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ECONOMIC TRANSFORMATION: RELIANCE TO SMALL BUSINESSES AND EXPORT ORIENTATION

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ABSTRACT: *Uzbekistan as a low-middle-income country with a population of 30 million, has seen stable economic progress (with the growth of average 8 percent per year) since 2004 and extreme poverty has declined from 27 percent in 2000 to 15 percent in 2012. The government has set an ambitious goal for the country—to join the group of upper-middle-income countries by 2030. This study discusses the main challenges of the structural transformations that the economy will face to achieve this objective.*

KEYWORDS: Uzbekistan, Transformation, Growth, Small Business, Export, Import.

INTRODUCTION

The post-independence policy model chosen by Uzbekistan was based on a gradual transformation of the economy, combining state control of "strategic" industries with gradual implementation of structural transformation (ADB, 2012). Throughout the independence period, the government of Uzbekistan has adopted five key principles of reforms: 1) economics takes priority over politics, with de-decolonization of both domestic and foreign economic relations; 2) preserving the state's role as the main reforming force during transition; 3) the primacy of law in all aspects of life; 4) social protection, especially the most vulnerable groups of people; 5) an evolutionary manner of transition to a market economy (BTI, 2016).

During the last 25 years Uzbekistan experienced considerable rates of economic growth mostly thanks to rich mineral resources and gradual socio-economic policy. Uzbekistan is the world's ninth-largest gold producer, with a production of 90 tons yearly, it also the world's fifth-largest producer of uranium, and natural gas, comprised more than 35% of exports (BTI, 2016).

Theoretical underpinning

The results of study reveal that gradual approach to economic reforms, coupled with strong social support and high international prices for export commodities, allowed the country to avoid the deep economic recession and social unrest (ADB, 2012). Post-independence decline in GDP of Uzbekistan was about 16.7% within 1991-1994 had been the lowest in comparisons with all other post-Soviet Republics, (for example, in Azerbaijan decline was by 53.8%, Armenia-60.9, Belarus- 36.3, Georgia-79.8, Kazakhstan-50.1, Kyrgyzstan-50.0, Moldova-61.2, Russia-42.2, Tajikistan-67.0, Ukraine-47.0%) (B.Islamov,1998). According to the study Uzbekistan started economic growth with over 4% from 1997 onwards and its GDP had recovered to 103% of its 1989 level, while many other transition economies were still struggling with recession (T. McKinley, 2010). Those achievements were mainly the results of structurally transformation of economy, adapting import-substitution strategy and beginning to diversity out of its heavy reliance on cotton exports. The analysis show that the GDP growth rate continued to average about 4% during the early 2000s, it accelerated to over 7% by 2004 and exceeded 9% in 2007, and stabilized over 8% after 2009 (Figure-1). This growth was based

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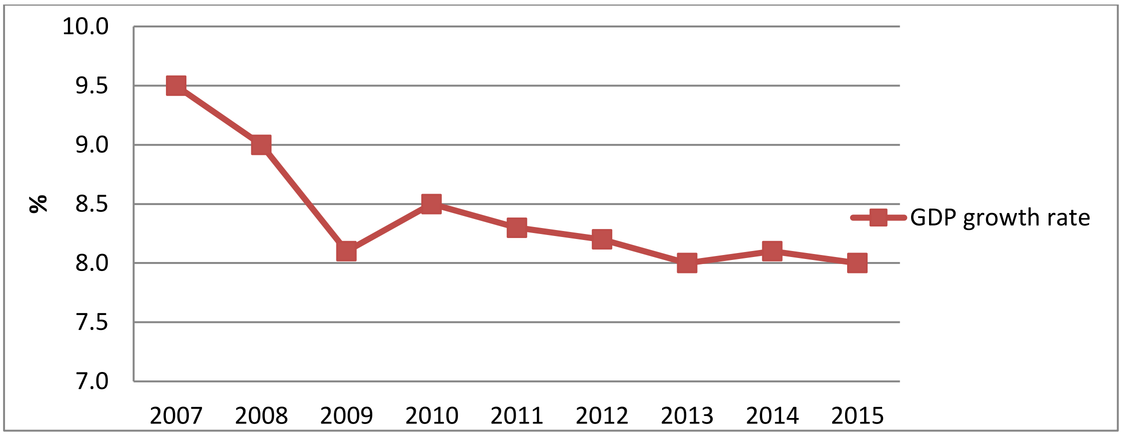
on rapid expansion of industry and fueled by increases in exports of commodities such as gold and energy resources.

The research reveals that (B.Islamov, 1998) Uzbekistan is the only country in Commonwealth of Independent States (CIS) which succeeded by mid-1990s in achieving positive growth in comparison with early 1990. The achievement of industrial policy goals was combined with structural changes based on import substitution in fuel sector and development of new facilities for machine building.

Despite a continuous stream of criticisms from international financial institutions and mainstream economists beginning early in its transition to a more market-based economic system, Uzbekistan became well known for its heterodox economic policies (see among others B.Islamov, 1998, T.McKinley, 2010).

Figure-1. GDP growth rate in Uzbekistan.



Source: State Statistic Committee, 2016.

According to the Advanced Financial Solution's research in 2011, Uzbekistan is in the top ten with the annual growth rate of 8.3%. The most important the structural transformations in Uzbekistan over the last 20 years has been the gradual change in the structure of the economy away from agriculture (mainly cotton) in the late 1990s toward a greater reliance on industry and services by 2012 (E.Trushin & F.Carneiro, 2013). This was achieved due to high rate of growth in industrial production in recent years (Figure-2) and government program of localization and import replacement.

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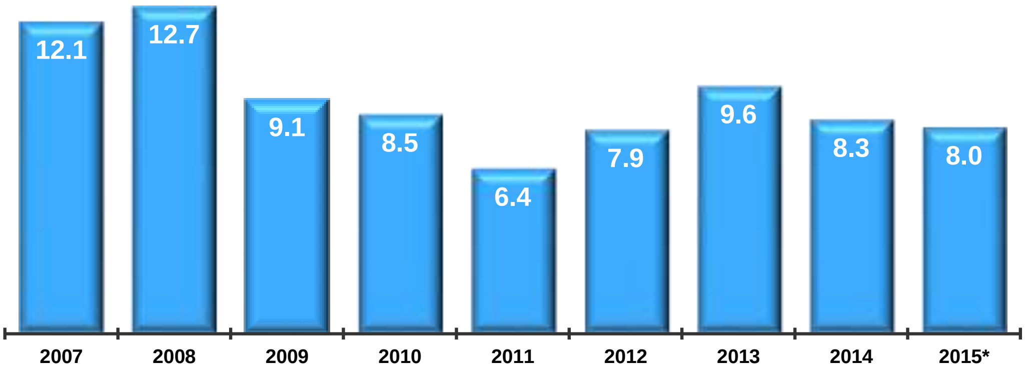
Figure-2. Industrial Production growth (in % to previous year).



Source: State Statistic Committee, 2016.

DISCUSSION

Although the global financial crisis has hardly affected the domestic financial sector directly, it has slowed exports, remittances, and investment due to slower economic growth in Russia, Kazakhstan and Uzbekistan's other trading partners (PWC, 2013).

According to IMF regional forecast (as reported in gazeta.uz, 2014) the growth in Central Asia & Caucasus slowed down to 1% of GDP as a result of Russian Economic turmoil (caused by Western sanctions and dropping oil price), which influence through foreign trade, investments and remittances[1] (U.Burkhanov et al., 2015) Continuous slow growth rates in EU and China will negatively affect also, according to the report. As oil prices hits four year low the risks of forecasting is increasing and reduced demand from Russia gives more pressure on Uzbekistan's trade balance.

The study reveals that the government has set the following strategic programs of advancing reforms, structural transformation and diversification of the economy for 2015-2019 to ease the negative effects of global and regional negative factors (R.Azimov, 2016): strengthening protection of private property, small business and private entrepreneurship; introduction of modern standards of governance; increasing the share and importance of private sector in the economy; ensuring structural changes, modernization and diversification of output; deepening localization of production of finished goods, components and materials; improvement of energy efficiency of the economy and social sector; development and modernization of key infrastructure.

Meanwhile in 2016 the government started a wide-scale privatization program which aims to sale of 1247 state enterprises and assets, including 512 enterprises - at "zero cost" and sale of the state share in 68 strategic enterprises ("Ferghana-azot", "Navoi-azot", "Photon" "Dzijak accumulator plant", "Qizilkum cement", "Urgench excavator plant", etc.) only for strategic foreign investors. The program aims to increase private share sector up to 86% of GDP in 2019 (R.Azimov, 2016), (Figure-3).

[1] The total amount of remittances by labor migrants in 2014 is estimated to reach about $5-6 billion which will constitute about 10% of the GDP (in the first two quarters of 2014 Uzbekistan received $2.54 billion).

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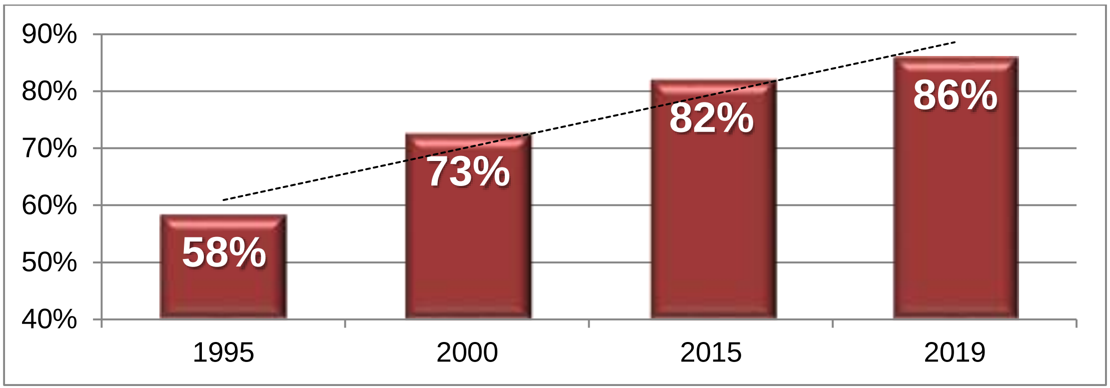
Figure-3. Private Sector Share, % of GDP



Ensuring structural changes, modernization and diversification of output for 2015-2019 include implementation of 900 projects with total investments of over 41 bln. USD, in: petrochemical industry – 54 projects; power sector – 35 projects; chemical industry – 25 projects; machinery – 77 projects; building materials industry – 11 projects; light industry – 79 projects; food industry – 304 projects; pharmaceuticals – 22 projects (I.Karimov, 2016).

The following table shows that by 2020 Uzbekistan will achieve sustainable high growth rates and basically accomplish the modernization of main industries.

Table. Expected results of strategic programs

Indicators	**in 2015 - 2020**
GDP growth rate	8% per annum
Industrial growth rate	9% per annum
Industry's share in GDP	from 24% to 28%
Share of high technology production in Industry	from 70 % to 76%
Production of new goods	over 100 types and 1000 varieties
Export growth	by 1.5 times up to 25 bln. USD
PPP based GDP per capita	over 10.000 USD

Reliance on small businesses

Small and medium enterprises (SME) have a long tradition in Uzbekistan. Also, from the start of economic reforms the Uzbek government encouraged SMEs. Small businesses in Uzbekistan are represented by three main forms: micro-enterprises, family businesses and entrepreneurs.

Despite the fact that the inheritances of state controlled large companies are the great economic potential in Uzbekistan's transition economy, they have a negative political impact by remaining monopolistic in the areas of specialization. SMEs in Uzbekistan can be seen drivers of fair competition and economic freedom which in fact a large number of small businesses could build a proper pricing policy. In addition, SME are more flexible which can respond

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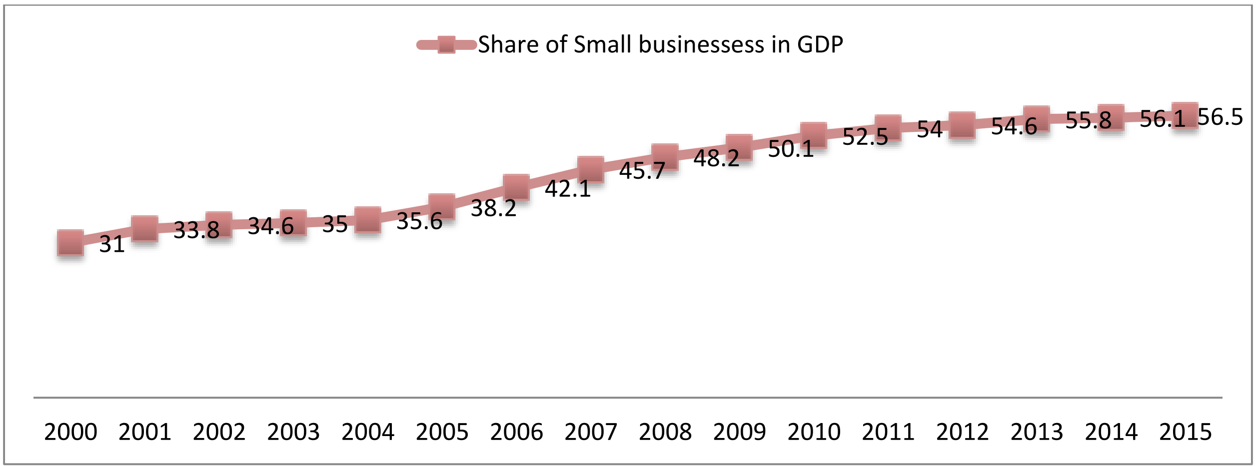
quickly to the needs of the economy and society where large industrial enterprises cannot quickly adapt new production.

In Uzbekistan, there are a number of programs to provide micro-credit for small and medium-sized businesses, as well as programs aimed at promoting the participation in international tenders (see among others Wojciech Hubner, 2000).

According to the statistics the share of small businesses and private entrepreneurship as a percentage of GDP has grown from 31% in 2000 to 56,7% in 2015 (figure-5), (I.Karimov, 2016).

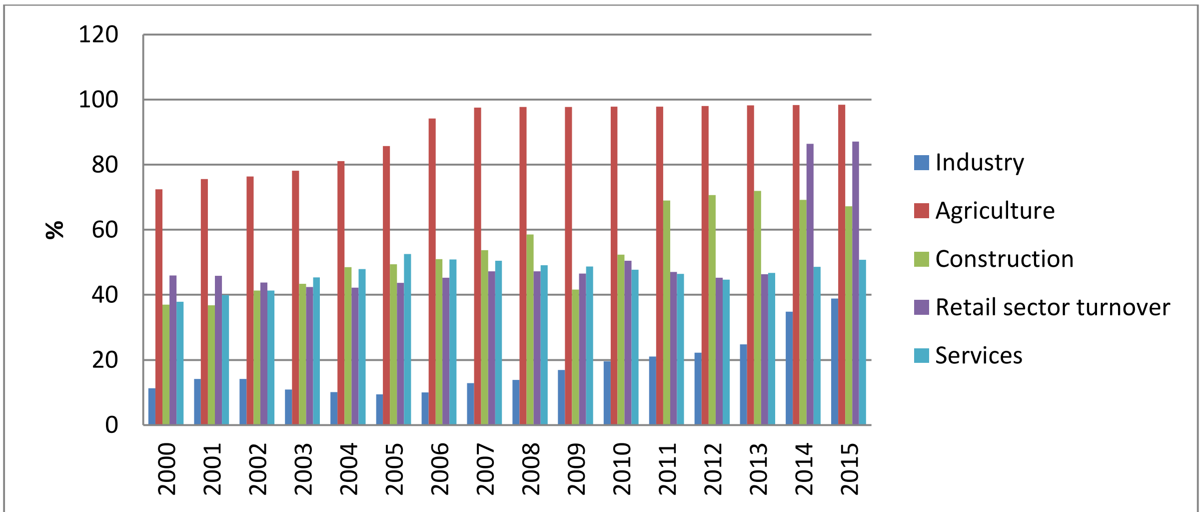
Figure-5. Share of Small businesses in GDP



Source: State Statistic Committee, 2016.

The most promising sectors of SMEs in Uzbekistan include the construction and food production (agriculture). Within the industrial production sector, this share has increased from 12.9% to 32% during the same period (figure-6). As of 2015, private-sector workers comprise 77% of the employed population, as compared to 49.7% in 2000 (I.Karimov, 2016).

Figure-6. % of Small Business in the sectors of economy



Source: State Statistic Committee, 2016.

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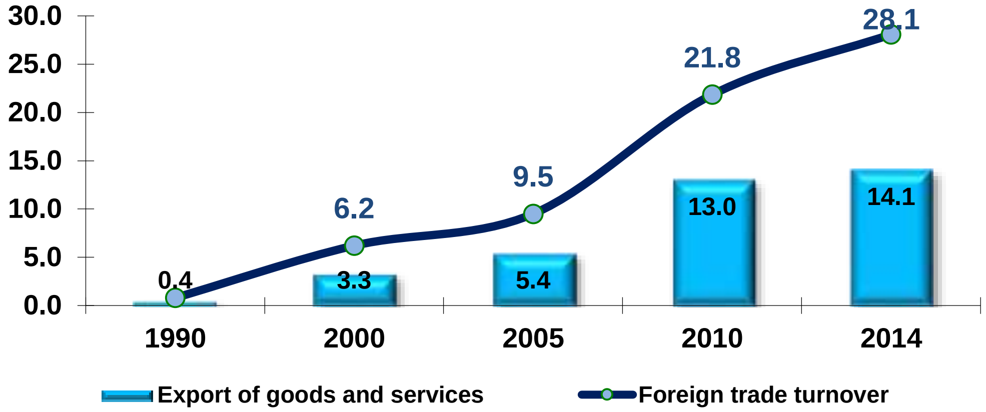
International integration

Despite the fact that Uzbekistan remains one of less globalized country (www.thegolbaleconomy.com) in the world the process of integration has also been taking place between Uzbekistan and the WTO regarding the country's membership to this organization. Particularly, Resolution No.190 was adopted on 11 July 2014 by the Cabinet of Ministers of Uzbekistan. This indicates new basic measures as a framework for the process of Uzbekistan entering the WTO (BTI, 2016).

In the late 1990s, Uzbekistan's economy was affected by decreasing export revenues caused by falling international prices for its main export commodities (including cotton), and the 1998 Russian financial crisis (the main trade partner). In response, authorities conducted tight monetary and fiscal policies during 1998–2001, accompanied by increased tax collection and foreign trade controls. These policies, together with improved export performance, resulted in a buildup of foreign exchange reserves, leading to a substantial accumulation of savings (figure-7). The first fiscal surplus of 0.1% of GDP in 2003 was results of stringent tax collection and tighter expenditure controls, reversing the trend of persistent fiscal deficits from 1994 to 2002. The government started developing mechanisms to transform savings into investments. The Fund for the Reconstruction and Development of Uzbekistan was established in 2006, with the dual purposes of monetary sterilization and economic development (ADB, 2012).

Figure-7. Foreign trade turnover, bln US dollar.



The growth of Uzbekistan's exports suffered a sharp drop, from a rate of 27.8% in 2008 (year on year) to only 2.8% during the first six months of 2009. While there were reductions in exports across a broad range of sectors, including cotton, chemical products, metals, and machinery and equipment, these declines were offset, to some degree, by Uzbekistan's exports of energy and oil products, which grew by a very high 240% rate. The drop in Uzbekistan's non-energy exports during early 2009 would have taken a noticeable toll on its economy had the government's new Anti-Crisis Program, equivalent to about 5% of GDP. Similar to China's stimulus, this program imparted a sizeable boost to investment in fixed capital. Both public and private investment grew by 32.7% in early 2009, and helped stimulate a 32.5% growth rate in the construction sector (T.McKenley, 2010).

Further analysis of foreign trade turnover evidences that the export and import structures also changed dramatically over the last 25 years as the economy diversified. The share of non-

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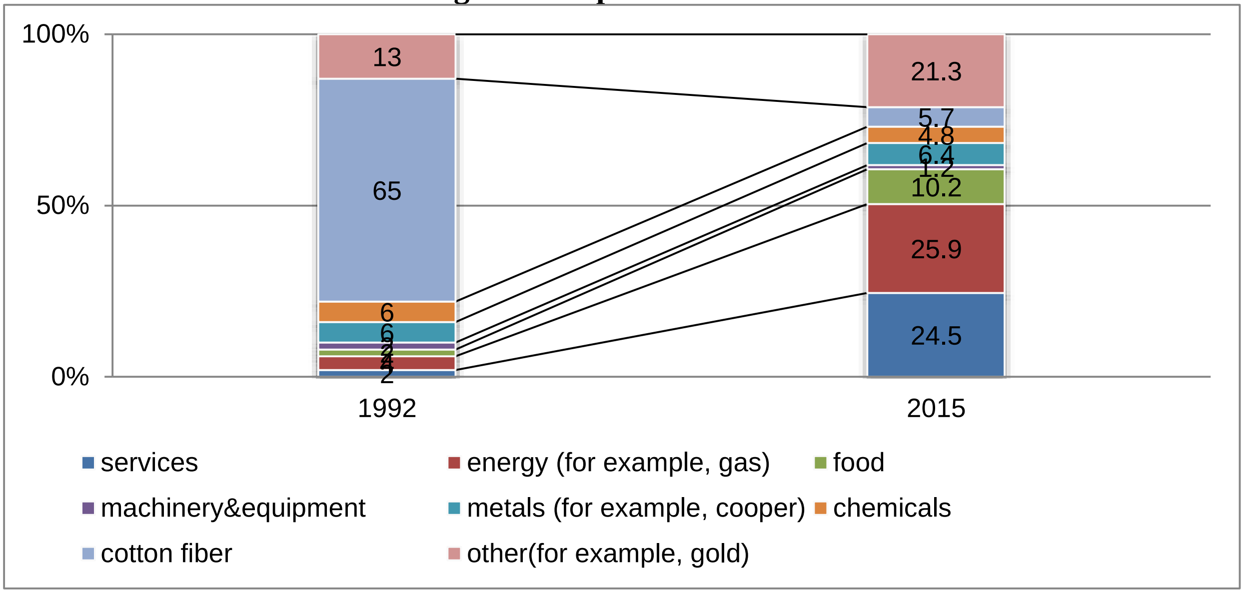
commodity exports such as services expanded from 2 percent in total exports in 1992 to 24.5 percent in 2015. Food export also increased from 2 percent in total exports in 1992 to 10.2 percent in 2015. The highest export item in foreign trade became energy with a total of 25.9 percent of all export. Meanwhile cotton fiber export declined from 65 percent in 1992 to 5.7 percent in 2015 (figure-8).

Figure-8. Export structure



The import structure has also diversified, with a shift away from food and energy in 1992 to mainly capital goods and raw materials (machinery, equipment, and chemicals) related to public investment projects (figure-9).

In addition, trading partners have also been diversified geographically, that is, away from the Russia—from 55 percent of trade in 1992 to 29 percent in 2012—to other CIS countries, which was 18 percent in 2012, of which Kazakhstan's share was 11 percent, China's was 12 percent, the Republic of Korea's was 8 percent, the European Union's was 7 percent, Turkey's was 5 percent, and Afghanistan's was 4 percent, among other destinations.

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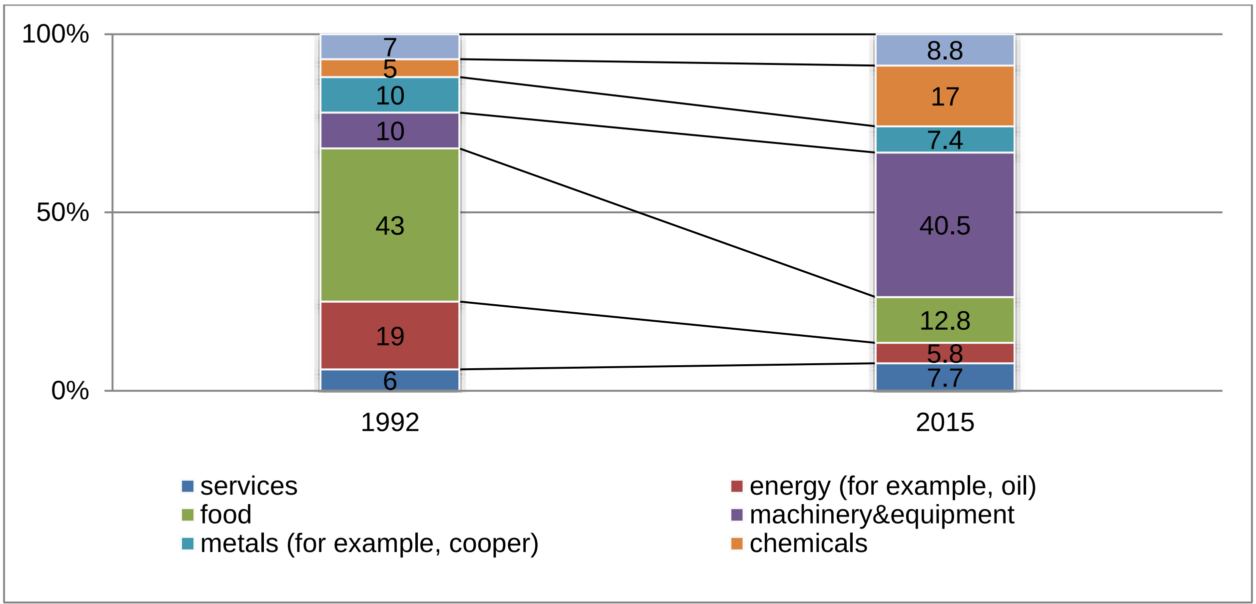
Figure-9. Import structure.



According to the study in the medium term, Uzbekistan's traditional sources of economic growth—exports and investments—need to be diversified. The government aiming to decrease the country's dependence on commodity exports and related vulnerability to external shocks, through industrial diversification, with higher-value adding processing industries receiving priority public and private financing (I.Karimov, 2016). To this end, the destination of investments needs to be diversified, as the bulk of existing foreign investments are directed at the natural resource sectors. To mobilize additional diversified investments, greater private sector participation is essential. This requires the creation of more enabling conditions for private sector growth, including further reduction of tax and administrative burdens, improvement of business and investment climates, as well as expanding access of businesses to credit. Trade liberalization would support the private sector significantly, while assisting the country's cooperation with countries in the region and beyond (ADB, 2012).

Expansion of middle class

The main aim of conducted reforms is creation of middle class in the country and enhance of welfare of population (I.Karimov, 2005). The government of Uzbekistan started to articulate a long-term vision with the main objective to become an industrialized upper-middle-income country by 2030 which requires the economy will have to grow on average at 6 percent per year for the next 17 years to achieve a GDP per capita of $4,900 by 2030 (E.Trushin & F.Carneiro, 2013).

The middle class in Uzbekistan forms about 28–30% of the population. For the social and economic development of the country, by 2030 this proportion needs to double. Currently about 45–48% of the population can be considered a "middle-class reserve" – people who under certain conditions could become part of the middle class (figure-10), (CER, 2015).

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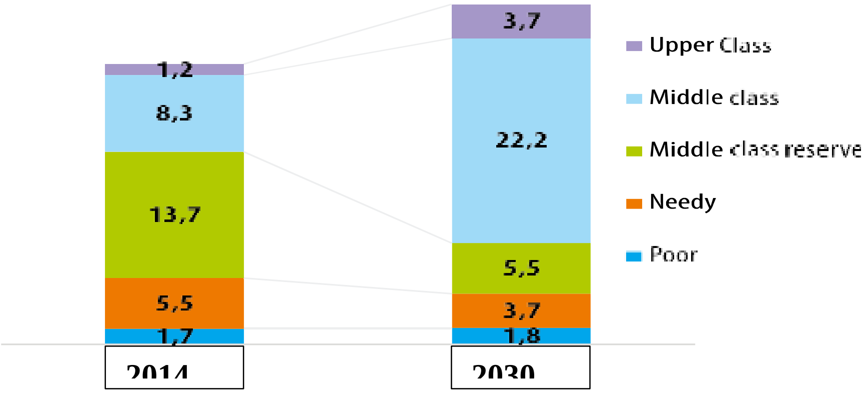
Figure-10. Change in the society's social structure, in millions of people



Source: CER, 2015.

Uzbekistan's Human development index is 0.661 where Gini index – 36.7. Poverty rate almost halved and it's rate – 0.008, country's female labor force is 47.6%.

It was officially announced that in 2015 60% of the state budget will be directed to the development of the social sphere, and that since 1 January 2015 individual incomes in the amount of one minimal monthly salary will not be taxed. Increasing salaries, pensions, stipends and social allowances by 22% and real incomes of the population by 10% in 2015 is envisaged (BTI, 2016).

Today's Uzbekistan enjoys high literacy rate with 99.4% and ratio of female to male enrollment is 0.945 of HDI. The U.N. Education Index ranks Uzbekistan 78th-80th out of 188 countries with an index score of 0.71.

However, the structural constraints on governance remain still significant. A doubly landlocked geographical location and high agricultural dependence on water resources which up to 90% coming from neighboring countries, and the desiccation of the Aral Sea in combination with an environmental disaster in Karakalpakstan are the key structural problems face Uzbekistan (BTI, 2016).

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