ECONOMIC AND FINANCIAL REFORMS IN UZBEKISTAN: KEY DEVELOPMENTS AND COMPARISONS

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Introduction

Uzbekistan's comprehensive reform program, initiated under H.E. President Mr. Shavkat Mirziyoyev, is designed to modernize the country's economy and attract foreign investment. These reforms focus on capital market development, privatization of state-owned enterprises, and legal changes to ensure the protection of foreign investors. This article examines the progress and challenges of these reforms, offering a comparison with other emerging markets to highlight Uzbekistan's position and growth trajectory in the global economy.

Capital Market Development: A Critical Priority

Uzbekistan's capital markets have traditionally been underdeveloped, contributing only 0.3% of the GDP in 2020, a stark contrast to more developed financial sectors globally. By comparison, the United Kingdom's financial services industry contributed 6.9% to the national GDP in 2020, generating £132 billion in output . Japan, with one of the largest financial markets globally, manages a significantly higher level of debt relative to its GDP due to robust domestic investment mechanisms. Meanwhile, neighboring Kazakhstan, with its Astana International Financial Centre (AIFC), has positioned itself as a regional hub for capital markets, contributing nearly 5% to its GDP.

To catch up with regional peers like Kazakhstan, Uzbekistan has initiated reforms through the Capital Market Development Agency (CMDA), established in 2019. The agency aims to drive liquidity into the domestic market, expand financial instruments, and encourage both foreign and domestic participation in capital markets. Uzbekistan's strategy involves privatizing state-owned enterprises (SOEs), introducing new financial instruments such as Sukuk bonds and exchange-traded funds (ETFs), and ensuring compliance with international regulatory standards such as those of the International Organization of Securities Commissions (IOSCO).

According to the European Bank for Reconstruction and Development (EBRD), Uzbekistan's efforts in modernizing its capital market infrastructure have led to a modest increase in market activity. In 2021, the total nominal value of local state securities reached 1,950 billion UZS, equivalent to about USD 241 million. While this growth is promising, it remains significantly smaller than regional benchmarks. Kazakhstan, for example, has over USD 10 billion in annual bond issuances, while Russia's corporate bond market exceeds USD 40 billion annually.

Legal Framework for Foreign Investment

Uzbekistan has made substantial progress in improving its legal framework to attract foreign direct investment (FDI). In 2019, Presidential Decree PP-4300 introduced sweeping reforms aimed at reducing government control over key sectors and ensuring legal protection for foreign investors. The decree led to the privatization of 64 state-owned enterprises, many of which were opened to foreign investors through public-private partnerships (PPPs).

One of the most critical legal guarantees is the Law on Guarantees and Protective Measures for the Rights of Foreign Investors, which shields foreign investments from nationalization or expropriation without fair compensation. This law aligns with international practices seen in

countries like China, where the 1986 Law on Wholly Foreign-Owned Enterprises also ensures protection from expropriation, albeit with slightly more restrictive terms. By contrast, Kazakhstan's legal protections for foreign investors are considered even more investor-friendly, thanks to its legal system's adoption of English common law in its AIFC.

Uzbekistan has also modernized its arbitration process, offering foreign investors the ability to settle disputes through international arbitration under the rules of the International Centre for Settlement of Investment Disputes (ICSID). This aligns Uzbekistan with many emerging economies that rely on international arbitration to boost investor confidence. For example, India has signed numerous bilateral investment treaties (BITs) that allow international arbitration for disputes, significantly enhancing its appeal to global investors.

Privatization of State-Owned Enterprises

Privatization is one of the core pillars of Uzbekistan's economic reform program, aiming to reduce state dominance and encourage private sector growth. Some of the largest state-owned enterprises (SOEs) slated for privatization include the National Bank for Foreign Economic Activities of Uzbekistan, Navoi Mining and Metallurgical Plant, and Almalyk Mining and Metallurgical Plant. The government's goal is to reduce its ownership in these entities, which would stimulate foreign direct investment (FDI) and increase market liquidity.

In terms of comparison, Uzbekistan's privatization strategy mirrors that of Russia in the 1990s, where large SOEs were sold to private investors to reduce state control. However, while Russia experienced rapid privatization, Uzbekistan has adopted a more gradual approach. The state aims to retain partial ownership in critical sectors such as mining and metallurgy to ensure economic stability. This strategy is also evident in other emerging markets like India, where the government maintains strategic stakes in major public enterprises while allowing private investment to drive growth.

In Kazakhstan, the privatization of state-owned enterprises has led to a more dynamic private sector, particularly in industries like oil and gas. Since 2015, Kazakhstan has privatized over 300 state-owned enterprises, contributing significantly to FDI inflows, which reached USD 24 billion in 2020, compared to Uzbekistan's USD 1.7 billion the same year.

Banking Sector Challenges

The banking sector in Uzbekistan faces several challenges that hinder its integration into the global financial system. A significant issue is the high level of dollarization, with over 41% of deposits held in foreign currencies in 2019. This level of dollarization is one of the highest in Central Asia, far above Kazakhstan's 17% and Russia's 22%. High dollarization creates exchange rate risks for both investors and the domestic financial system, which remains vulnerable to external shocks.

State-owned banks dominate Uzbekistan's banking sector, with over 80% of banking assets controlled by state-owned institutions. This limits competition and innovation, creating inefficiencies within the financial system. The government's plan to privatize several large banks and introduce fintech regulations aims to enhance competition, but these changes will take time to materialize.

Comparatively, Kazakhstan's banking sector underwent significant reform following the 2008 financial crisis, leading to the privatization of several banks and the establishment of a more resilient regulatory framework. Kazakhstan's banking system now enjoys greater participation from foreign banks, which account for approximately 20% of the total market. Russia, despite

ongoing challenges, has also seen significant foreign bank participation, with over 30 international banks operating within its borders.

Pension Reform and Sovereign Wealth Fund

Pension reform is essential for Uzbekistan's long-term fiscal sustainability. The current system operates on a pay-as-you-go basis, with more than 800,000 early retirees, accounting for over 27% of the total retired population. This structure is unsustainable in the long term, especially as the population ages. In comparison, Kazakhstan's pension system, which includes a mandatory defined-contribution scheme, covers over 9.7 million contributors and has assets exceeding USD 11 billion. Uzbekistan's government is currently working on modernizing its pension system, which faces challenges due to demographic changes and the prevalence of informal employment. A key part of this reform is a proposed gradual increase in the retirement age, as recommended by the World Bank, which would begin in 2025 and incrementally rise to 65. This aims to address the undercoverage of the pension system, which currently reaches only 38% of the population, and ensure sustainability given the country's high pension contribution rates but average benefits. The reforms are being guided by international experts and local institutions, with public engagement also being prioritized through surveys and discussions

Uzbekistan is moving towards the creation of a Sovereign Wealth Fund (SWF) to manage the revenues from natural resources and invest in bonds and equities. Kazakhstan's SWF, Samruk-Kazyna, which manages over USD 65 billion in assets, serves as a model for Uzbekistan. However, Kazakhstan's fund has faced challenges in terms of transparency and effective management, issues Uzbekistan must address as it develops its own SWF. Uzbekistan's sovereign wealth fund, known as the Fund for Reconstruction and Development, plays a critical role in managing the country's natural resource revenues and excess reserves. Established to support economic growth, especially post-pandemic, the fund channels investments into infrastructure and key sectors like energy and technology. Additionally, the Uzbekistan Direct Investment Fund (UzDIF), created in 2021, serves as a vehicle for attracting foreign investment and managing large-scale projects. This fund has been involved in various initiatives, including the issuance of green and social bonds to support sustainable and socially impactful projects.

Uzbekistan's Fund for Reconstruction and Development (UFRD) plays a central role in supporting the country's economic modernization and growth. Established in 2006, the UFRD is designed to fund large-scale projects that modernize critical industries and foster sustainable socio-economic development. It functions as Uzbekistan's sovereign wealth fund (SWF), focusing on infrastructure, energy, and industrial projects.

As of 2023, the UFRD manages significant assets, with estimates placing its assets under management (AuM) at over $23 billion. About 34% of these assets are categorized as "alternative assets," signifying investments in sectors beyond traditional stocks and bonds, such as infrastructure and real estate projects. This diversification is intended to stabilize returns and support long-term economic resilience.

In recent years, the UFRD has been involved in various initiatives to boost Uzbekistan's industrial capacities. For example, the creation of a $1 billion Industrial Development Fund (IDF) under the UFRD will focus on expanding the production of high-tech products and supporting industrial enterprises through loans, equity participation, and financial support for marketing and certification activities. This move aligns with Uzbekistan's broader strategy to strengthen its industrial base and promote innovation.

The UFRD has also contributed to Uzbekistan's national budget, supporting infrastructure investments and regional development. In 2024, it is set to receive 2 trillion soums annually from the state budget for infrastructure projects, enhancing its role as a critical engine for Uzbekistan's economic growth.

Although governance and transparency have been improving, the UFRD still faces challenges in global rankings. Its Governance, Sustainability, and Resilience (GSR) score for 2023 was 24%, reflecting progress but also areas where further reforms could enhance efficiency and accountability.

Comparative Analysis with Other Emerging Markets

Uzbekistan's financial reform trajectory can be compared with countries like Vietnam and Egypt, which have also undertaken significant economic liberalization. Vietnam, for example, has experienced rapid growth in its stock market since liberalizing its economy in the 1990s. By 2020, Vietnam's stock market capitalization had reached over 80% of its GDP, compared to Uzbekistan's 0.3%. Similarly, Egypt's reforms, which include privatizing SOEs and developing financial markets, have resulted in FDI inflows of USD 9.9 billion in 2020, significantly higher than Uzbekistan's inflows.

Vietnam's success highlights the importance of fostering a strong domestic investor base, while Egypt demonstrates the need for a robust regulatory framework to attract foreign investors. Uzbekistan's reforms, though promising, will need sustained momentum and clear policy implementation to achieve similar success.

Conclusion

Uzbekistan's ambitious economic reforms are designed to position the country as an emerging market with substantial growth potential. The government's focus on capital market development, privatization of state-owned enterprises, and legal protections for foreign investors is gradually transforming the business environment. However, challenges in the banking sector, high dollarization, and an underdeveloped financial market require further attention.

Comparatively, Uzbekistan's reform efforts are similar to those undertaken by other emerging markets such as Vietnam, Egypt, and Kazakhstan. While progress has been made, Uzbekistan's ability to fully integrate into the global financial system will depend on its capacity to attract long-term foreign investment, ensure transparency in privatization, and strengthen its legal and financial institutions.

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