VII MANAGING GLOBALIZATION IN UZBEKISTAN

Introduction

Globalization involves a combination of such processes as cross-border flows of goods, capital, technologies, information and people and the territorial and institutional integration of markets. There are also attendant problems such as environmental degradation, which require global cooperation. Globalization is necessary because of the uneven distribution of natural and human resources on the planet, which requires international cooperation for their most effective use. On the whole, the process of globalization has no real alternative but there are different approaches to the resolution of some of the problems provoked by it.

Pursuing globalization increases the mobility of factors of production, which should help reduce income disparities between different countries and equalize development levels. In reality, the reverse appears to be true, particularly as the gap in average income per capita between developed and developing countries is growing significantly. Nevertheless, these tendencies are not the inevitable consequences of globalization but, rather, emerge owing to the inadequacies in the development policies of both international organizations and States.

In many instances, both internal and external factors condition the difficult economic situation of a number of developing countries. As an illustration, the labour market for highly qualified workers, who form a professional elite, is becoming more and more integrated internationally while national barriers continue to limit the market for unqualified workers. Tariff increases and foreign trade barriers, erected by developed countries to protect their producers, are considerable impediments for realization of the export potential of developing countries. According to the World Bank, ending protectionist policies in developed countries could add US$ 30 billion to the GDP of poor countries.

A. Globalization and regional integration

1. Integration into the multilateral trading system

In December 1994, Uzbekistan applied for WTO membership and the country is currently going through the accession process. The major principle underlying WTO is MFN treatment for all members. Membership in WTO should bring about an increase in production efficiency and competitiveness, enhance integration into the global economy and provide more benefits from globalization in the long run. Membership in WTO also opens greater possibilities for settling trade disputes fairly and raises the confidence of trade partners and investors in a member country.

However, WTO membership places some restrictions on members that can create problems during the adjustment phase, especially in the short run. These include decreased government support for local producers, reductions in subsidies and restricted application of State instruments for regulation. In addition, the decline in tax revenues from foreign trade following the reduction of customs duties can have a negative impact on the budget. The risk of these adverse outcomes can, however, be minimized by the liberalization of foreign trade before entry into WTO.

2. Regional trading arrangements and partnerships

In the process of foreign trade liberalization and accelerated integration of Uzbekistan into the global economy, regional integration is of special importance. Regional integration restricts sovereignty in economic policy, but has a number of advantages, including:

- Increased specialization and realization of economies of scale through the pooling of resources and markets;
- Increased consumer choice through access to a wider range of markets;
- Increased competitiveness of goods and services in global markets following the development of intraregional competition;
- Better opportunities for wider scientific and engineering exchange and joint efforts to develop science and technology;
- Creation of better infrastructure in transport, finance and communications; and
- Greater ability to protect regional and national interests in relation to other countries, transnational companies and international economic organizations.

Currently, Uzbekistan is a member of several regional and subregional groupings and the country attaches a high priority to improving their functioning.

The fundamental regional grouping in Central Asia is the CIS, which seeks to preserve and deepen traditional economic relations. It has become a model of political integration and is divided into several integration zones. The most important multilateral agreements within its framework are the Treaty on Economic Union (1993) and the Agreement on a Free Trade Zone (1994). An agreement on creating a Common Agrarian Market in CIS was signed in 1997, to which Uzbekistan later subscribed.

In 1992, Uzbekistan, along with other countries in Central Asia, became a member of the ECO, a grouping originally founded in 1964 by Iran, Pakistan and Turkey to further economic, cultural, scientific and engineering cooperation. In 1994, the Union of Central Asia was formed, grouping Kazakhstan, Kyrgystan, Uzbekistan and Tajikistan. This became the Central Asian Economic Community (CAEC) in 1998. In February 2002 it was transformed into Central Asian Cooperation Organization (CACO). In 1999, Uzbekistan joined the regional economic union of GUUAM and, in 2001, the SCO.

The conditions exist for the further development of Central Asian countries on the basis of greater integration. However, the process of regional integration is currently being hindered by toughened customs barriers caused by the increased threat from international terrorism, differences in national interests, uncoordinated efforts in foreign currency reform, problems of water and energy supply and lack of coordination in the transport sphere. Possibly the situation will change in the future, but viable regional integration within Central Asia and within the CIS will require some time, as well as an understanding that economic development and integration into the world economic system need joint efforts and mutual concessions. However, WTO membership creates a conflict of interest between global trade liberalization and regional integration, particularly for those countries that are members of customs unions.

B. Transition assessment

1. Stages in the reform process since independence

Following the collapse of the former Soviet Union, Uzbekistan found itself with a structure of production highly specialized in supplying raw materials and intermediate goods, such as agricultural products, fuels and other mineral products. Most consumer and capital goods were imported. Specialization in the production and export of raw materials was especially important in the early years of transition, since these goods were very competitive on world markets.

Within a short period of time, Uzbekistan managed to redirect its foreign trade away from the markets of the former Soviet Union to overseas markets. As a result, economic collapse slowed down, in part owing to the low level of industrialization. However, specialization in raw materials led to a strong dependence on world commodity markets, leaving the country vulnerable to their notorious instability.

Uzbekistan also had one of the lowest standards of living among the republics of the former Soviet Union. Development was unbalanced, with industrial and commercial activity, often conducted by giant monopolies, concentrated in urban centres. Rural areas, where 60 per cent of the population lives, were industrially underdeveloped. Furthermore, scant regard was paid to the environment during the Soviet era. The policy of large-scale, irrigated agriculture pursued in Central Asia in the 1960s to the 1980s, particularly in Uzbekistan, was largely responsible for the death of the Aral Sea, one of the greatest environmental disasters in the world.

At independence, low productivity and poor management characterized industrial production. The rupture of economic links between enterprises located in different republics of the former Soviet Union, which occurred during the first years of independence, also aggravated the situation. In order to integrate with the world economy, Uzbekistan was faced with the challenge of radically reforming the structure of production and diversifying its economic base to correct the imbalance between raw material and process industries.

To add to its problems, Uzbekistan had rudimentary political and governance infrastructure. The republic lacked institutions and experienced staff in the area of domestic and foreign policy formulation and implementation, including economic policy. A reform programme was elaborated based on five principles:

- Priority of economic matters over politics and domestic and foreign economic relations divorced from ideology;
- Primary reliance on the State to initiate and undertake reforms during the transition;
- Primary reliance on the rule of law in all spheres of public life;
- A strong social policy, providing social security and support to vulnerable population groups during the transition period;
- Gradual transition to a market economy without the use of shock therapy.

In the initial stages of the reform process, from 1992 to early 1994, the country encountered difficulties related to the breakdown of economic relations between the former Soviet republics and the loss of subsidies, which resulted from the collapse of the Soviet Union.[1] It was impossible to conduct an independent monetary policy as the country was part of the rouble zone and there was a high rate of inflation. As a result of the liquidation of the State monopoly on foreign trade and foreign economic activity, competition from imports hurt local industry. The key objectives of social and economic policy during this period were the creation of the infrastructure of an independent state, introduction of the legislation needed for transition to a market economy, privatization, price liberalization and stabilization and the provision of social security for the population.

In an attempt to offset reduced domestic demand, production and consumption were subsidized, increasing budget and balance-of-payments deficits. Lax macroeconomic policies, macroeconomic imbalances and limited market reforms characterized these years. Since the Government supported key industries and foreign trade was reoriented to overseas markets, the economic recession was relatively insignificant during the early reform period. Real GDP had fallen by 17.7 per cent by 1993-1994 from its value in 1991, the smallest decline among all CIS countries.

The second phase of the reform process began in 1994 with the publication of a presidential decree aimed at deepening economic reforms, protecting private property and developing entrepreneurship and lasted until 1996. The second stage was characterized by a more rigid financial policy, accelerated reforms in many areas and, most importantly, a significantly improved macroeconomic situation. The Government cut subsidies to consumers and producers significantly and measures were undertaken to increase budget revenues and strengthen financial and budgetary management. As a result, the consolidated budget deficit was greatly reduced. Treasury bills were introduced in March 1996.

Monetary policy was also tightened, refinancing rates raised and subsidized credit to enterprises was cancelled. The financing of the budget deficit by the banking system was restricted to 1.4 per cent of the GDP in 1995. As a result,

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1 In 1991, subsidies to Uzbekistan from the budget of the former Soviet Union amounted to 18.5 per cent of GDP.

the annual inflation rate fell from 1,557 per cent in 1994 to 184.5 per cent in 1996. A national currency was introduced on 1 July 1994, following which consumer prices were further liberalized, rationing of staple foods was abandoned and restrictions on foreign exchange eased. State procurement was cancelled for all agricultural products, excluding cotton and grain where it was considerably reduced. The fall in real GDP was arrested, with real GDP growth achieved for the first time in 1996 after the initiation of reforms. During this period, social policy was radically reformed, shifting to targeted support for the most vulnerable population groups. More attention was paid to maternal and child health and to bringing up and educating the new generation through targeted government programmes.

From the end of 1996 to mid-1999, internal and external shocks led to increased public investment aimed at accelerating structural reforms. Monetary policy was eased and foreign currency rationing introduced. Trade restrictions were tightened and management of exports by the State increased. The difference between the official and unofficial exchange rates widened notably. Rapid inflation and falling world prices for key exports led to real exchange rate appreciation with a negative impact on exports, while foreign currency rationing hindered the inflow of foreign direct investment.

Liberalization recommenced in 1999 and government interference in the economy began to decrease. Increased guarantees and protection from the illegal interference of controlling agencies in the activities of economic entities were provided and economic policy shifted gradually from import substitution towards export orientation. Before 1999, the major instrument of structural reform was, to some extent, the creation of large enterprises supported by the Government through directed lending, subsidies and the sale of foreign currency at below market rates. Beginning in 1999, the main priorities for economic policy were structural reform through the development of SMEs, optimization of public expenditure, reduction of the tax burden, export promotion and achieving currency convertibility. A single tax on SMEs was introduced and measures were undertaken to reduce transaction costs for these firms by simplifying controls on them. Significant tax incentives were granted to exporters, the national currency was greatly devalued and measures undertaken to achieve foreign currency conversion on the current account. Privatization of strategic industries commenced in 2000 with the oil and gas sector and, in 2001, restructuring and privatization was extended to the power, municipal services, transport and communications sectors.

2. Lessons from privatization

A number of factors necessitated privatization in Uzbekistan as well as other economies in transition, mainly the weak capacity and low efficiency of State-owned enterprises and the low quality of their products. Privatization in Uzbekistan was undertaken by transferring State shares to investment companies. In this way, speculative and criminal activity was avoided.

The initial phase of privatization in 1992-1994 laid the basis for a mixed economy. Many ministries and departments were reorganized into concerns, associations and corporations that were originally formed as closed joint-stock companies. Small-scale privatization was undertaken of SMEs engaged in trade and services, as well as in local, light industries, construction and construction materials, and food industries. In total, 54,000 entities were privatized. At the same time, a programme on allocating land to the rural population was being implemented with the aim of enlarging the number of private plots. This strengthened the private sector in rural areas, increased production of food, increased employment and encouraged house building. Social stability was achieved as a result of the expanded private sector.

At the beginning of 1994, a real estate market was established in Uzbekistan and a real estate exchange started functioning. Closed joint-stock companies, principally medium- and large-sized enterprises in food and light industries, machinery, transport and other sectors of the economy, including those of a strategic nature, were transformed into open ones. Their shares were distributed between the State and labour collectives and were also sold to local and foreign investors, mainly on the local stock exchange. The second stage of privatization, between 1994 and 1998, also promoted the formation of a treasury bills market. To develop securities markets, appropriate regulatory and legislative frameworks were adopted and during this period the value of securities issued increased six-fold. In September 1996, the Program of Privatization of Investment Funds (PIF) was adopted. The programme aims at privatization through the attraction of a wide spectrum of the population, while seeking to protect the public's investments. The privatization effort resulted in the share of private enterprises in the total number of enterprises reaching 83.7 per cent by 1998.

Before 1998, the method of privatization widely adopted in the country was based on standardized privatization plans regardless of size, economic potential and sectoral affiliation of the enterprises to be privatized. Though it opened up new opportunities for increasing the tempo of the privatization process, the method did not take into account the specific features of enterprises in designing privatization plans. This stage of privatization was aimed largely at promoting competition in the economy to enhance competitiveness.

Privatization from 1999 to the present is focused on large State-owned enterprises in basic industries, giving priority to the participation of foreign investors. An individual approach is applied in the privatization of those enterprises, which provides for participation of strategic investors. A distinctive feature of privatization based on an individual approach is thorough study of the enterprise to be privatized and the adoption of a strategy adapted to each enterprise, as well as the participation of experienced international financial consultants. From table VII.1, the success of the privatization effort can be seen in the greatly increased share of the private sector in economic activity. Furthermore, by 2001, over 74 per cent of property was in private hands.

Table VII.1. Development of the private sector in Uzbekistan

(Percentages)

Share of the private sector in	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*
GDP	n.a.	n.a.	n.a.	n.a.	56.0	54.7	63.5	64.4	69.9	72.6	74.1
Industrial production	10.0	11.9	15.9	46.3	50.2	53.5	59.0	60.2	61.4	63.0	70.8
Agriculture	64.7	68.5	86.6	96.7	97.6	97.8	98.6	98.7	98.7	98.7	99.0
Fixed capital investment	24.4	31.1	24.9	31.6	44.9	30.0	32.3	40.7	34.0	38.0	40.1
Subcontracted construction	7.6	8.4	7.3	23.0	62.1	64.2	71.9	77.1	77.7	78.0	83.9
Retail trade	52.5	53.5	72.0	90.6	91.7	94.5	95.3	95.5	96.0	96.5	97.2
Services	14.0	12.4	10.5	8.5	21.4	35.0	43.0	53.7	54.7	55.5	58.0

Source: Data obtained from the Ministry of Macroeconomics and Statistics.

Note: n.a. = not available.

A major constraint on private entrepreneurship development is the underdeveloped securities market. This is due to the lack of trust in the financial system, low profitability of enterprises and weak shareholder power. Macroeconomic stabilization and improvement in the financial situation of enterprises through restructuring are also needed if investment activity and private entrepreneurship are to grow.

Limited internal resources and the need to keep external indebtedness within acceptable limits during the period of deepening economic reforms and integration into the global economy lead to the need for a selective approach by the Government to industrial policy. In the context of foreign trade liberalization, subsidizing financially troubled economic sectors could be a heavy burden on the State budget. Overall, public intervention in private sector activities needs to be reduced, with the State concentrating on formulating an effective economic policy and providing the legal basis for reforms.

From the perspective of increasing industrial capacity in Uzbekistan, the current stage in privatization is central to the integration of the country into the world economy. Large industrial enterprises in Uzbekistan can survive only if they are oriented to external markets but in these markets they are likely to encounter stiff competition from established producers. Given this fact, foreign investors need to identify potential niches in world markets that the privatized enterprises receiving their investments could potentially seize according to their competitive advantage.

3. Fiscal policy reform

During the first years of independence, Uzbekistan had to create independent budget and tax systems and learn how to formulate a fiscal policy suited to a market economy and to the challenges of the global economy. In the initial stages of the reform process, key priorities were ensuring the social security of the population and achieving a balanced budget. The budget deficit was large, as subsidies from the former Soviet Union had ended and the tax base was dramatically reduced owing to the fall in production. This, together with the narrowness of the tax base, explains the expediency of the introduction during 1992-1993 of an easily collected value added tax (VAT) at the very high rate of 30 per cent, an excise duty of 40 per cent on some commodities and a tax on exports. At the same time, income tax rates on enterprises were not high and ranged from 12 to 15 per cent.

In 1993, new taxes were introduced and the tax base was expanded for some types of tax payments. The income tax rate was raised and the scheme for calculating VAT was changed. However, opportunities for pursuing an independent fiscal policy were still constrained by Uzbekistan's membership of the rouble area. After the national currency was introduced, this constraint was removed and the tax system was simplified and unified in 1995. Tax rates on natural resources and property were raised, a mining tax was imposed and a land tax was levied on agricultural enterprises.

After 1995, the public budget has been dominated by the Government's support of large investment projects related to structural adjustment. Since 1998, the Tax Code of the Republic of Uzbekistan has been in effect. The code comprises several laws on taxation and has made the taxation system more efficient, providing a unified legislative basis aimed at expanding revenues and allowing for the division of taxes between local and national authorities. Some of the key changes that took place in the taxation system between 1998 and 2002 include a reduction in the number of taxes, particularly for SMEs and agricultural enterprises, through unification and simplification; a reduction in profits tax; greater reliance on indirect taxes and resource levies; and tax incentives for exporters.

In spite of the measures undertaken to reform the taxation system, the tax burden remains rather heavy. In 2001, the share of budget revenues in GDP was 35.1 per cent, taking into account social transfers to off-budget funds. Though the tax burden is falling, it is still much higher than in other economies in transition, developing countries and even many developed countries with much higher incomes per capita. The situation becomes even more problematic when the number of tax incentives and the expansion of the shadow economy are taken into account, indicating that the effective tax burden is extremely high.

In the context of globalization, a heavy tax burden not only impedes competitiveness of domestically produced commodities and services, but also promotes tax evasion and the growth of a shadow economy, deters product and export diversification and leads to capital flight and skilled labour emigration. Given the socio-economic situation of the country, the need to lessen the tax burden call for an urgent review of existing tax and expenditure systems. At present, about 19 per cent of public expenditure is accounted for by central government investments that are not very effective. It would be more productive to use public funds to finance infrastructure development, including social infrastructure of public health and education, leaving commercial projects to the private sector.

The share of social sectors in total public expenditure in 2001 was 37 per cent. Given the special role played by science, education and public health in ensuring the country's competitiveness with respect to human capital in conditions of globalization, this large share is justified. However, planning of education, health care and other social spending is based on the so-called baseline method that implies retaining given spending priorities with inflation-adjusted increases. As a result, non-priority spending is adequately funded, whereas new promising directions receive inadequate financial support. To optimize use of the State budget, greater reliance on a programme-based approach could be justified. Better control of public expenditures and additional privatization would go some way towards reducing public spending and making tax reduction possible.

4. Monetary policy reform

A high rate of inflation inherited from the former Soviet Union continued to accelerate during the early years after independence. In 1992, the GDP deflator increased by 711 per cent and by 1,079 per cent in 1993 and 1,239 per cent in 1994. One of the factors behind the hyperinflation was a huge budget deficit that amounted to 12.5 and 10.4 per cent of GDP in 1992 and 1993 respectively. After the introduction of the national currency in July 1994, an opportunity opened up to formulate an independent monetary policy and to implement a programme of stabilization, aimed at restraining inflation and preventing further declines in production. Tightened fiscal and monetary policies resulted in a decrease in the budget deficit to 6.1 and 4.1 per cent of GDP in 1994 and 1995 respectively. The annual rate of inflation estimated using a consumer price index dropped dramatically to 117 per cent in 1995. Macroeconomic stabilization was achieved by 1996, resulting in increased business activity, the growth of domestic savings and greater investment.

Subsequently, macroeconomic policy changed significantly. The most notable changes were new limits on the foreign exchange market and greater use of direct instruments for conducting monetary policy.[2] As a result, the monetization ratio, as measured by the ratio of the broad money supply to GDP, decreased continuously, falling from 14.9 per cent in 1996 to 10.4 per cent in 2001. Monetary reforms accelerated during 2001-2002 but absence of a stable money market has prevented the adoption of indirect instruments to regulate monetary policy. Such a situation hampers the ability of monetary policy to prevent and neutralize financial crises. Trust in the Central Bank may also be undermined by its apparent lack of independence. The creation and develop-

[2] These instruments include centralized credits, interest rate limitations and preferences, regulation of transactions related to funds on hand and so on.

ment of an integrated money market will help accelerate economic reforms, allowing commercial banks to reduce excess reserves and increase lending so preventing de-monetization. Monetary policy can then focus on targeting the inflation rate and maintaining the exchange rate after it has been unified and convertibility achieved, which will help in realizing the advantages of globalization and mitigate risks.

5. Financial sector reform

The formation and development of the financial sector in Uzbekistan is a reflection of overall developments in the economy during transition. At the initial stages of economic reform, economic recession and hyperinflation seriously damaged the sound functioning of the financial system and the efficiency of commercial banks. The financial sector in Uzbekistan is still characterized by segmentation and poorly developed institutions. The banking system[3] accounts for most financial intermediation as the legislative base is not yet in place to regulate the activity of quasi-bank financial institutions. Money and interbank markets are not active and the market of securities is underdeveloped.

The segmented nature of financial markets in Uzbekistan is evident in many areas. For example, one of the fundamental sectors of economy, agriculture, permanently lacks financing owing to low profitability. This creates serious problems for the economy, impeding the smooth circulation of money between agriculture and other economic sectors. The system of multiple exchange rates, currently in existence in Uzbekistan, is also a source of price distortions and financial segmentation. In its attempts to eliminate price distortions, government policy aims at the liberalization of the currency market and unification of exchange rates by devaluing the official rate rapidly and liberalizing access to the interbank currency market.

The banking system in Uzbekistan is under-capitalized, the ratio of aggregate bank capital to GDP being just under 4.5 per cent in 1999, well below the average 12 per cent figure of other economies in transition in the same year. The development of the banking sector is also hampered by the absence of

[3] At present, the banking system in Uzbekistan consists of 37 commercial banks, of which 6 banks have foreign capital participation, 17 are privately-owned and 3 State-owned. The remaining banks are joint-stock commercial banks.

market-determined interest rates. The refinancing rate of the Central Bank serves, to some extent, as the base interest rate, mainly because all existing restrictions on interest rates are linked to it and it is used by commercial banks in setting their own rates.

At the end of 2000, 93 per cent of credits granted by the banking sector were foreign currency credits guaranteed by the Government. In this situation, devaluation of the official rate automatically raises the cost of debt service and worsens bank credit portfolios. Considerable devaluation of the official rate in 2000-2001 led to a substantial increase in non-performing loans, increasing the risk of a crisis that could strike the entire bank system. Further liberalization of the currency market and unification of exchange rates envisages additional devaluation of the official exchange rate, which may increase the risk of a systemic crisis, a factor that needs to be taken into account in restructuring banks and their debts.

For deeper economic reforms and integration into the world financial system, inflation has to be brought down to single digits. Reducing concentration in the industry through further privatization of State-owned banks and the removal of restrictions on the access of foreign financial institutions to the internal financial market can foster competition in the banking system and increase efficiency. Increasing transparency and financial disclosure while strengthening the legislative base to ensure fulfilment of contractual obligations are vital matters requiring further attention. The Government must also encourage the independence of financial institutions in managing their affairs.

C. Markets and trade

The foreign trade policy of Uzbekistan can be divided into several phases. During the initial stages of reform, in 1991-1994, low tariff levels in the 5-10 per cent range and a lack of non-tariff barriers characterized import policy. At the same time, exports of food and industrial goods were subject to 40 per cent tariffs and most exports, especially those of State-owned enterprises, were subject to quotas and licenses. During 1994-1996, imports were further liberalized but the restraints on exports continued and tariff rates on exports were raised. However, in 1996-1998, the number of goods exported on the basis of quotas and licenses was greatly reduced. Quotas and licenses were retained for those goods where domestic and world prices differed significantly, such as cotton fibre, non-ferrous metals, energy and raw materials and exports were banned for another 13 goods. High export duties remained principally on raw material exports. After 1998, export tariffs were reduced significantly and later abolished while protection against imports has increased.

Besides tariff and taxes, at present there are also de facto constraints on both exports and imports, which have the same effect as quotas. These include foreign currency rationing, which is still in use. The annual import forecast prepared by the Ministry of Macroeconomics and Statistics acts as an additional constraint. As for regulation of exports, only some commodities require licenses. However, the cabinet must approve the distribution of key industrial products on an annual basis and this is no less a constraint than the export ban on many commodities. Since import restrictions also lead to a decline in exports through their effects on the exchange rate and the prices of intermediate goods, further liberalization of exports and imports is a necessity. Foreign trade liberalization should be done gradually to avoid major dislocations in the economy but even temporary deviations from the liberalization course can lead to more radical and expensive measures being needed down the road.

The breakdown in economic links between enterprises located in different republics of the former Soviet Union, their insolvency and the collapse of the payments system were major problems that Uzbekistan faced in the years immediately following independence. Since then, it has reoriented its foreign trade away from the former Soviet area to overseas markets. The share of CIS countries in exports from Uzbekistan has fallen from two thirds of the total in 1994 to about one third in 2001, while their share in its imports has fallen more slowly, from just over 53 per cent to just over 37 per cent in the same period. The reorientation of foreign trade and trade liberalization have had beneficial effects on the volume of Uzbekistan's exports. However, the value of total exports has fluctuated somewhat, reflecting changes in its terms of trade. As these terms have improved recently, the value of exports has stabilized. The structure of Uzbekistan's exports has changed since independence. Along with traditional exports such as cotton yarn, fabrics and non-ferrous metals, exports of products of the chemical, oil and gas and machinery industries have increased. In spite of this, raw materials continue to account for about two thirds of total exports, which makes the country vulnerable to fluctuations in world commodity prices.

D. Investment liberalization policies

From the very beginning of the transition period, the Government of Uzbekistan placed particular emphasis on domestic and foreign investment. In the early stages of reforms, investment fell owing to various factors related to the collapse of the former Soviet Union. During this period, investment policy was concerned primarily with preserving existing industrial capacity. Subsequently, investment grew very rapidly and investment policy shifted to directing domestic and foreign capital towards the structural reform of key sectors such as the oil and gas industry, as well as establishing industries to produce consumer goods, vehicles, raw materials and semi-finished goods.

More recently, investment policy has focused more on SME development. As part of the reprioritization effort, licensing, registration, accounting and taxation regulations for SMEs were simplified and the Council of Small and Medium-Size Enterprises Development was established. Several incentives were offered to SMEs, including a reduction in the income tax rate applicable to first and second year income of 75 and 50 per cent respectively. SMEs receive preferential credit and the income earned by commercial banks from SME lending is tax exempt.

Support for SMEs has become a fruitful arena for international cooperation and Uzbekistan has so far received some US$ 455 millions to finance SME projects from international financial organizations. Despite these massive efforts, however, at present there are only approximately six SMEs for every thousand persons in the country, whereas the comparable figure in Western Europe is at least 30. The share of SMEs in foreign trade activity is less than 2 per cent, a comparatively low figure, as most small businesses are concentrated in trading and public catering where entrepreneurs need little capital and expect a short payback period.

The investment policy of the Government of Uzbekistan has enabled it to achieve self-sufficiency in energy and food. In 1990, Uzbekistan could meet only 28 per cent of its demand for oil, whereas by 1995 oil imports had practically ceased and oil exports had more than tripled. As early as at the mid-1990s, grain self-sufficiency was achieved and grain imports began declining gradually in 1995. Nevertheless, the investment policy has had some negative consequences for the competitiveness of some sectors and enterprises in the context of globalization and integration into the world economy.

As a result of an investment policy directed towards import substitution, a number of enterprises were established in Uzbekistan to exploit the short-term effects of import rationing. As a rule, those enterprises were also granted monopoly powers, which did not favour the development of a competitive environment or quality improvement. Many of the enterprises created and developed during this period are likely to become unprofitable after foreign trade and the currency market are liberalized.

The basis of investment policy of the Government of Uzbekistan is the annual investment programme, a component of the overall socio-economic development forecasts. The investment programme contains a list of priority investment projects, detailing customers, foreign partners and sources of financing. Those projects receive several incentives and privileges, the most important of which is access to foreign currency convertibility at an overvalued exchange rate at the Central Bank. This, along with support from the public budget and access to low-cost credit from the banking system, greatly increases economic rents for investors. However, approximately 60 per cent of all fixed investment is still undertaken by the State. Much of this investment is in heavily capital-intensive activities, stimulated by numerous preferences and privileges. Not surprisingly, much of it is inefficient. During 1998-2001, the ICOR averaged 6.5 whereas the comparative figure in countries with a strong export orientation is 3-4.

The share of foreign investment in total investment increased from 19 per cent in 1996 to 33.7 per cent in 2001. However, the overwhelming majority of foreign investment, around 85 per cent, was in the form of loans guaranteed by the Government, increasing external indebtedness and potentially posing debt service problems in future. FDI has been increasing (table VII.2) but remains low despite the fact that foreign investors are given legal guarantees and several privileges with respect to taxation and the foreign trade regime, such as the removal or reduction of customs and excise duties and other trade taxes.

Table VII.2. Indicators of FDI in Uzbekistan, 1994-2001

Indicator	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*
Total FDI (million US dollars)	70	352	169	275	133	111	105	108
Number of registered enterprises with FDI	1 246	1 878	3 061	3 355	3 594	3 554	3 445	3 281
Number of employees in enterprises with FDI	–	28 929	55 145	79 613	86 322	86 281	91 100	90 400
Share of enterprises with FDI in GDP (per cent)	2.6	2.0	7.0	12.0	13.0	13.0	12.1	7.9
Share of enterprises with FDI in the total exports (per cent)	0.6	2.0	4.0	9.0	10.0	11.0	13.8	12.8
Share of enterprises with FDI in the total imports (per cent)	5.6	14.5	33.0	39.0	34.0	33.0	25.8	29.9

Source: Data obtained from the Ministry for Macroeconomics and Statistics.

E. Impact of globalization on social and human resources development

1. The labour market and employment

The collapse in production following independence was accompanied by a fall in employment. Since 1995, however, there has been an increase in the labour force owing to increased employment opportunities in the non-governmental sector and the growth of informal employment. As a result, the structure of employment has changed rapidly. In 1991, the public sector employed 60 per cent of the total number in employment but by 2001 this share had fallen to less than 30 per cent. The dynamics of the labour market are largely affected by demographic factors. High birth rates in the 1970s and 1980s led to an increase in the population in younger age brackets and there were more than 10 million children under the age of 15 at the beginning of 1998. In the short term, there is likely to be a surge in the number of young, unskilled workers entering the labour force whereas it is skilled professionals that are in demand. The official unemployment rate in 1993-1998 was 0.5 per cent or less but unofficial estimates put the true figure at approximately 5.7 per cent.

The apparent increase in unemployment as economic reforms were implemented is a reflection of several factors. First, there was the privatization of large, State-owned enterprises that released labour resources that have still to be absorbed fully by private enterprises. Second, the restructuring of agricultural enterprises speeded up the release of the labour surplus in agriculture, estimated at 100,000 workers per year. Even so, employment in agriculture remains excessive and according to some estimates, the total labour surplus in agriculture amounts to approximately 600,000 people. Finally, the demographic factors mentioned above are adding about 400,000 people to the labour force annually.

The Government's policy with regard to the labour market is to give priority to its regulation and implement measures to support employment in those areas and sectors where the situation is especially difficult. The creation of new jobs, improving professional training and retraining and organizing temporary public works to improve economic and social infrastructure are other aspects of this policy.

2. Professional training

According to many indicators, educational standards in Uzbekistan are among the highest in the world. The country managed to retain these high standards during transition, without distinction according to gender, age, nationality and ethnic origin. This was possible owing to the passage of the Law on Education in 1997 that made free secondary and vocational education mandatory. Since then, several new school and pre-school facilities have been opened. Also in 1997, the Law on the National Professional Training Programme, which gives priority to ensuring continuity of education and professional training according to the requirements of the labour market, was adopted. The programme provides for:

- Professional training of specialists at all levels, according to the changing requirements of the country during development;
- Reform of educational institutions in the light of the country's transition to a market economy;
- Introduction of universal education for twelve years, comprising nine years of secondary education that are already mandatory plus three additional years of vocational education;
- Development of State standards for education in line with the new demand for specialists in the economy; and
- Certification of educational institutions at all levels.

3. Support for incomes during transition

In the period from 1991 to 1995, both money and real incomes declined in Uzbekistan. The Government sought to support income levels by pursuing an accommodative monetary policy and providing subsidies, social transfers and other benefits to almost all the population. Other measures included subsidizing local producers, as well as the prices of imported essential goods, limitations on exports and price controls for basic consumer goods, including medicines. Wage and income indexation was widespread and little attempt was made to control informal economic activities. This approach allowed incomes to be cushioned to some extent from the shock of price liberalization.

After the introduction of a national currency, in the second half of 1994 monetary and fiscal policies were tightened. In line with this, wage and income indexation became less widespread and, since 1995, index-linked increases in the minimum wage and related payments have been limited to twice a year. Consumer subsidies were reduced to a minimum, remaining only for some municipal services and a system of targeted social security benefits for vulnerable population groups was created, with non-targeted subsidies and privileges being eliminated. Along with improved administration of social security funds, this enabled payments to vulnerable population groups to increase significantly while budget expenditures for these purposes were simultaneously reduced. By 1996, economic activity had recovered and income from entrepreneurship, property and farming increased.

4. Poverty and social safety nets

During most of the Soviet era, information related to poverty was classified as secret. Beginning in the late-1980s, the existence of poverty was recognized and a working definition of poverty was developed, with people having an income level below the minimum wage defined as being poor. According to this definition, 44 per cent of Uzbekistan's population were poor, mainly people living in rural areas, pensioners, widows, single mothers and disabled people. No effective independent system of social protection existed in Uzbekistan, which was included in the former Soviet Union's social protection system. Although this system had a comprehensive coverage, misallocation of funds and lack of targeted measures prevented effective poverty alleviation.

Poverty has many aspects so that general statements about it are difficult to make. In addition to this, the lack of reliable information complicates an in-depth analysis of the situation. Absolute and relative poverty levels are very difficult to identify in Uzbekistan. Some information can be obtained from the data submitted monthly by the system of local government institutions known as *mahallas*. These data suggest that currently some 500,000 families, around 12 per cent of all households and 13-15 per cent of the population, are extremely poor and there is a high concentration of poverty in rural areas. In addition, there are currently estimated to be about 1 million low-income families in Uzbekistan and a considerable number with incomes close to low levels.

Until 1994, social protection in Uzbekistan followed the Soviet model, seeking, where possible, to enhance it. One of the first national laws adopted, in 1991, was the Law on Social Protection of Disabled People that provided legal guarantees for this vulnerable group. In 1992, the Law on Employment of the Population was adopted to provide legal guarantees and social support to unemployed persons. Gradual reform of the system of social protection commenced in 1994. First, this system was reoriented to target subsidies to the neediest groups in the population. Second, social support was channelled largely to families and, third, indicators of family welfare, such as income, property ownership and paid employment, were taken into account in determining benefits.

The main feature of the mechanism of social protection was the delegation of the power to nominate beneficiaries and to distribute benefits to local government institutions or *mahallas*. This allowed the State to improve targeting and reduce administrative expenditures, while at the same time enhancing the role of local government institutions in social and economic life. In 1994, local government institutions distributed about 2 per cent of the budgeted expenditures to low-income families, a figure that had increased to 9 per cent by 1996.

At present, over 43 per cent of all families get direct State financial support, half of them receiving child benefits. Targeted social payments and privileges are provided for population groups such as pensioners, elderly persons ineligible for a pension, widows, orphans and children from low-income families. The assistance is largely to pay for municipal services and public transport, as well as to provide these groups with free food, medicines, winter clothes and school necessities and also to give them an opportunity to attend health centres and resorts. Compensatory benefits and payments are also made to war veterans and victims of natural disasters.

The right to social support in old age and in the case of disability or the loss of a breadwinner is enshrined in Article 39 of the Constitution of the Republic of Uzbekistan. The largest component of social security in Uzbekistan is the State pension system. It functions in accordance with the Law on State Pensions for Citizens, adopted in September 1993, that created a new pension system based on the pay-as-you-go principle.

Although the dependency ratio (i.e. the ratio of the retired to the employed) is comparatively low at 0.3, financial problems may appear in future. Actuarial estimates indicate that only 42 per cent of the employed contribute to the pension fund, the remainder being in arrears with pension fund payments. The greying of the population of Uzbekistan that is forecast to occur in the near future necessitates early pension reform.

F. Key challenges ahead

Globalization leads to an increase in the demand for highly skilled, well educated and well paid workers in developed countries and the movement of jobs requiring lower skill levels to developing countries where labour is relatively cheap. While this process will clearly help in absorbing surplus labour in developing countries in the short term, the effect in the long term may be negative if it leads to a slowdown in the qualitative improvement of the labour force. However, for a country like Uzbekistan, where 400,000 people were unemployed at the end of 2001, increasing employment in the short term is of considerable importance. It should also be emphasized that the prerequisites and conditions exist in Uzbekistan to counteract the danger of an expansion of unskilled labour, or a slowdown or suspension of human resources development, in the form of the national training and retraining programme.

1. Job opportunities and emigration

Creating job opportunities for population groups most in need of employment would enhance the positive effects of globalization. The Bizintrud Programme, executed by the Employment Fund of Uzbekistan in cooperation with the Pfaff Singer Company provides an example of what can be done. The Company provides sewing equipment to unemployed women with low skill levels, mostly in rural areas where unemployment and underemployment are high. It also places orders for clothing and similar soft products that are distributed through a network of partnering trade companies. However, such programmes by themselves are obviously not enough to improve the labour market situation in Uzbekistan. Improving the investment climate in the country to attract FDI, for example to the food processing and other light industries, which can successfully be developed in rural areas, would have a more consistent effect on employment.

Economic restructuring driven by globalization can lead to unbalanced growth in national economies. In Uzbekistan, however, the need for economic restructuring did not emerge only as a result of globalization but as early as the 1980s, when it became clear that an economy based on cotton and mining would be unable to generate either accelerated economic growth or higher incomes for the population. However, it is necessary to ensure that economic restructuring caused by internal factors is not dissonant with global trends. For example, deindustrialization of the world economy is linked to rapid growth of the services sector, where employment has been growing rapidly. As a consequence, other sectors have been shedding jobs. This suggests that job-security programmes should seek to accelerate development of services through giving priority to investment in this sector.

The increased mobility of labour can also be a potential problem in an open economy. International migration has both positive and negative effects. It allows workers to upgrade professional skills and to acquire new skills and new ways of thinking. It also leads to increased remittance flows to the home country, which can be quite substantial. However, the most valuable domestic labour resources are highly skilled workers who are also the most mobile.

These workers are able to move to other countries, frequently in the developed world, in response to the widening wage gap between high- and low-skill jobs and, as many countries are interested in recruiting talented professionals, these workers can obtain entry visas relatively easily. It is very difficult to cope with this brain drain, in view of the constitutional guarantee on freedom of movement. However, market reforms in Uzbekistan are leading to the creation of new opportunities for well educated, skilled workers within the country, which should slow emigration.

Uzbekistan possesses about 40 per cent of the labour resources of Central Asia. Literacy, at 99.2 per cent, is almost universal. The average number of years spent in school is 11.4, ranging from 13.9 years in urban areas to 9.8 years in rural areas. Every fourth employed person has higher or vocational education. This has lead to many workers seeking seasonal and short-term work in other CIS countries following the introduction of market reforms there. For example, during the summer of 2002, 150,000 persons sought work in neighbouring countries, 80 per cent of them in Russian Federation.

With limited official labour migration through the Ministry of Labour and Social Protection of Population, illegal migration has also become popular among the people of Uzbekistan. In Uzbekistan, there are no licensed private companies and agencies that can help people seek employment abroad. However, firms engage in this activity under the guise of tourism or other organizations licensed to operate in sending people abroad. Individuals pay for their services but have no guarantees as to social security once they have gone abroad. With time, many restrictions on emigration may be removed as globalization proceeds.

2. Income inequality and social stratification

Although real income has been growing moderately in Uzbekistan in recent years, much of this growth has gone to families in higher income brackets, indicating increased social stratification. The number of families on low incomes increased in the late-1990s as a result of economic restructuring and this process can be expected to continue with deeper integration and the demand for greater efficiency in the agricultural sector. Globalization will inevitably affect the social situation of the country. While in the early-1990s, poverty was the result of factors such as low skills, disability, widowhood and old age, now even skilled workers are in danger of joining the ranks of the poor if they are not retrained and professionally upgraded. Enhanced social protection is, therefore, advisable along with deepening economic liberalization.

Income inequality is not new to Uzbekistan, as incomes remained unequal during the socialist period.[4] After independence, income inequality was estimated to be somewhat higher in Uzbekistan than, for example, in Russian Federation, owing to the large agricultural sector and rural population. By 1996, transition to a market economy is estimated to have increased measured income inequality in Uzbekistan by about one fifth. Another troubling feature of changes in the distribution of income in the country during the transition period is that there appears to have been little relation between educational attainment and increased income. This factor has triggered a revision of values and ideals among the younger generation, leading to substantial emigration and undermining human capital formation. There is also a visible gap between ethnic groups in terms of income. Whereas only 20 per cent of families of ethnic European origin are in the low-income brackets, 54 per cent of families of Uzbek origin are in these brackets. This is particularly true of women in rural areas, and the typical poor person in Uzbekistan is most likely to be an Uzbek countrywoman.

Major attempts at income redistribution would create a heavy burden on the public budget and affect labour and production incentives adversely. Although it is hoped that economic growth will eventually help the poorest groups in the population, the Government of Uzbekistan has attempted to support subsistence levels of income even at the cost of a comparatively slower transition to a market economy. Public expenditures have not been pared to the same extent as in other CIS countries and expenditures on education and healthcare have increased. These expenditures have also been redirected to meet the needs of the public. For example, spending on health care has focused on increasing the number of out-patient centres instead of increasing the number of beds, while medical training has concentrated on producing more general practitioners rather than specialists. An important thrust of social protection measures to prevent severe social stratification has been the recent adoption of programmes for raising living standards for vulnerable groups, including by fostering entrepreneurship and self-employment. In this regard, more attention is being given to coordinating microcredit programmes supported by donors.

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4 This section draws on K. Malik, "Poverty and income in Uzbekistan and other Central Asian countries", *Ekonomicheskoye Obozrenie*, Centre for Economic Research, Tashkent, pp. 20-25, January 1998; and R. Pomfret, "A comparative study of national poverty reduction strategies: Uzbekistan, Kazakhstan, Kyrgyzstan", *Ekonomicheskoye Obozrenie*, Centre for Economic Research, Tashkent, pp. 30-32, January 1998.

G. Conclusions

In general, the impact of globalization on economic development in different countries is closely related to their competitiveness. Globalization has benefited those countries that have managed to create the most favourable conditions for entrepreneurial activity and the attraction of FDI through developing efficient financial systems and fostering economic development based on comparative advantage. Countries that have failed to create those conditions have lost out.

The unfavourable initial conditions that Uzbekistan inherited at independence, such as a heavy reliance on the production of primary commodities, lack of economic infrastructure, its doubly landlocked position and its demographic situation, continue to hinder the realization of its economic potential. There is also a predisposition to taking a relatively cautious approach to reform and economic openness, seen in the sharp increase in protectionism and financial regulation in the late-1990s following the Asian financial crisis and the deterioration in the country's terms of trade.

The need to ensure sustainable development and resolve a number of socio-economic problems demand attracting significant new investments embodying new technologies and mastering modern efficient forms for organizing production and labour and improving human resources. This is impossible without deep participation in the world economy. Developments in many spheres have not, however, been conducive to meeting these challenges. In particular, the present system of foreign exchange regulation distorts incentives for investment. Taxation is high and the tax system complex, increasing the danger of capital flight. Inadequate financial markets and a weak banking system do not encourage domestic and foreign investment and hinder the formation of large enterprises. Regulations governing FDI are bureaucratic and complex. The significant presence of the State in basic economic sectors as well as State regulation of economic activity through a cumbersome, non-transparent process hinders the development of the private sector.

Nevertheless, important measures were undertaken recently in liberalizing the financial sector and foreign trade in Uzbekistan and in the areas of fiscal reform, reduced State control of economic activity, privatization and foreign investment. Uzbekistan is planning to join WTO and is currently implementing a series of measures approved by international financial organizations that will, it is hoped, bring about rapid integration of the country in the world economy, enabling it to take advantage of the opportunities offered by globalization, for the sake of the people.