

## PRIVATE SECTOR ASSESSMENT (SUMMARY)<sup>1</sup>

### 1. Size and Significance of the Private Sector

1. Private sector development (PSD) in Uzbekistan is determined by a state-led development strategy. An extensive industrial policy and a state-regulated market mechanism configured to implement this strategy means that the private sector has traditionally played a supportive but supplementary role in economic development. Although important policy and structural reforms since 2003 have gradually improved the policy and institutional environment for PSD, much remains to be done before the potential of the private sector can be fully harnessed.

2. Uzbekistan's economic landscape in 2010 comprised 472,800 registered legal entities<sup>2</sup> (including private farms but excluding individual entrepreneurs and *dehkan* (peasant) farms), of which farm entities accounted for 51.6%, state-owned enterprises 7.8%, and private enterprises 21.2% of the total. The non-state sector's share of gross domestic product (GDP) was 81.7% and accounted for 79.4% of total external trade turnover and 79.1% of employment.<sup>3</sup> It represented nearly 100% of output in agriculture and retail trade, 95% in telecommunications, 83% in industry, 89% in construction, and 56% in transport. Data on the private sector's share of GDP are not available, but partial data for selective sectors show that it accounted for 83.9% in retail trade, 37.8% in construction, and 38.5% in paid services. Data on the share of the private sector in industry are also unavailable but sectors such as electricity, fuel, metals, and machinery and metallurgy, which together accounted for 61% of industrial output in 2010, are mainly state-owned or controlled. Light industry and the food industry, where private enterprises are likely to have a greater presence, account for 23% of total industrial output.

3. Official data on small and medium-sized enterprises (SMEs) since 2004 have been reported under a single small business classification.<sup>4</sup> The sector in 2011 employed about 8.9 million persons (75% of national employment). The small business sector's share of GDP was 54% and accounted for 100% of agricultural output, 33% of industry, 72% of construction, and 70% of retail trade. Small manufacturing businesses are mainly limited to raw materials and light processing of goods (e.g., agribusinesses) and are generally uncompetitive in international markets. Only 1.2% of small business entities in Uzbekistan engage in foreign trade.

4. Private sector participation is allowed in certain segments of the infrastructure sector. Private participation in sectors such as oil and gas production and the construction of transmission pipelines is mainly limited to foreign investors under production-sharing agreements and joint ventures. Local firms generally lack the resources, technology, and management know-how to participate. Transmission and distribution networks for electricity, oil, and gas are closed to private sector participation except for construction and maintenance. Road transport, on the other hand, has a high level of private sector participation, with private businesses involved in road maintenance contracts and in passenger and freight transport services. Private sector participation in rail and air transport is mainly limited to a joint venture and a pilot project on the modernization and operation of an airport serving the Navoi Free Industrial Economic Zone. Private sector participation in telecommunications is significant and dominant in cellular phones but landline telecommunication is still a state monopoly. Municipal services are predominantly, if not entirely, state controlled, although the private sector is involved through licenses in urban

<sup>1</sup> This summary is based on Asian Development Bank (ADB). 2011. *Private Sector Assessment Update for Uzbekistan*. Manila. Unpublished. Available on request.

<sup>2</sup> Unless otherwise noted, the sources for data cited in this summary are from the State Statistical Committee, Centre for Economic Research Uzbekistan Economic Trends (2010 and 2011), and Uzbekistan Almanac 2010.

<sup>3</sup> The non-state sector includes entities with minority state shareholding of less than 50%. The private sector, comprising fully privately-owned entities, forms a subset of the non-state sector.

<sup>4</sup> A small business is defined as an entity that employs 21–50 persons in agriculture and industry or 6–25 persons in services. A microenterprise is an entity with 1–20 persons in industry and 1–5 or 1–10 persons in services, depending on the trade.

road passenger transport, maintenance of physical infrastructure, and a few public–private partnerships (PPPs) pilot projects on tariff collection for electricity. According to the database of the World Bank’s Public–Private Infrastructure Advisory Facility, eight PPPs were undertaken in Uzbekistan from 1992 to 2005, of which most are in the telecom sector.

5. The financial sector remains dominated by the state, with state-owned commercial banks accounting for 68.5% of the sector’s total assets.<sup>5</sup> The securities market remains underdeveloped, with stock exchange capitalization of only 2.7% of GDP in 2010. Most of the 89 companies listed on the stock exchange were large state-controlled companies and banks. The corporate bond market is also underdeveloped, with only 17 issues in 2010 and total outstanding issues amounting to 0.4% of GDP. In the leasing industry, the largest company (Uzselhozmashleasing) is state-owned, with two other large leasing companies (Uzbek Leasing International and Kurillishleasing) also state controlled. The insurance market is highly concentrated and dominated by state-owned insurance companies, which accounted for 54% of the market in 2007. The pension industry is entirely state-owned.

## 2. Factors Impacting Private Sector Development

6. PSD is determined by government policies on privatization; sectoral plans and regulatory frameworks; licensing and foreign trade approvals; directed lending; access to foreign currency and cash; and legal, tax, and administrative procedures. Targets for state assets to be divested are usually under-fulfilled because of institutional capacity issues, unrealistic valuations, cumbersome sales methodologies, and weak investor demand. For some state-owned or controlled enterprises in strategic industries (such as energy, railways, and regional water supply), the government plans to retain 25%–51% ownership while the remaining shares are to be sold for specific investment commitments.<sup>6</sup>

7. The World Bank’s *Doing Business* survey ranks Uzbekistan 166th in 2012.<sup>7</sup> Uzbekistan performs relatively well in contract enforcement; moderately in starting a business; but poorly in trading across borders, tax payments, access to credit, property registration, and investor protection. A World Bank enterprise survey for Uzbekistan in 2008 identified major business environment obstacles (in descending order of importance) as: tax rates, access to finance, inadequately educated workforce, tax administration, corruption, practices in informal sector, licenses and permits, and electricity.<sup>8</sup> While the introduction of an application-based procedure for business registration in 2006 was an improvement, the introduction of the new simplified Tax Code in 2008 did not solve the main taxation problems, with small businesses continuing to pay SUM170 in taxes and other payments for every SUM100 in net profit retained.<sup>9</sup> More stringent measures were introduced in 2009 for payment of unified social contributions (for purposes of pension, employment, and professional trade union funds) and imposing compulsory minimum tax payment thresholds for small businesses.

8. Businesses in Uzbekistan face high transaction costs on foreign trade activities. On average, 44 days were needed to clear exports and 109 days to clear imports according to a 2008 report by the United Nations Development Programme (UNDP).<sup>10</sup> Uzbekistan has one of the world’s highest freight transport costs because of its double landlocked geographic location,

<sup>5</sup> Banking sector data provided by the Central Bank of Uzbekistan.

<sup>6</sup> Major state companies partially privatized in recent years include 51% of UzVneshTrans (major freight forwarder), 25.4% of Uzbekiston Pochtasi (Uzbekistan Post), 44% of Ferghana Electr Tarmoqlari (distribution and sale of electricity in Fergana region), and 39.9% of Bukhoro Electr Tarmoqlari (distribution and sale of electricity in Bukhara).

<sup>7</sup> World Bank. 2012. *Ease of Doing Business in Uzbekistan*. <http://www.doingbusiness.org/data/exploreconomies/uzbekistan>.

<sup>8</sup> World Bank 2008. *Uzbekistan Country Profile 2008 (Enterprise Surveys)*. <http://enterprisesurveys.org/Data/ExploreEconomies/2008/Uzbekistan>.

<sup>9</sup> International Finance Corporation (IFC). 2009. *Business Environment in Uzbekistan as Seen by Private Enterprises*. Tashkent.

<sup>10</sup> UNDP. 2008. *Report on Improving Regulatory Mechanism of Export-Import Transactions and Increasing the Effectiveness of Custom Control*. Tashkent.

the condition of transport infrastructure, and high transaction costs for obtaining clearances. Businesses encounter problems of inadequate infrastructure and utilities. Two other important impediments are (i) technical barriers to trade and a national quality infrastructure incompatible with international standards, and (ii) restrictions on access to cash withdrawals and foreign currencies.

9. Uzbekistan's underdeveloped financial system poses a major impediment to PSD. The banking system deposit base and penetration is low. Commercial banking sector assets were 34.1% of GDP in 2010, capital accounted for 19.8% of GDP, and deposits amounted to 21.4% of GDP. Enterprises in Uzbekistan consequently have one of the highest levels of internal financing and one of the lowest levels of bank financing in the region, with the average enterprise obtaining 92% of its investment financing from internal sources, while only 10% of enterprises had bank loans or credit lines (footnote 8). An increasingly important, albeit still minor and insufficient, source of financing for the private sector are 93 microfinance organizations, but their assets represented only 0.03% of GDP in 2010.

### **3. Measures to Promote Private Sector Development**

10. A number of revised and new sector-specific legislations and policies, such as for the establishment of the Navoi Free Industrial Economic Zone, localization programs, rural development, and housing development programs—along with measures for promoting small businesses—provide important opportunities for greater private sector participation. An important initiative is the Presidential decree making 2011 the year of small business and private entrepreneurship, which included a program of over 100 measures to improve the business environment for small businesses.

11. Sector loans by international financial institutions for infrastructure and utilities benefit PSD by improving the overall business environment within which private enterprises operate, and by providing opportunities for private businesses to tender for procurement contracts. International financial institutions' sector lending can also facilitate improvements to industrial policy and regulatory frameworks to promote private sector participation. ADB and the World Bank have been the major sources for such assistance.

12. Technical assistance (TA) and grants by development partners provide direct support for PSD through capacity building and advisory services for strengthening public administrative bodies; and legislative, tax, and financial sector reforms that help improve the business environment. TA projects in ADB's country operations business plan, 2012–2014 that promote PSD include those on capacity building for insurance market supervision, access to finance, private sector skills development, public management, and industrial diversification and economic competitiveness.<sup>11</sup> ADB's Private Sector Operations Department has undertaken its first deals in Uzbekistan in 2011 and 2012, through which direct private sector assistance for gas and petrochemicals sectors has been provided. The International Finance Corporation provides extensive advisory support for PSD, focused on improvements to the business environment and financial market development. It also provides equity and loan financing to private businesses. UNDP engages in policy advisory, capacity building, private sector surveys, and pilot programs for small businesses and rural development. German development cooperation through GIZ provides support for developing value chains for agribusinesses.

### **4. Options for an ADB Private Sector Development Strategy**

13. To promote private sector participation in infrastructure sectors, ADB's efforts could focus on facilitating privatization of those state enterprises from which the government has already decided to divest partially or fully. ADB support could take the shape of improving the investment and regulatory climate for divestiture. Measures needed from the state to improve the business

---

<sup>11</sup> Country Operations Business Plan (accessible from the list of linked documents in Appendix 2 of the country partnership strategy, 2012–2016).

environment include accommodating reasonable increases in tariffs to allow investors a fair commercial return, pilot testing PPP models in selective segments of the infrastructure industries, improving corporate governance of state-owned companies, developing the securities market, supporting localization measures to generate private sector participation, and promoting the entry of the private sector into new industries such as clean energy.

14. ADB support for PSD could focus on the following areas:

- (i) **Improvement to the business environment**—aimed at identifying priorities and sequencing of measures to promote growth of small businesses.
- (ii) **Foreign trade liberalization**—by supporting a cost-benefit assessment of Uzbekistan's possible accession to the World Trade Organization and options for risk mitigation measures.
- (iii) **Corporate governance development**—through support to the formulation of a national code incorporated in the joint stock company law and statutory codes for listed companies, banks and nonbank financial institutions, and state-owned companies. It is important for enterprise- and sector-specific corporate governance to be developed in accordance with the framework of a national corporate governance code to ensure minimum standards and a degree of consistency across enterprises and sectors.
- (iv) **Improvement of state asset management**—through support for the establishment of a commercially-oriented state asset company to ensure that state assets are managed professionally and the state investment portfolio is optimized.
- (v) **Strengthening the financial sector**—involving support for microfinance organizations, leasing companies, and commercial banks, including through taking equity positions, promoting diverse lending windows, and TA.
- (vi) **Securities market development**—through improving regulation, revisions to the joint stock company law to facilitate initial public offerings (IPOs), and development of a new law and framework for collective funds.
- (vii) **Developing and pilot testing public-private partnerships**—through support to the State Committee on Demonopolization and Development of Competition for developing and pilot testing PPPs in the infrastructure sectors.
- (viii) **Renewable, clean, and efficient energy development**—through promoting greater private sector participation in renewable, clean, and efficient energy technologies such as solar and wind power, and more efficient energy use.
- (ix) **Municipal services and water supply services**—through support to Tashkent and other municipal governments for developing comprehensive urban upgrading plans with clear provisions for private sector participation in areas such as water, electricity, gas, heating supply, and waste management.

15. Additional overarching measures needed to strengthen the overall business environment include continuing reform of the public administration system, further improvement of the tax regime, liberalization of regulations governing the activities of small businesses, and increasing access to external finance. The key challenge to promoting the role of the private sector is to harness the government's willingness to improve and open up the business environment, while ensuring that the national industrial policy objectives are met.

16. ADB can achieve greater impact on PSD by leveraging its assistance to promote greater private sector participation. ADB could also consider longer-term TA to support PSD policy and institutional reforms on a larger scale. The scope and priorities of ADB's PSD assistance in Uzbekistan would be demand-driven, in line with the government's strategic development objectives as stated in its new Welfare Improvement Strategy (WIS II), and prioritized according to the key concerns of private businesses.