



Uzbekistan's Economy: Recent Developments and Its Challenges

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<Excerpt>

- Mr. Shavkat Mirziyoyev, the Second Uzbekistan President who took office in 2016, has been promoting to build a nation based on a market economy, while succeeding the governance structure initiated by the former president.
- In recent years, no terrorism attacks were seen within the country, and the public security situation has been stabilized. In addition to promoting a good-neighbor policy, the government has been actively engaging in dialogues with countries including Russia and China. Despite the recent political and social stability, however, given the extremely concentrated power to the president, it will be a big challenge for the government how to keep stability when the presidents should be replaced.
- Uzbekistan's economy is on the way to shift to a market economy. In the past the real growth rate stayed at around 8%, but in 2017 it slowed down to 5.3% due to a decline of export prices including natural gas price. Although it was spared a further deceleration in 2018 helped by the pickup of export prices and government's new economic policies, it seems the growth rate has stayed at about 5%. Import inflation is rising reflecting the depreciation of its currency sum.
- The current account is expected to be in the red of about 1% of GDP in 2019 as imports are increasing due to liberalized foreign exchange transactions. The fiscal balance is expected to remain in deficit of 1.2% of GDP in both 2018 (actual) and 2019 (budget).
- Under the guidance of the IMF, the government started to disseminate economic data, with its

efforts gradually bearing fruit. There remains much to be improved, however, as the data are often fragmentary and it is difficult to date back to the past.

- External reserves seem to have increased to \$28.9 billion at the end of 2018, the highest as ever or 25.7 months of imports, giving the government ample room for foreign exchange financing. According to the IMF and the World Bank, the country has experienced no delinquency nor rescheduling on its external debts, either of sovereign or state enterprises.

<Full Text>

1. Political and Social Stability ~good start of the new government but its sustainability remains a big challenge~

Uzbekistan attained independence in 1991 after the dissolution of the Soviet Union, The first president Mr. Islam Karimov governed the country through an institution directly controlled by the president which had been reorganized from the former Communist Party Central Committee with great power and authority concentrated to the president. For instance, the president had the right of dissolving the parliament while the parliament was not provided with the right to indict the president. The president was surrounded by bureaucrats who pledged their loyalty to him. The general public were controlled through “mahallas”¹, autonomous social communities. Such concentrations of power to the president and feudalistic way of rule were the characteristics of the Karimov administration.

Mr. Shavkat Mirziyoyev², who took the office of the second president in 2016 succeeded the governance structure of the former president. However, during the two years after his inauguration, he managed to reshuffle almost all the major government posts to exert his influence over them. He also announced new strategies including the following five points to improve social stability (refer to the annex for detailed discussion over the new economic policy to promote point (iii) below)

- (i) Reforms of Government institutions
- (ii) Implementation of law by independent judiciaries
- (iii) Promotion of economic liberalization (transition to market economy)
- (iv) Improvement of education, social security and public infrastructures
- (v) Promotion of friendly relationship with foreign countries

Furthermore, President Mirziyoyev expressed his intention to hand over the powers too much concentrated in his hand to governmental institutions. The current government has gained the support by the Uzbekistan people, and it is generally viewed that there is no possibility of antigovernment movements like the Arab Spring movement. In fact, there have occurred no terrorist

¹ Territorially connected civil societies unique to Central Asia. They have functions of mutual assistance as well as mutual surveillance.

² As he was a prime minister of the former Karimov government between 2003 and 2016, and is from the same home town of the former president forming a clique, the transformation of the power was smooth.

attacks and the like in recent years within the country and the public security has been stabilized³. The past incidents include the one in which the Islamic Movement of Uzbekistan (IMU⁴) kidnapped Japanese engineers in the neighboring Kyrgyz Republic in 1999 during the days of former president Karimov. Since 2011 the IMU also sent fighters to the Syrian Civil War and got involved in the internal fighting of Taliban in Afghanistan, but through these activities it lost many fighters and has been weakened. The Andizhan case⁵ which occurred in 2005 was a military collision with the anti-government group. Although China and Russia supported this military suppression by the Uzbekistan government, the EU criticized the Uzbekistan government by suspending weapon exports to the country and placing a ban of travel to the government officials⁶.

On the diplomatic front, President Mirziyoyev shifted away from the isolationist policy of the former government, and he has laid more emphasis on easing a tension in the region by a good neighbor policy. With respect to Russia, which has traditionally been a friendly nation, he had a summit meeting with President Putin in October 2018 and confirmed their strategic bilateral relationship. Uzbekistan has a friendly relationship with China as a member of the Shanghai Cooperation Organization (SCO)⁷ and supports China's "Belt and Road" Initiative. The president had a summit meeting with the US President Trump in May 2018 under the theme of reinforcement of economic relations between the two countries.

As is seen above, the Mirziyoyev administration is making efforts to improve domestic social stability through stimulation of economic activities, with a result of no terrorist attacks and no visible anti-government movements within the country. Externally, it is focusing on strengthening friendly relations with neighboring countries as well as major countries, achieving a level of success. It can be evaluated that currently the efforts of the government have contributed to the political and social stability in Uzbekistan.

However, since Uzbekistan now follows one-man rule with the president assuming great power and authority, it remains a challenge how to maintain stability of politics and society if and when the president should suddenly be replaced due to his death or an incident of coup d'etat⁸.

³ The Japanese MOFA's Travel Information classifies Uzbekistan in the lowest among the four levels for "travel advice and warning" which says that Japanese nationals traveling to and residing in the relevant country or region are advised to stay alert to the security situation and take necessary precautions. (As of January 7, 2019)

⁴ It was organized around 1998 aiming at establishing an Islamic state based on the Shariah in the Turkistan (meaning a country of Turkish origin) which spreads from the Caspian Sea to China and Xinjiang Uyghur Autonomous Region.

⁵ It was an armed conflict between an Islamic group and the government forces that took place in Andizhan City in Fergana Basin located in the eastern Uzbekistan. Gunfights by the government forces to suppress the rebels caused many deaths among the citizens.

⁶ Sanctions by the EU were lifted in 2009.

⁷ On January 1, 2019, Mr. Vladimir Norov, former foreign minister of Uzbekistan, took office as the Secretary-General of the Shanghai Cooperation Organization.

⁸ Article 96 of the Constitution of Uzbekistan prescribes the procedures for electing the next president when the incumbent president fails to perform his duties, but given the current autocratic regime, it is unclear whether the selection of the successor will be made smoothly as the constitution defines.

2. Developments of macro economy ~ promoting transition to market economy ~

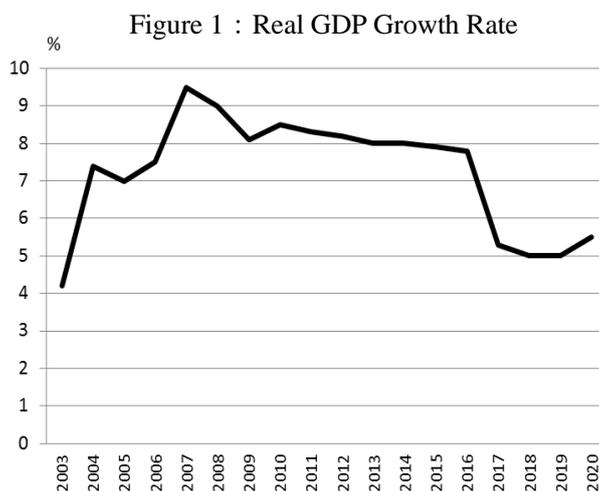
The Uzbekistan economy heavily relies on the exports of cotton, energy and gold and receipts of remittances from overseas migrant workers. Since 2017, the new government has promoted structural reforms to transit to market economy with new economic policies, but the country is still on the road of transition.

(1) Real growth rate

When Uzbekistan got independent in 1991, the country rejected a rapid transition to market economy as the IMF recommended, and instead adopted a so-called “Uzbek model” under which the government implemented economic management based on state control while advocating its unique policy course of progressive reforms.

As it did not follow a rapid change of economic system, the drop of economic growth in the post-independence era was rather mild in Uzbekistan as compared to other former Soviet Union members which adopted a shock therapy following an advice of the IMF. The real growth rate of the Uzbekistan economy peaked at 9.5% in 2007, and then remained at around 8% until 2016. However, the growth rate slowed down to 5.3% due to a fall in export prices of natural gas and the like as well as sluggish increase in remittances mainly from migrant workers in Russia.

The economy was spared further economic deceleration in 2018 helped by a recovery of export prices, improved agricultural productivity⁹, and infrastructure development associated with the government new economic policies. It is estimated that the growth rate stayed at around 5% in 2018.



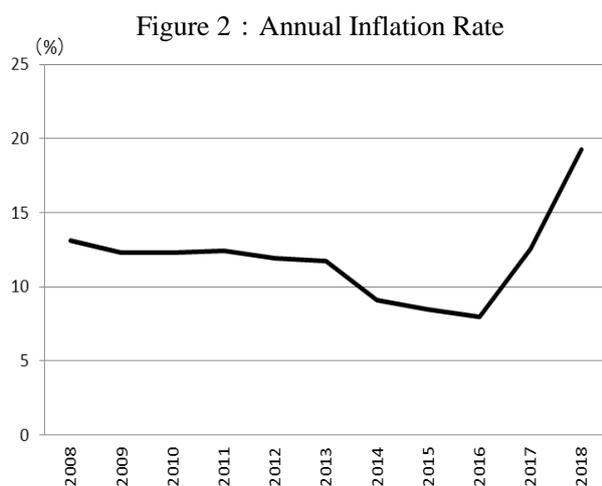
(Note) IMF estimate for 2017 and projections for 2018-2020

(Source) IMF World Economic Outlook Oct. 2018

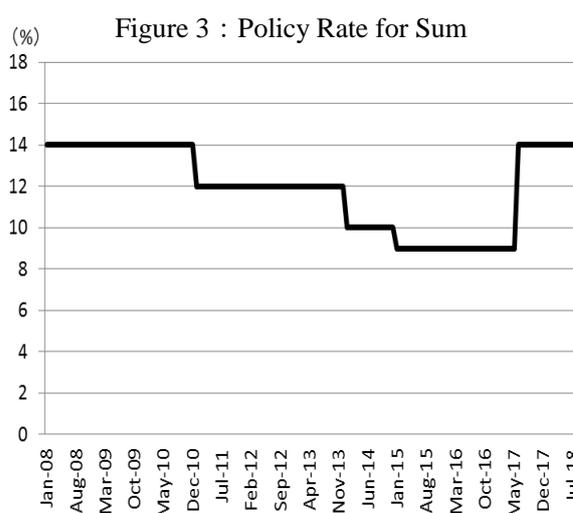
⁹ Agricultural sector accounts for 20% of GDP.

(2) Inflation

Inflation tended to gradually fall from 2008 to 2016, but it rose rapidly in 2017, mainly due to the rise of import prices reflecting a sharp devaluation¹⁰ of the sum implemented in September 2017. The central bank has been trying to control inflation by raising its policy rates, but the rising tendency of inflation is considered to continue for the time being as imports of capital goods will increase due to the new economic policies and also trade liberalization will encourage increase in imports of consumer goods.



(Note) IMF estimate for 2017 and prospect for 2018.
(Source) IMF World Economic Outlook Oct. 2018



(Source) Central Bank of Uzbekistan

(3) Current Account

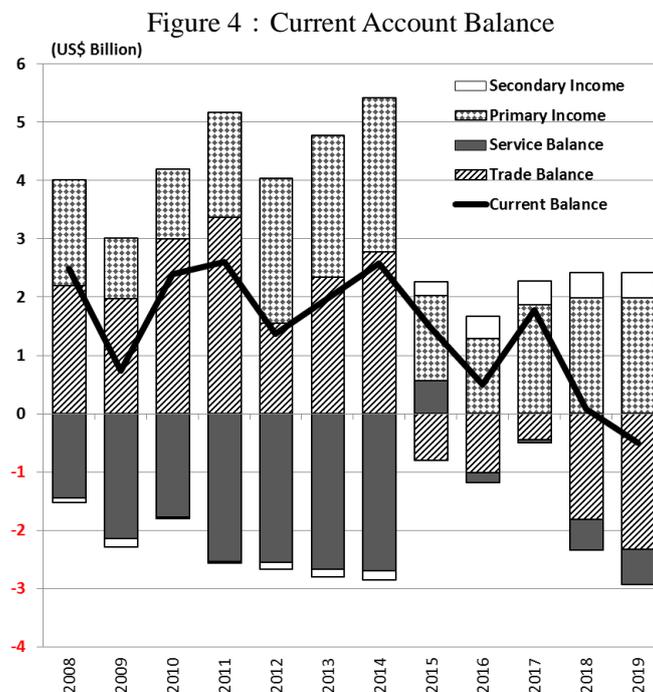
More than 50% of Uzbekistan's exports are accounted for by such marketable products as cotton, oil, and gold. Accordingly, its trade balance is subject to influence of the developments of commodity prices, while the remittances from migrant workers in Russia consist of major part of the services account¹¹.

Until 2014 the current account had registered a surplus of around \$2 billion supported by the trade surplus and the workers remittances. Since then, the trade balance fell into deficit due to a drop of commodity prices, but the current account remained in surplus due to the workers remittances. However, in 2018 the trade deficit expanded reflecting an increase in imports and the current account surplus is estimated to have declined to almost zero.

¹⁰ The Central Bank announced on September 4, 2017, to unify the exchange rate of the sum and liberalize the exchange of foreign currencies, devaluing the official sum rate of 4,210 sum per dollar to a market rate of 8,100 sum a dollar.

¹¹ Workers remittances are normally recorded in the secondary income balance, but in Uzbekistan, they are recorded in the primary income balance based on the recognition that the migrant workers are usually short-term seasonal workers (usually shorter than one year).

In 2019, the trade deficit is expected to expand as imports of consumer goods will increase reflecting trade liberalization in addition to the increase of capital goods associated with economic modernization policies. Assuming the same level of increase for workers remittances as in previous year, the current account is estimated to fall into deficit of a little lower than \$5 billion (about 1% of GDP)



(Notes) IMF estimate for 2012 and projections for 2013-2014 as of September 2013.

IMF estimate for 2017 and projections for 2018-2019 as of May 2018.

(Source) IMF, Article IV Consultation Reports, September 2013, May 2018

(4) Fiscal Balance

The fiscal balance of Uzbekistan includes the Fund for Reconstruction and Development (FRD) in addition to the general account. The government responds through this FRD to the need for off-budget expenditures. As the whole picture of the Uzbekistan budget situation can be shown by the consolidated balance of the general account and the FRD, the following discussion is based on the consolidated fiscal position¹².

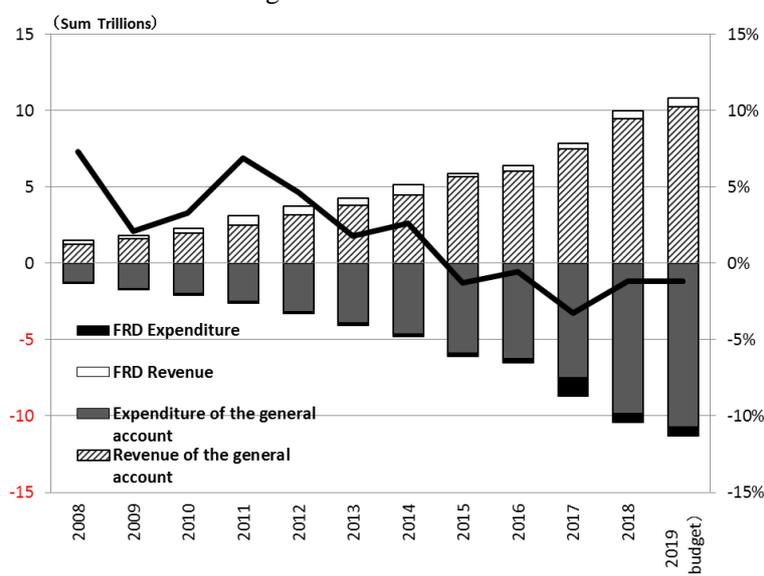
The fiscal balance fell to a deficit of 3.2% of GDP in 2017, as revenues continued to remain sluggish since 2015 due to falls of commodity export prices, while expenditures increased reflecting the new economic policies that was launched in 2017. The deficit seems to have been contained at around 1.2% of GDP in 2018 helped by the pickup of commodity prices.

¹² The FRD builds up the surplus funds arising from the exports of gold and others. The IMF points out the lack of transparency in its use of fund and recommends the government to integrate it with the general account. Meanwhile the rating agency Standard and Poor evaluates it as a provident fund for the future. The IMF deliberates the Uzbekistan budget situation based on a consolidated position, and this author also followed its practice. The FRD corresponds to “Future Provident Funds” in many oil producing countries. It is presumed that in Uzbekistan the government controls the fund as part of aggregated foreign exchange reserves.

The government proposed the biggest-ever budget in 2019. Revenues in the general account amount to 102.6 trillion sum, while expenditures amount to 107.4 trillion sum. Assuming the FRD at the same level as previous year, the consolidated budget position will amount to a deficit of 4.8 trillion sum (1.2% of GDP). At the same time the government announced the issuance of government bonds amounting to 4 trillion sum to finance the deficit¹³.

Looking ahead, expenditures are expected to increase due to infrastructure investment and sophistication of education while revenues will continue to be influenced by the developments of commodity prices. In addition, the IMF recommends the government to secure revenues through tax reform as there is a risk that the tax revenues will decline associated with the privatization of state enterprises which will have decreased incomes¹⁴.

Figure 5: Fiscal Balance



(Notes) IMF estimate for 2012 and projection for 2013 -14, as of September 2013 respectively. IMF estimate for 2017 and projection for 2018 as of May 2018 respectively, and budget for 2019

(Source) IMF, Article IV Consultation Reports, September 2013, May 2018

3. Reliability of Economic Data -Improvement started but half way through-

The Mirziyoyev administration started in September 2017 to reform the economic statistics for public dissemination which the previous administration restricted.

According to the IMF, in the past the collection of primary data was implemented based on the old procedures used in the former Soviet Union. They included the enumeration of the surveyed persons, use of cumulated figures, etc. There were no unified standard rules for data classification,

¹³ As of end-2017, GDP ratio of public debts stood at 10.7%, which suggests that the fiscal position has no problem on a stock base.

¹⁴ State enterprises make profits and pay taxes by taking advantage of their privileged positions.

often causing inconsistency between the data, with several items aggregated into one.

The Presidential Decree obligated the government to disseminate the economic and financial data and in January 2018 the State Statistics Committee (SSC) began publishing a new consumer price index based on an updated methodology.

The government, under the guidance of the IMF, agreed to publish data based on the IMF's enhanced General Data Dissemination System (e-GDDS)¹⁵, and started in May 2018 to post data on its National Summary Data Page. The government aims to further improve its contents, ultimately to produce a Uzbekistan country page in the IMF's International Financial Statistics (IFS).

In this way, under the guidance of the IMF, Uzbekistan has started to publicly disseminate economic statistics, gradually achieving the results. However, the contents of disseminated data are still incomplete, needing further work to improve as they pose difficulty in dating back to historical data in the past. The improvement of reliability of the economic data has to be judged as still half way through¹⁶.

4. Financing of foreign exchange

Uzbekistan has made it a priority to build up foreign exchange reserves, controlling external payments. As a result, the international reserves seemed to have amounted to \$28.9 billion (25.7 months of imports) at the end of 2018, the highest as ever.

On the other hand, external debts stood at \$15.57 billion (31.9% of GDP) at the end of 2017¹⁷. This represents an increase of 19.4% from the outstanding at the end of 2016, but it reflects the decrease of GDP in dollar base due to the sharp devaluation of the sum in September 2017.

The IMF cites the high growth of the economy, strong exports, and no external borrowings in recent years as the reasons for relatively low ratio of Uzbekistan's external debts to GDP.

Going forward, there will be a decrease in the foreign exchange reserves due to the trade and FX liberalization, but given the high level of reserves, there seems to be no fear that the government will face difficulty in foreign exchange financing for now¹⁸.

Table 1 : External Debts (end 2017)
(In \$ billion)

Public Debt	5.24
Publicly Guaranteed Debt	2.29
Private Debt	8.04
Total	15.56

(Source) IMF

¹⁵ Standard for timely dissemination of economic and financial data set by the IMF which aims at improving the transparency of data, promoting development of statistic compilation, and synergy effect of data dissemination and surveillance.

¹⁶ In preparing this report, the author tried to search for the data on the e-GDDS and others. However, it was found that the compilation of data is still incomplete with the information often fragmental and disconnected. Therefore this article is mainly based on the data provided in the Article IV Consultation Report published in September 2013 and May 2018 as a reliable data source.

¹⁷ Private debts are presumed to be a borrowing by the energy sector (electricity, oil and gas)

¹⁸ As of the end of 2017, public debts totaled to about \$5.2 billion. Therefore, even if all the borrowings to be repaid are tied, there are more than \$20 billion available as a freely usable fund. The IMD comments in its Article IV Consultation report that "Uzbekistan holds foreign exchange reserves considerably above the IMF's reserve adequacy

Figure 6 : Foreign exchange Reserves
(months of imports, and % of nominal GDP)

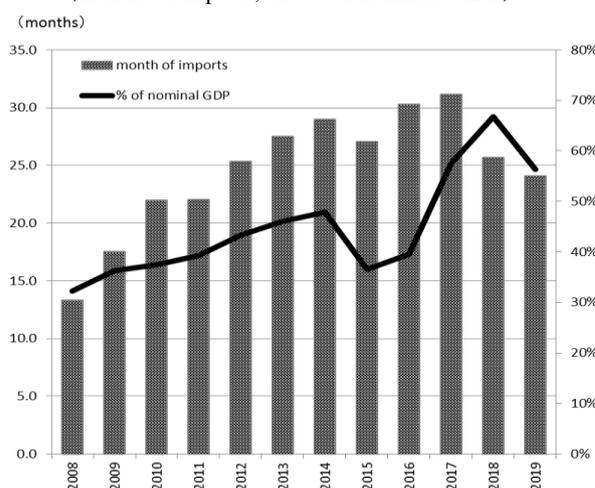
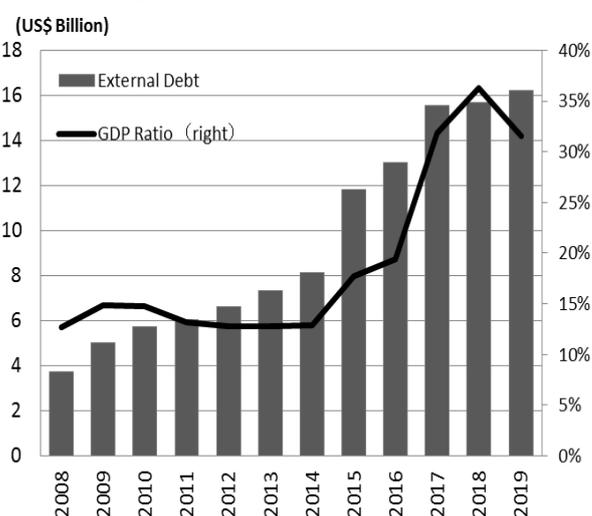


Figure 7 : External Debts



(Note) IMF Estimate for 2017 and projections for 2018-2019

(Source) IMF, Article IV Consultation Report, May 2018

5. Possibility of delinquency of sovereign and State enterprises or rescheduling within 5 years

According to the IMF Article IV Consultation Reports (September 2013 and May 2018), Uzbekistan has received no debt relief measures in the past. Also the International Debt Statistics of the World Bank reports no late repayment since 2012 for both Uzbekistan's public and private debts. Accordingly, it can be said that the government and state enterprises have not experienced delinquency on their external debts nor rescheduling of their debts¹⁹.

metrics for emerging markets or developing countries".

¹⁹ As for the domestic debts, since the government has seldom raised funds domestically and the economy is performing well, it is presumed that there has been no rescheduling of debts.

Annex: New economic policies of Uzbekistan

The Mirziyoyev administration has been implementing new economic policies to prepare for a shift to market-oriented economy. Major policy measures include:

- (1) Unification of multiple exchange rate system of the sum

Simplification of complicated system eliminated the late external payments which had been delayed due to allocation procedures of foreign exchanges.

- (2) Devaluation of the sum to an effective market rate (Figure 8)

It completely swept out black market for the dollar.

- (3) Liberalization of FX transactions

The government abolished the FX allocation system and realized a free exchange of foreign currencies of companies.

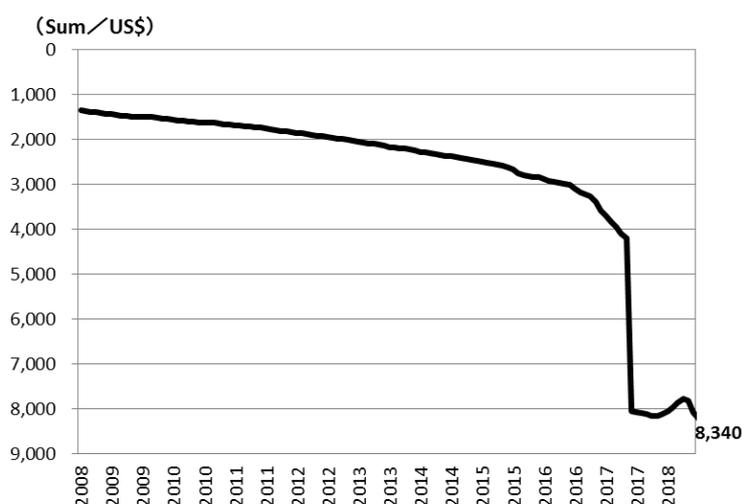
- (4) Cutting of import tariffs

- (5) Relaxation of entry visas

The government permitted entry without visas to 26 countries including Japan.

At the same time as implementing measures noted above, the government has supported the economy through the government-led infrastructure investment, with ultimate target of increasing foreign capital attraction. In 2017, foreign direct investment (FDI) to Uzbekistan remained at only \$96 million, but it is expected that the new economic policies will encourage the expanded inflow of the FDI. The government hopes to attract more foreign companies especially in the seven sectors including electric machinery, construction materials, food processing.

Figure 8 : FX rate of Uzbekistan sum to the dollar



(Source) Thomson Reuters

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