

32. The policies and institutional arrangements adopted by Uzbekistan might have been effective in mitigating the adverse economic impacts of the collapse of the FSU. Arguably, they might have been justified and even appropriate as emergency measures to cope with the crisis conditions immediately after independence. However, like a virtue that is pushed too far and becomes a vice, they are unsuitable in the longer term for robust and sustainable growth. Their retention has inhibited, rather than promoted, growth—and will continue to do so. The challenge for Uzbekistan is unshackle PSD.

### **III. PROFILE AND DEVELOPMENT DYNAMICS OF THE PRIVATE SECTOR**

#### **A. Process and Pace of Privatization**

33. At the time of independence, the private sector in Uzbekistan was practically nonexistent. Its development since 1991 was initiated through the privatization of small state-owned enterprises (SOE). Important progress was made in privatization during 1992–1997, when almost all small enterprises were said to have been privatized by 1995 and the privatization of medium enterprises began. By the end of this first phase of privatization, almost all small and medium-sized enterprises (SME) in retail trade, services, food industries, transport, and construction had been privatized.

34. Since 1997, however, privatization has slowed markedly. Most key medium and large industrial enterprises remain under state ownership or control. Case-by-case privatization of medium-sized and large enterprise started during the second phase of privatization around 1998, when the Government announced its intention to launch a mass privatization program with the aim of increasing the private sector's share of GDP to 60%. The program envisaged restructuring about 3000 state enterprises as corporations, and selling 51% controlling interests to private investment funds. The program had limited success, in large part due a lack of interested investors. To promote foreign participation in the case-by-case privatization of larger enterprises, the Bureau for Individual Privatization of Enterprises was established within the State Committee for State Property Management and Entrepreneurship Support (Goskomimushchestvo or GKI) with World Bank support. By 2000, however, the privatization of large enterprises and key industries, such as fuel, energy, and railway, still had not commenced.

35. The annual privatization plan in 2000 included the privatization of 167 enterprises, with the actual number privatized at 374.<sup>12</sup> In 2001, only about 20% of the 1,803 large and medium industrial enterprises operating at the time had been fully privatized. The Government still held stakes of 25% or more in the remaining 80% (Table 4). At the end of 2001, 35% of medium-sized and large industrial enterprises remained fully state-owned and had not even been restructured as corporations, while 10% were unincorporated private enterprises.

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<sup>12</sup> CEEP. 2003. *Uzbekistan Economy: Statistical and Analytical Review – Annual Issue 2002*.

**Table 4: Privatization of Large and Medium Enterprises, 2001**

	Industrial Enterprises	Percentage of Total	All Sectors	Percentage of Total
Large and Medium Corporatized	1,803	100	27,805	100
Of which:	999	55	4,654	17
100% Private	187	10	1,746	6
Up to 25.5% State-Owned	641	36	2,568	9
25.5%-50.5% State-Owned	10	0.6	102	0
Over 50.5% State-Owned	161	9	220	1
Uncorporatized <sup>a</sup>	804	45	23,151	83

<sup>a</sup> 35% of all uncorporatized industrial enterprises were 100% state-owned, with 10% of the remaining 65% privately-owned. This means about 20% of the total was private.

Sources: State Committee on Statistics, State Committee for State Property Management and Entrepreneurship Support, World Bank.

36. Official reports stated that privatization of companies in trade, construction, and machine building had been “mostly completed” by early 2002, while privatization of large-scale industries such as fuel, energy, and railway had not begun. Subsequently, with the issuance of Government resolutions on privatization of large enterprises and additional sale of state shares in (partially) privatized companies, the number of privatized enterprises increased to 1,912 during 2002.<sup>13</sup> In 2000–2002, approximately 3,410 enterprises were newly established under various ownership forms (Table 5). Large plants and enterprises were converted into shareholding entities, and smaller enterprises mostly transformed into private individual enterprises. Most of the latter were formed through the privatization of small production and service units (e.g., trade, catering, and other services) belonging to large enterprises.

**Table 5: State-Owned Enterprises Privatized, 1995–2003**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Number of SOEs Privatized	8,537	1,915	1,231	451	448	374	1,449	1,912	1,519
Number of Non-SOEs Established: <sup>a</sup> including:	8,537	1,915	899	266	373	372	1,238	1,800	1,452
Joint stock companies	1,026	1,257	456	110	141	152	227	223	75
Sole proprietorships	6,036	420	260	103	156	103	827	1,252	981
Other types of Incorporation	1,475	238	183	53	76	117	184	325	396
Privatization Proceeds (SUM billion)	2.4	5.3	4.4	8.9	9.1	14.3	23.2	43.6	56.1

<sup>a</sup> Established on basis of private property.

Source: Centre for Effective Economic Policy.

37. By early 2003, only one large privatization transaction had been completed, although a few others were reported to be at advanced stages. The state remained the dominant owner of large enterprises. Less than half of all large enterprises were majority owned by the private sector. Most strategic industries, including energy, telecommunication, and mining, remained under state control. In April 2003, the Government issued a resolution titled “On the Program for the Denationalization and Privatization of Enterprises in 2003–2004.” In line with this resolution,

<sup>13</sup> Enterprises in the basic industries that were (partially) privatized included Elektrokhimprom, Navoiazot, Uzbekrezinotekhnika, the power plants in Tashkent and Ferghana, and the Sarddarya hydropower plant.

the authorities divested state property, unplaced state shares and stakes in the charter capitals of 972 joint stock companies (JSC) and 129 limited liability companies. For 2003, 1,519 enterprises (and other entities) were privatized, of which 9.3% were privatized through sales of shares and resulted in the formation of 75 JSCs.<sup>14</sup>

## B. Current Economic Landscape

38. This study was unable to find reliable disaggregated data on the private sector in Uzbekistan. Such data might not exist. Official statistics put the non-state and private sector share of GDP in 2003 at 74.5% and 42.3%, respectively. The European Bank for Reconstruction and Development (EBRD) estimated the private sector share of GDP in Uzbekistan at 45% for 2003.<sup>15</sup> Neither estimate is satisfactory or unambiguous as they do not explain clearly how the figures were determined. The Uzbek authorities explained that non-state enterprises are defined as those with less than 50% state holding, while private enterprises are defined as those 100% privately owned. However, many officially reported non-state enterprises have unplaced state shares, i.e. shares earmarked for privatization but not yet sold, and/or indirect state holdings. This means the state effectively remains the majority shareholder (Box 2). In addition, even in non-state enterprises where the state is clearly a minority shareholder, agencies often continue to exercise controlling rights and the dominant voice in corporate governance.

### Box 2: Classification of State, Non-State, and Private Enterprises

The process of privatization of medium-sized and large enterprises in Uzbekistan typically involved their corporatization into joint stock companies (JSCs) with shares divided into four blocs of 25%. Three of the blocs were designated for sale to insiders, outsiders, and foreigners, respectively; the remaining bloc was to be retained by the state. In most cases, employees and managers took up the 25% bloc for insiders. Over time, however, management gradually increased its shareholding. Such enterprises are classified as non-state. When the state directly or officially holds less than 50% of the shares, the enterprise is classified as private.

In practice, however, less than 20% of all medium-sized and large enterprises that were corporatized have been fully divested or privatized. The blocs allocated for sale to outsiders and foreigners usually have not been sold. In these cases, the state continues to hold the majority of shares. Still, since a percentage (25%) has been divested, these partially divested enterprises are categorized as non-state in the statistics—even though the state actually holds a majority of the shares through the officially registered 25% state holdings and unsold shares. This creates considerable confusion in the official statistics on the size of the state, non-state, and private sectors. Thus, a large part of what is officially reported as the non-state sector comprises enterprises in which the state has majority holdings. Further, several hundred medium-sized and large enterprises have not even been corporatized.

In a significant number of partially privatized enterprises, where the state directly holds less than 50% of the shares, the state often has additional indirect shareholdings through shares owned by partially privatized (e.g., non-state and private) enterprises in which the state also retains shareholdings. While the enterprise would be categorized as non-state or even private, the effective cumulated state shareholdings could constitute a majority. This leads to greater overestimation of the private sector.

The state's often opaque mutual and crossholdings in enterprise ownership also poses serious problems for corporate governance. Further, this creates moral hazards for anti-competitive behavior, as the shareholding of enterprises can be highly concentrated in only a few hands, or even in a single individual or entity. In fact, in many partially privatized enterprises where the state holds a nominal 25% share, it appoints trustees. This allows the state to retain a blocking right and exercise controlling rights and a dominant voice in corporate governance, which are much larger than the size of its official shareholdings.

<sup>14</sup> The largest number of state-owned enterprises SOEs privatized was in telecommunications (111), agriculture and water management (124), oil and gas (62), education (96), and health care (71).

<sup>15</sup> EBRD. 2004. *Transition Report*. London.

39. With the caveat on what non-state and private might mean in practice in terms of state ownership and control, the majority of Uzbekistan's enterprises belongs to the non-state and private sector. At the end of 2003, 90.8% of the 283,900 registered enterprises were non-state or private. The largest sub-group of non-state or private enterprises (39.7%) were farms. JSCs accounted for 1.8%, limited liability companies for 1.1%, and enterprises with FDI for 1.1% of the total (Table 6).

**Table 6: Distribution of Registered Enterprises by Forms of Legal Ownership, 2002–2003**  
(%)

<b>Form of Ownership</b>	<b>2003</b>	<b>2002</b>	<b>2002<sup>a</sup></b>	<b>Form of Ownership</b>
State Property	9.2	10.0	12.0	State Property
Various Types of Farms	39.7	37.0	30.0	Peasant and Farmers
Joint Stock Companies	1.8	2.9	4.0	Joint Stock Companies
Foreign-Invested Enterprises	1.1	1.1	6.0	Limited Liability Companies
Others	48.2	49.0	29.0	Sole Proprietorships
			19.0	Cooperatives and Noncommercial Firms

<sup>a</sup> The data for 2002 in the right column are from the Center for Effective Economic Policy. Note the differences in classification and inconsistency between the two sets of data for 2002.

Sources: State Committee on Statistics, Center for Effective Economic Policy.

40. Of all active enterprises, which is a subgroup of registered enterprises (some of which might not be active), non-state enterprises accounted for 74.5% of GDP (Table 7), 73.9% of industrial output, 99.2% of agricultural output, 88.8% of construction work, and 98.6% of retail trade turnover. Although JSCs and limited liability companies together accounted for only 2.9% of all active enterprises, they generate an overwhelming share of the output and employment.

**Table 7: Distribution of GDP and Sectoral Output by State and Non-State Sectors, 2003**  
(%)

	<b>State</b>	<b>Non-State</b>
GDP	25.5	74.5
Industry	26.1	73.9
Agriculture	0.8	99.2
Construction	11.2	88.8
Retail Trade Turnover	1.4	98.6
Paid Services	31.1	68.9
<b>National Employment</b>	<b>22.8</b>	<b>77.2</b>

GDP=gross domestic product.

Source: State Committee on Statistics.

41. Data on the size distribution of enterprises and industrial concentration in the Uzbek economy is scarce. The little information available indicates a high degree of concentration, with large enterprises accounting for 66% of GDP and 47% of employment in 2001 (Table 8). A study<sup>16</sup> of the performance of Uzbek industrial enterprises also found that production was highly concentrated in large enterprises. SMEs accounted for only 15% of GDP and 9% of employment. Medium-sized and large enterprises generated 86.2% of industrial output in 2003,

<sup>16</sup> Kim, B.S. and G. C-B. Fedyasheva. 2004. *Industrial Enterprise Rating Evaluation System*. CEEP. Tashkent.

according to official figures. Disaggregated data on the contribution of medium-sized and large enterprises to the output of industrial subsectors are not available.<sup>17</sup>

**Table 8: Distribution of GDP and Employment by Enterprise Size, 2001**  
(%)

	<b>GDP</b>	<b>Employment</b>
Large	66	47
Medium, Small, and Micro	15	9
Subsistence Farmers and Individual Entrepreneurs	19	44
<b>Total</b>	<b>100</b>	<b>100</b>

GDP = gross domestic product.

Source: State Committee on Statistics.

42. The State Committee on Economic Insolvency of Enterprises monitors all enterprises with state shareholding, as well as the more important enterprises that are classified as fully privatized (Table 9).

**Table 9: Enterprises Monitored by the State Committee on Economic Insolvency of Enterprises, 2004**

	<b>Number of Enterprises</b>
<b>Total</b>	<b>5,751</b>
Of which:	
Without State Shares <sup>a</sup>	1,326
Of which: Large	875
With State Shares	4,425
Of which:	
100% State-Owned	1,551
Large	837
Medium and Small	714
51–100% State Shares	729
Large	434
Medium and Small	295
25–51% State Shares	1,969
Large	1,127
Medium and Small	842
25% or Less State Shares	176
Large	89
Medium and Small	87

<sup>a</sup> Enterprises without direct state shareholding, many of which include indirect state shareholdings.

Source: State Committee on Economic Insolvency of Enterprises.

43. The enterprises covered by this monitoring system probably represent the backbone of the Uzbek industrial system and corporate sector. Data from the state committee show 4,425 enterprises with state shareholding, including 1,551 enterprises (35%) that are fully state-

<sup>17</sup> The statistical yearbooks only report total output (in physical terms) produced by medium and large enterprises in a number of key subsectors, such as (i) fuel and energy; (ii) chemical and petrochemical; (iii) mechanical engineering and metal working; (iv) timber, woodworking, pulp and paper; (v) building materials; (vi) glass and porcelain; (vii) light industry; (viii) food; and (ix) flour milling and feed mill. For these subsectors, which comprise the bulk of industrial production, medium and large enterprises can be assumed to account for the overwhelming share of production, with small (and micro) enterprises accounting for a very small share.

owned. Of these SOEs, the majority (53%) were large enterprises. Further, the state holds shares in an additional 2,874 partially divested enterprises, the majority of which are also large. Thus, almost all large enterprises in the country appear to be state-owned or state-controlled.

44. The State Committee on Statistics estimates formal employment in Uzbekistan at between 642,500 and 660,300 in 2001. Formal employment in industry and agriculture has fallen, with industrial employment declining from more than 1 million in 1991 to about 650,000 in 2001. The 38% contraction in industrial employment during 1991–2001 was nearly double the 20% contraction in industrial output, although the decline in formal industrial employment was partially offset by higher employment in the informal sector. Most of the increase in formal employment has been in the budgetary or public sector.

45. The State Committee on Statistics estimated the number of individual entrepreneurs at 2.8 million in 2001, including 500,000 in industry. However, the tax authority reported only 290,000 persons were registered as individual entrepreneurs in all economic sectors (or about 10% of the figure of the State Committee on Statistics).<sup>18</sup> Formal and informal employment in small, medium-sized, and micro-enterprises rose to more than 1 million by 1996, but almost halved in 1997 before gradually increasing again to about 800,000 in 2001. Employment generation by SMEs has been disappointing, while informal individual enterprises are increasing. The large and growing number of individual enterprises has increased the informal component of the economy.

46. In 2001, employment in non-state enterprises accounted for 77.2% of the national total. Individual enterprises and subsistence farmers, many of whom do not operate as registered enterprises, accounted for 19% of GDP and 44 % of total employment (13% in agriculture and the remainder in other sectors, mainly services).

### **C. The Private Sector in Agriculture**

47. Agriculture is the second largest sector after services in the Uzbek economy, with its share of GDP at 28.8% in 2003. Before Uzbekistan's independence, two formal organizations undertook agricultural production: state and collective farms, and individual household plots. The process of transition since 1991 has created new organizational and legal forms (Box 3).

48. Agriculture in Uzbekistan is characterized by two key features. First, the state owns the land. Farmers are given time-bound usufruct rights (right to use), not full property rights over land. Second, the state heavily regulates the size and types of activities, severely limiting the amount of land that can be devoted to particular activities. This heavy regulation leads to land fragmentation, inefficiencies due to the very small scale of operations, and irrational land use where restrictions prevent specialization according to comparative advantage. The combination of state ownership and regulation creates disincentives for investments to raise productivity. Further, these two features demonstrate that private operators, who are not private owners, generate much of agricultural production; and that extensive state controls hamper private initiatives. For these reasons, some observers have challenged the notion that much of agriculture belongs to the private sector.

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<sup>18</sup> A World Bank study argues that the total number of individual entrepreneurs and the number of individual entrepreneurs engaged in industrial activities are overestimated significantly, with actual numbers for the latter likely to be at most 71,000 (or 14% of the estimate of the State Committee on Statistics). Kitain, A. 2003. *Uzbekistan: Creating an Environment for Enterprise Development*. Washington, DC: World Bank.

### Box 3: Agricultural Organization in Uzbekistan

Before independence, state farms (sovkhoz) and collective farms (kolhoz) undertook agriculture production, with household plots playing a residual role. Sovkhozs, a form of state-owned enterprise, have been dismantled largely since independence. The main organizational forms in agriculture now comprise the following:

#### Collective Enterprises

Legal form: collective enterprise.

Land tenure: permanent collective possession (usufruct, not ownership)

Labor: labor contract with members and hired workers (nonmembers)

#### Cooperative (shirkat) Farm

Legal form: cooperative

Land tenure: permanent collective possession (usufruct, not ownership)

Labor: allotment of land and inputs, household contracts, shared benefits

#### Farming Enterprise

Legal form: various forms of legal entities

Land tenure: lease of 10–50 years

Labor: 1 household plus hired workers

Restrictions: size limits depending on type of activities; cattle less than 30 heads plus 0.3 ha per head in irrigated areas, or 0.45 in non-irrigated area, or 2 ha in desert area; vegetables, and fruits, less than 1 ha; wheat or cotton, less than 10 ha.

#### Farm

Legal form: not necessarily a legal entity

Land tenure: short-term lease of 3 years

#### Family (dekhan) Farm

Legal form: not necessarily a legal entity

Land tenure: lifetime possession

Labor: household workers plus only occasional hired labor

Restrictions: less than 0.35 ha in irrigated area or 0.5 ha in non-irrigated area or 1 ha in desert area

#### Household Plots

Land tenure: lifetime inheritable possession

Restrictions: less than 0.35 in irrigated area or 0.5 ha in non-irrigated area

Note: household workers include head of family, his/her spouse, children, parents, and other relatives of labor age, living together and undertaking peasant farming.

Source: Center for Effective Economic Policy.

49. Since 2000, agricultural production has been almost 100% non-state, according to official reports. The overwhelming share of agricultural output was accounted for by peasants, in terms of ownership forms, and by family farms in terms of organizational forms (Table 10). Cooperative and family farms together accounted for 80–85% of agricultural output. While farmers have permanent collective or household lifetime possession of land, their property rights are ambiguous, because land might not be freely sold or transferred.

**Table 10: Distribution of Agricultural Output  
by Ownership and Organizational Forms  
(%)**

Ownership Form	Rural Enterprises			Farmers			Peasants		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
Agricultural Output	27.8	26.8	24.6	5.5	6.9	9.9	66.7	66.3	65.0
Ownership Form	Family Farms		Agricultural Enterprises		Farms				
	2002	2003	2002	2003	2002	2003			
Agricultural Output	64.1	62.4	25.9	23.5	10.0	14.1			

Source: Centre for Effective Economic Policy

50. The lack of clear property rights and tradable rights in land are not the only things that hamper agriculture. Other constraints include the state's monopolistic powers in the provision of critical inputs and powers in the procurement of important food and cash crops, as well as its control over prices and quantities. Since 2002, collective and private farms have been allowed to sell 50% of the cotton and wheat harvest outside the state procurement system at free auctions. Still, state procurement remains significant. In 2003, for example, the state procured 43% of the total spiked cereals production of 5,780,700 tons.

#### **D. The SME Sector**

51. The SME sector in Uzbekistan comprises four categories of enterprises, and two forms of farming activities (Box 4).

52. The SME sector has grown significantly since transition began. The number of active SMEs increased from 126,000 in 1999 to 230,000 in 2003. However, small and microenterprises have accounted for most of the recent growth of the sector, while the number of medium enterprises has declined.<sup>19</sup> As a result, the SME sector is dominated overwhelmingly by microenterprises, which accounted for 86% of all SMEs in 2003.<sup>20</sup> Nearly half of SMEs were in agriculture, the sector with the largest concentration, followed by trade and catering (23%). Only 10% of SMEs were engaged in industry (Table 11).

53. The SME and individual entrepreneurs sectors engaged 5,465,100 people in 2003. Excluding individual entrepreneurs, registered SMEs employed 1,045,000 persons. Small, medium, and microenterprises accounted for about 11% of national employment in 2003.

54. With 229,000 active SMEs, Uzbekistan has nine SMEs per thousand people. This figure is higher than in Kazakhstan and Russian Federation, which have about seven SMEs per thousand persons, and twice as high as in Ukraine, which has four SMEs per thousand persons. However, the figure is well below the European Union average of 37–46 SMEs per thousand persons.

<sup>19</sup> The number of small and microenterprises grew by 18% and 50%, respectively, in 1999–2001, while the number of medium-sized enterprises fell by 8%.

<sup>20</sup> State Committee on Statistics. 2004. *Statistical Review of the Republic of Uzbekistan in 2003*. Tashkent.

#### Box 4: Definitions of Small and Medium Enterprises

**Individual entrepreneur:** an individual resident of Uzbekistan who is involved in entrepreneurial activity based on a patent issued by the local authorities. Unlike in most other Commonwealth of Independent States countries, including Russian Federation, Ukraine, and Kazakhstan, individual entrepreneurs in Uzbekistan are not allowed to contract or employ other individuals.

**Microenterprise:** an enterprise or organization with an annual average number of employees of up to 10 in manufacturing and up to five in trade, services, and other non-manufacturing activities.

**Small enterprise:** a company with an annual average number of employees above that for a microenterprises, but not exceeding 40 in manufacturing; 20 in construction, agriculture, and other sectors of industry; and 10 in science, scientific servicing, retail trade, and other non-industry sectors.

**Medium enterprise:** a company with an annual average number of employees above that for small enterprises, but less than 100 in manufacturing; 50 in construction; 30 in agriculture, wholesale trade, public catering and other sectors of industry; and 20 in retail trade, services, and other non-industry sectors.

**Family (dekhan) farm:** a small-scale family enterprise involved in production and sales of agricultural products. It may exist as a legal entity or without legal establishment. A family farm that is not a legal entity cannot hire full-time employees. Nevertheless, taking into account the family-based structure and specifics of dekhan farms, the employment of relatives is considered as their personal contribution and is, as such, permitted.

**Private farm:** an independent economic entity established with the status of a legal entity engaged in agricultural production on land plots under a long-term lease.

Source: State Committee on Statistics and International Finance Corporation.

55. In 2000–2001, the SME and microenterprise sector recorded the highest sectoral output growth rate in the Uzbek economy, growing by 13% per year in 2000–2001. This far exceeded GDP growth of 4% and large enterprises output growth of 0.6%. During this period, SMEs and microenterprises contributed 39% of the GDP growth, compared with 11% for large enterprises. Despite this rapid growth, the SME and microenterprise sector still constitutes only a thin layer of the economy between large enterprises and the substantial informal sector. Large enterprises accounted for 66% of GDP in 2001 (Table 8). Subsistence farmers and individual entrepreneurs together accounted for 38%, while the SME and microenterprise sector contributed 15%. In 2003, SMEs and microenterprises, excluding individual entrepreneurs, accounted for 16.4% of GDP.

**Table 11: Size of Small and Medium Enterprise Sector, 1999–2003**

	1999	2002	2001	2002	2003
Share of Sector in GDP (%)	29.1	31.0	33.8	34.6	35.5
Of which:					
Small and Medium Enterprises	12.6	13.1	14.8	15.7	16.4
Individual Entrepreneurs	16.5	17.9	19.0	18.9	9.1
Number of Registered SMEs	159.7	183.0	201.9	239.5	263.8
Number of Active SMEs (1,000 units)	125.6	149.3	177.7	236.4	229.6
Number of Persons Engaged in SMEs (‘000 persons)				4,994.1	5,465.1
Number Employed in SMEs <sup>a</sup> (‘000 persons)	647.7	745.3	801.8	900.3	1,045.1
Share of Sector in Employment (%)	47.0 <sup>b</sup>	50.0 <sup>b</sup>	53.0 <sup>b</sup>	53.5	57.0
Of Which:					
Individual Entrepreneurs					6.1
Medium Enterprises					1.4
Small and Microenterprises					9.5
Share of SME In Sector Output (%):					
Industry Production	10.5	11.3	14.1	14.1	16.6
Agricultural Production	68.0	72.4	75.6	76.4	76.8
Fixed Capital Investment				28.2	7.4
Total Retail Trade	45.6	45.9	45.8	43.8	45.5
Paid Services	35.9	37.9	39.9	41.3	45.7
Exports	29.4	10.2	9.0	7.5	7.3
Imports	35.5	27.4	26.9	24.9	33.7
Number of SMEs Engaged in Foreign Trade (‘000 units)	2.4	2.8	2.5	2.7	3.3

GDP= gross domestic product, SME=small and medium enterprises.

<sup>a</sup> Excluding individual entrepreneurs.

<sup>b</sup> Figures from International Finance Corporation, which differ from those given in Centre for Effective Economic Policy.

Sources: State Committee on Statistics, Centre for Effective Economic Policy, International Finance Corporation.

56. SMEs accounted for 77% of national agricultural output in 2003, and for about half of sectoral output in retail trade and paid services. However, SMEs are conspicuously underdeveloped and insignificant in industry—their share of industrial output was only 17%. This means that industrial SMEs’ share of GDP was a miniscule 2.6%.<sup>21</sup> The SMEs’ share of exports is also very small, declining from 36% in 1999 to about 7% in 2003 (Table 11). Important factors in the dramatic decline of SME exports include (i) the backwardness of the clearing and settlement mechanisms, (ii) red tape, (iii) uncompetitive prices of products, (iv) lack of variety and innovativeness, and (v) low value-added.

57. The underdevelopment of industrial SMEs shows a strong correlation with the

<sup>21</sup> Given that SMEs account for 17% of industrial output, and industrial output share of GDP was 15%, the share of SMEs’ industrial output is 2.5%.

surprisingly small share of private sector activities among industrial SMEs. Privately owned SMEs account for only 34% of SME industrial output and 32% of SME exports (Table 12). The small share of SMEs in total exports shows a similar correlation with the small share of private sector activities.

**Table 12: Private Sector Share of Small and Medium Enterprise Output, 2003**

SME Sectors	Private Sector Share (% of SME Sectoral Output)
Industry	33.9
Agriculture	99.9
Construction	78.4
Retail Trade Turnover	84.8
Paid Services	91.6
Exports	31.5
Imports	26.3

SME = small and medium enterprise.  
Source: State Committee on Statistics.

58. These numbers show that the state sector is dominant even in SME manufacturing activities. As a result, private sector industrial SMEs account for only 5.6% of total industrial output and 0.8% of GDP.<sup>22</sup>

59. The underdevelopment of the SME sector of the Uzbek economy, as indicated by its low 16.4% share of GDP, can be attributed largely to the constraints facing the private sector generally. Constraints grow as the size of the enterprises increases, thus encouraging a movement towards smaller operations and the informal sector. A World Bank study<sup>23</sup> argued that enterprises underreport employment and the wage bill due to the complicated tax system in general, and high employment taxes in particular. The underreporting of formal employment allows enterprises to be registered as smaller-sized enterprises, giving them the option of using simplified taxation schemes. Stagnating or slow output growth and deteriorating financial conditions forced SMEs as well as large enterprises to shed labor. This accounts for the decline in formal employment by 700,000 in 1999–2001. Microenterprises, the only sector in which the number of enterprises and employment increased markedly during this period, absorbed much of the retrenched labor. The conclusion is obvious but still noteworthy: The less regulated informal sector has performed substantially better than the formal large enterprise and SME sectors in terms of output growth and employment generation.

60. This suggests that the business environment for the formal sector does not facilitate growth, because of unfavorable Government policies. Factors that have impeded the growth of the SME sector include (i) import compression due to the crackdown on shuttle trade, which restricted SMEs' access to inputs and supplies; (ii) restrictions on cash withdrawals by SMEs from their bank accounts; (iii) cumbersome inspection regime for SMEs; (iv) difficulties of SMEs in converting local currency to foreign exchange in their bank accounts, even with foreign exchange permits from the central bank; (v) lack of foreign exchange retention rights for trading entities that purchase SMEs' goods for export; (vi) difficulties in accessing investment and working capital credits from banks; (vii) opaque and complicated tax system; (viii) poor

<sup>22</sup> Privately owned industrial SMEs account for 34% of SME industrial output. With total SME industrial output accounting for 16.6% of national industrial output, privately owned industrial SMEs thus account for only 5.6% of national industrial output. The share of privately owned SME industrial output in GDP is derived by taking 5.6% of 15%, which is the share of industrial output in GDP.

<sup>23</sup> Kitain, A. 2003. *Uzbekistan: Creating an Environment for Enterprise Development*. Washington, DC: World Bank.

enforcement of laws, and corruption; and (ix) difficult creditors' protection that make banks reluctant to lend to SMEs. These constraints are discussed in greater detail below.

61. Since 1999, the Government has made some attempts to reduce the tax burden on SMEs, simplify registration requirements, and facilitate SME export. However, these measures have been insufficient to stimulate strong entry in, and development of, the private sector. The measures often are implemented weakly, and sometimes are contradicted by other measures and restrictions, such as those on cash withdrawal and access to foreign exchange.

#### **IV. FACTORS IMPACTING PRIVATE SECTOR DEVELOPMENT**

62. The relatively small size and underdevelopment of the private sector in Uzbekistan indicate that its potential to drive GDP growth, employment generation, and poverty reduction remain unexploited. The underdevelopment of the private sector in Uzbekistan can be attributed to an adverse policy and institutional environment. A wide array of restrictive regulations and controls throughout the economy has circumscribed PSD. The structure of the controls—ranging from banking to market entry to domestic and foreign trade—has been configured to support a transition strategy, and an industrial policy in particular, based on state-led development. This strategy relies on extensive state interventions, which leave little room for the private sector and market forces to function effectively.

##### **A. Macroeconomic Stability**

63. Uzbekistan faced severe macroeconomic imbalances following the collapse of the FSU. Although the country made significant progress in macroeconomic stabilization in 1991–1996, macroeconomic imbalances have increased since then.

64. The Government's ambitious industrial investment program, largely funded through external borrowing, has been a major source of macroeconomic imbalances since 1996. External loan commitments since independence total about \$6.6 billion, half of which has gone to industry and the energy sector. In addition to state guaranteed funding, industry received privileged access to foreign exchange at overvalued rates of the Uzbek currency (the sum) for import financing and debt servicing. About 85% of the \$1.3 billion in subsidized hard currency sales by the Central Bank of Uzbekistan (CBU) has been used for investment goods and imports by industrial enterprises.

65. Adverse external factors also contributed to worsening macroeconomic conditions. Most important were the 1996 fall in world market prices for gold and cotton, which were (and still are) Uzbekistan's most important export goods, and the 1998 Russian financial crisis.<sup>24</sup>

66. The reliance on administrative economic controls to achieve industrial policy objectives, as well as fiscal and monetary targets, distorted markets and contributed to macroeconomic

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<sup>24</sup> A sharp devaluation of the Russian currency and a default on government debt resulted in a sharp decline of economic activity in the Russian Federation. Given the strong trade links, this spilled over to the real and financial sectors of most countries in the region. Second-round effects on the Uzbek economy included the impact of trade restrictions imposed by neighboring countries to stabilize their economies.