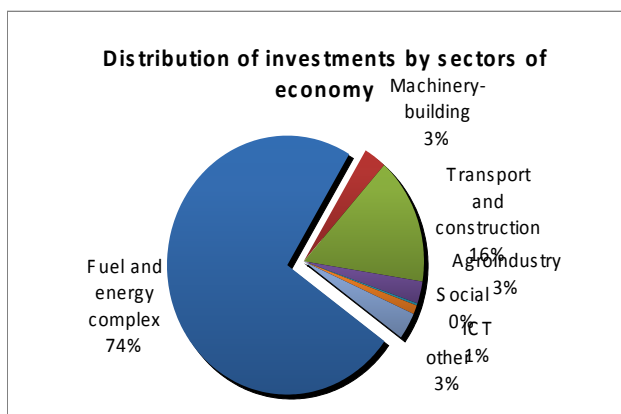
Summarizing the interim results of implementing the anti-crisis program, we can say that the measures aimed at stimulating internal demand appear to be relatively effective. They led to high economic growth rates of 8.2% in the first half of 2009 (as against 9.3% in the first half of 2008).

Prospects for post-crisis development

In the long run, Uzbekistan will focus on intensifying its structural transformation to significantly increase the competitiveness of the national economy. This will require the following.

Accelerating modernization of real economy sectors. In March 2009, Uzbekistan adopted the Long-term Program on Technical and Technological Reequipping of Production for 2009–2014.

Figure 13



Source: Calculated based on data from the Program on Technical and Technological Reequipment of Production for 2009–2014.

With a considerable program budget (US\$42.5 billion), it envisages large-scale absorption of investment as well as job creation, which will be the driving force of economic development for the next 8–10 years. Such a huge amount of resources allows us to refer to an “investment boom”.

Reducing dependence on external markets. This entails increasing the share of products with high added value in the structure of GDP and exports. In addition, it is planned to expand the geographic diversification of exports, primarily via the growing Asian market.

Figure 14

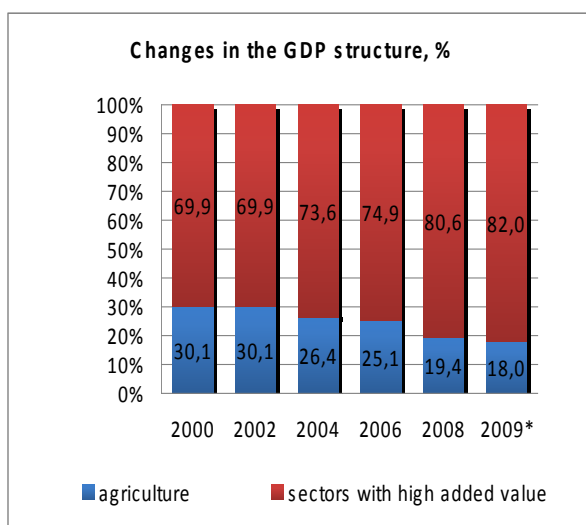
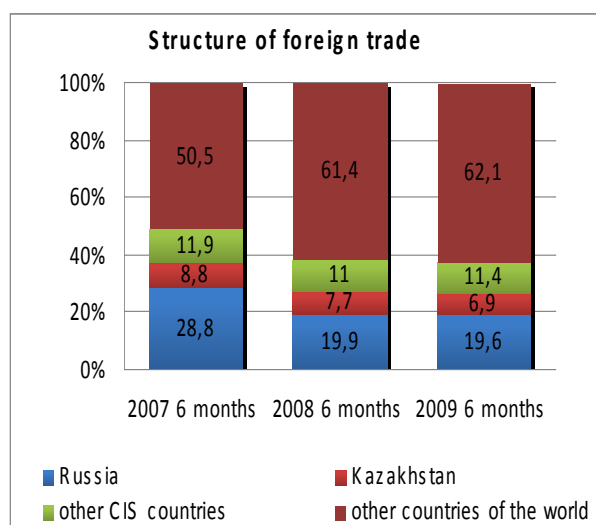


Figure 15



Source: State Statistics Committee of Uzbekistan.

Long-term challenges and sustainable growth in Uzbekistan

While implementing the long-term reform agenda, Uzbekistan will face a range of challenges, in the following areas.

Demography and accelerating urbanization. Uzbekistan has a relatively high population growth rate (1.3–1.7%), especially in rural areas. In the medium run, the country will face a challenge related to an excessive labor force in rural areas, which may reach approximately 7 million by 2025. This, in turn, may lead to unemployment, and lower incomes and living standards of the rural population. Increasing the

supply of labor in rural areas will create new migration flows (both internal and external) thus aggravating urbanization and employment-related problems in cities. Their possible outcome is an accelerated shift from rural to urban poverty.

The state and the private sector. The need for financing capital-intensive, long-term modernization projects will lead to a need to decentralize certain functions and transfer some roles to the private sector. This will require a search for new forms of interaction between public and private sectors. Such forms have to ensure effective mobilization of investment and flexibility in developing and implementing investment initiatives.

Large and small business. Despite the important role of entrepreneurship in promoting employment, its current financial capacities are insufficient for implementation of large-scale modernization projects that require a high concentration of capital. As a result, there will be disconnects between the objectives of modernization projects and the labor-intensive nature of the economy. It will become more important to find an optimal balance between large and small business for resolving such disconnects, calling for an intensified dialogue among the state and private sectors, as well as for an accelerated process of public–private partnership.

Competitiveness and integration process. A significant increase of economic competitiveness assumes intensification of innovation processes and the creation of new sectors calling for protection of the domestic market. This will inevitably reduce the pace of integration. Yet investment in the real sector will create a basis for markets in the post-crisis period, because, having preserved and modernized its industrial capacity, Uzbekistan will be able to carry out a more aggressive foreign trade policy in regional markets.

Strong investment activity and the environment. The majority of developing countries that demonstrated high investment-led economic growth are paying the price for it with environment-related problems. The investment boom in Uzbekistan may aggravate the problems of energy and water supply, worsen the quality of land and water, and exacerbate wind erosion. Much will depend on the pace of introducing innovative energy- and resource-saving technologies.

Modernization and a new class of creative labor force. An ambitious modernization program aims to increase demand for a more skilled and diversified labor force. However, the current national standards of secondary education (introduced in 1999) are mainly focused on regulating the volume of theoretical knowledge to be transferred to graduates. They do not reflect the key skills and competencies that students need to be successful in a knowledge-based economy (such as communication, problem solving, creative thinking, analytical skills, learning to learn, and use of information).

Currently there is a growing attention to studying these problems and to elaborating relevant public policy measures.

Recommendations

Demography and accelerating urbanization. The framing of a common vision of urban territories in relationship to socioeconomic development requires the development of urban planning systems. In this regard, a commonly applied instrument for medium-sized and large cities, or for networks of small cities, is the City Development Strategy, which helps cities move beyond short-term planning to consider where they should be in 20 years, and identify the steps that need to be taken to achieve those goals. In Uzbekistan, particular attention should be paid to regional networks of cities, small urban centers, and villages because of competition with agriculture on land use.

It is also essential to develop capacities and instruments to promote integrated territorial development at regional, district, and city levels in order to adequately address the wide variety of challenges related to human settlements. This approach is currently implemented at the regional level under the program Enhancement of Living Standards in the Republic of Karakalpakstan and Namangan Region. The next step is the preparation of a national country housing profile that will provide a comprehensive

assessment of the housing sector's performance and help the Government frame an appropriate action plan.

The state and the private sector. Despite the fact that creation of a new class of owners and full-fledged support to private entrepreneurship in Uzbekistan are deemed as key priorities of economic transformation, the Government is still continuing to use some administrative measures on businesses. Thus the mechanism of interaction between local and representative governance bodies should be improved. It is important to make widespread the use of corporate governance institutions, to reduce the barriers to doing business (to the extent possible), and to use purely economic levers for regulating the activity of enterprises.

Large and small business. Large-scale modernization programs increase the importance of concentration of capital and creation of relevant institutions. This can be done through the creation of financial-industrial groups, which represent one of the most flexible and effective forms of integrating companies in various branches and sectors of the economy.

Competitiveness. Improving the public investment policy in Uzbekistan should be considered in the context of enhancing the quality focus of ongoing modernization programs. The relevance of such an approach is complemented by implementation of large-scale modernization programs designed to lay the foundation of the development of the country's production capacities some 20–30 years in advance. The following directions of developing the quality components can be considered:

- *Rethinking the focus in setting objectives for sector investment policy.* It is necessary to shift from a universal development strategy, which inevitably determines the universal nature of objectives and instruments of public investment policy for all branches of the real sector of economy, toward a strategy focusing on certain industries to be used for technological breakthrough ("points of growth").
- *Introduction of a technological component in investment policy tools.* Uzbekistan needs to develop its own long-term technological policy. The law on technical regulation and the system of sector technical regulations developed on that basis should serve as instruments of incentives and sanctions. They should be the only criteria for the quality of modernization programs, as a substantial part of the real sector "lives" according to the standards of the Soviet economy.
- *Optimal use of the benefits of international technological exchange.* To strengthen the process of international technological cooperation it is necessary to choose such forms and instruments that will provide unique technologies (determining the success of a technological breakthrough), and, at the same time, allow Uzbekistan to avoid greater industrial and technological dependence on other countries.

Strong investment activity and environment. The objective is not to limit economic growth, but to ensure its environmental sustainability. To this end, it is necessary to shift from traditional concepts of environmentally unsustainable growth ("growth comes first, then pollution control") to the concept of "green growth". This concept allows a reduction in pressure on the environment by improving the environmental efficiency of production and consumption models, thereby ensuring a mutually beneficial interaction between the economy and the environment. The success of environmentally friendly models of growth depends on efforts to support the conceptual and system changes required for mutual strengthening and interaction between environmental and economic policies.

It is necessary to include environmental costs in the structure of prices. Conceptual and system changes should be achieved through coordinated efforts among government, private sector, and civil society. The Government should take leadership in the implementation of these changes, whereas the private sector can offer technical innovations required for the integration of the environment and economy, thus ensuring mutually beneficial relationships between them. Civil society is expected to recognize the concept of environmentally friendly growth, and promote its use.

Modernization and a new class of creative labor force. Further investment in secondary education should be accompanied by a revision of approaches to formulating educational standards. New standards should be focused on providing graduates with essential knowledge, skills and competencies,

as well as reflecting teaching methods and approaches. Specifying the minimum resource requirements for education is also important in order to streamline the work of equipping schools. Standards and systems for assessment and monitoring the implementation of educational standards and learning achievements should be established for secondary education, as part of an overall system of quality assurance. The Government should therefore review the institutional arrangements for the sector and establish an independent agency with the necessary human, financial, and technical resources.

Reference

“Urbanization and industrialization in Uzbekistan: Challenges, problems and prospects,” Policy brief, CER, 2009.