Sustainable socio-economic development in Uzbekistan: recent trends

Chepel S.V., D.Sc. in Economics,
chief scientist of the Project
swchep@mail.ru

Sadriddinov N.S., Acting Head of the Project
Nodir.Sadriddinov.70@mail.ru

Document prepared for the EMERiCs Project Introduction

Introduction

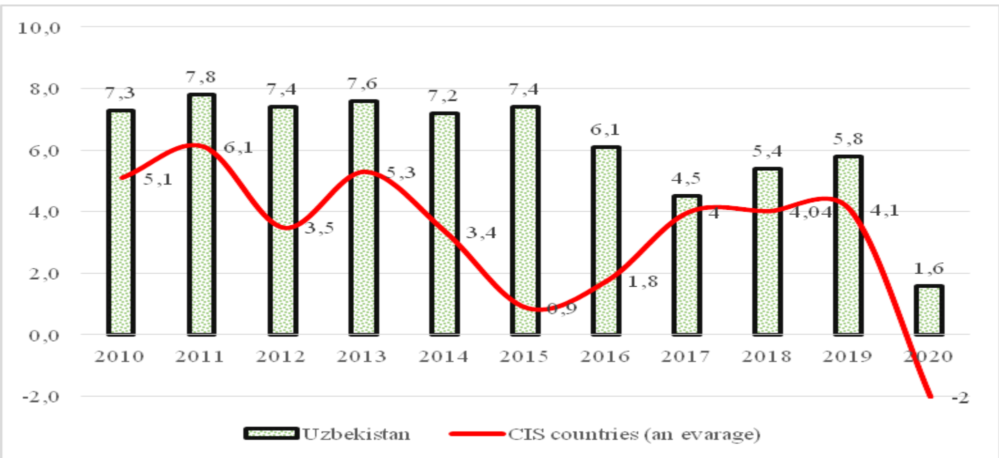
The high economic growth rates achieved by the republic in the pre-crisis period (from 4.5% to 8.5%, 2010-2019) were not accompanied by the expected qualitative changes in all areas of economic transformation. For different stages of development, the factors that determine the potential for sustainable development are analyzed: structural shifts, macroeconomic balance, resource efficiency, changes in the institutional environment as a consequence of the acceleration of the reform process launched in 2017.

The article shows the unused growth reserves, suggests measures and mechanisms for their involvement in economic turnover and increasing the potential for long-term growth sustainability.

Features in the latest dynamics of economic growth

Uzbekistan is one of the few countries in the world with a *fast-growing economy*. Over the last decade, the Republic's GDP growth rate has been steadily exceeding the average rate for the group of leading CIS countries (Russia, Kazakhstan, Belarus) and several countries of the Central Asian region (Kyrgyzstan, Tajikistan). Even during the pandemic crisis of 2020, when these countries recorded a decline in the economy (with the exception of Tajikistan), Uzbekistan managed to maintain positive economic growth (Fig. 1).

Fig.1. Dynamics of economic growth of Uzbekistan in comparison with other CIS countries in 2010-2020.



Source: Uzbekistan - data from national statistics, CIS countries - World Bank and operational estimates of national statistical agencies for 2020.

From the perspective of qualitative changes and conditions of development three sub-periods should be distinguished: preservation of the growth model that existed until 2010 (2010-2016); acceleration of the economic reforms process (2017-2019); development in a pandemic crisis (2020). For the first sub-period, the average annual GDP growth rate was 7.2%, the second 5.2%, and the third 1.6%.

A new stage in the reform of the national economy

The reform process, which began in 2017, was aimed at *activating new factors of economic growth* - improving the investment climate, expanding export potential, intensifying foreign trade, strengthening macroeconomic stability.

1) Regulatory and Legal Framework

Over the past four years, a large number of regulatory documents have been adopted, including the Concept of administrative reform, decisions to strengthen personnel policy, executive discipline, to improve the accessibility of public services, introduce digital economy, develop public-private partnerships.[1]

In 2017, the *anti-Corruption law* was adopted, and the functions of the Parliament and the public to monitor the corruption were strengthened. As a result of all these efforts, over the past two years, officials who illegally caused 2 trillion sums[2] (189million USD) of damage to the state back in 1986 have been prosecuted for corruption-related crimes.[3] During this period, 371 billion sums (30billion USD) of budget funds were embezzled throughout the republic and 2,477 persons were held criminally liable for these crimes.

2) Economic Liberalization

Liberalization of the economy, proclaimed as the most important priority of the new leadership of the country, is impossible without a profound modernization of the system of economic management. Its main priorities - reducing the scale of direct government regulation through the transition to the principles of indicative planning, forecasting and economic programming, reducing spending on the state apparatus, optimizing the structure of public administration, improving the efficiency of functioning.

3) Improvement of the management system

Significant milestones in this path were the liberalization of the foreign exchange market, visa simplification, the transition to a flat income tax scale of 12%[4], reduction in a number of administrative costs of doing business, and opening branches of some famous foreign universities of Korea, Russia and the United States. With the participation of foreign experts in 2017 alone, 18 free economic zones and 77 small industrial zones, as well as 10 techno-parks were established in the country, which contributed to the accelerated development of certain regions in

[1] Decree of the President of the Republic of Uzbekistan "On Approval of the Concept of Administrative Reform in the Republic of Uzbekistan" №UP-5185 on 08.09.2017 and so on

[2] National Currency of of Uzbekistan

[3] https://anticorruption.uz/ru/item/2020/12/23/korruptsiyaga-qarshi-kurash-strategik-yondashuvni-talab-etadi

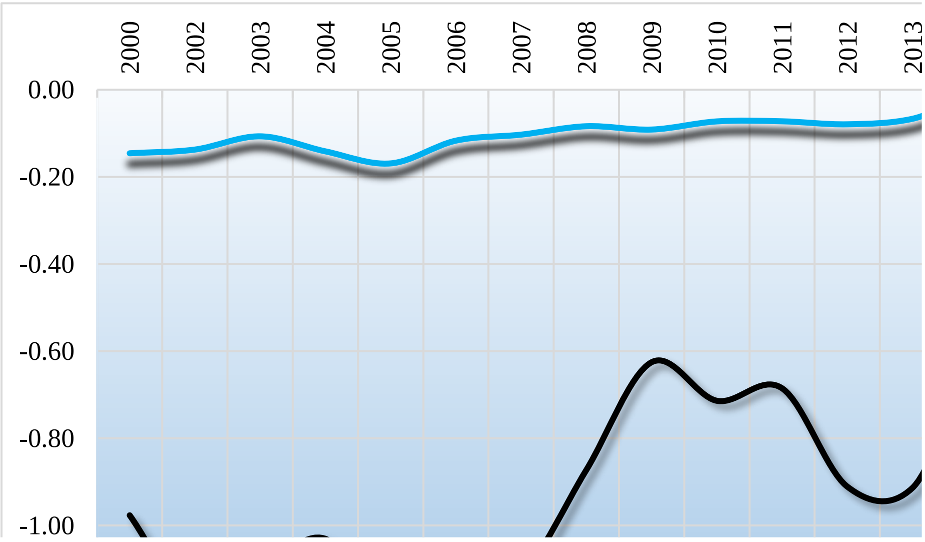
[4] Other changes in the tax system - a radical reduction of taxes on labor (1.5-2 times), a significant reduction of the tax burden on large enterprises, including the reduction of the VAT rate from 20 to 15%, the elimination of deductions to the State trust funds from revenues, a significant reduction of the sphere of influence of taxes on turnover.

Uzbekistan[5]. In the sphere of foreign economic policy, a number of restrictions were lifted, and additional conditions were created for the export of fresh fruit and vegetable products.

To improve the level of coordination of projects and programs, and to comply with the national interests, the state authorities have adopted the "Strategy of actions in the five priority areas of development of the Republic of Uzbekistan in 2017-2021", and it was approved by the Decree of the President of the Republic of Uzbekistan of February 7, 2017[6].

These and other changes in the legislative environment and administrative system have also affected a number of *qualitative development indicators* including Government Effectiveness Index, compiled by World Bank analysts [7]. An analysis of the dynamics of this index over the past 20 years (see Fig. 2) compared to the average estimates for the developing world shows that since 2012 there has been some progress in the dynamics of this indicator. However, the gap with the developing countries of the world is still significant, hence it is clear that the country is only at the beginning of the process to modernize the economic management system.

Figure 2. Dynamics of the Government Effectiveness Index for the period 2000-2019 in comparison with the average estimates for the totality of the developing countries of the world



Source: Authors' calculations based on World Bank estimates.

Due to the coronavirus epidemic, some businesses have been given tax vacations and a number of inefficient budgetary and quasi-budgetary expenditures have been reduced. There is hope that after the epidemic it will be possible to consolidate some positive steps towards reducing government involvement in the economy.

At the same time, in recent years, the question of the effectiveness and consistency of measures to deepen the processes of liberalization of the national economy has become increasingly relevant.

Structural shifts and remaining challenges

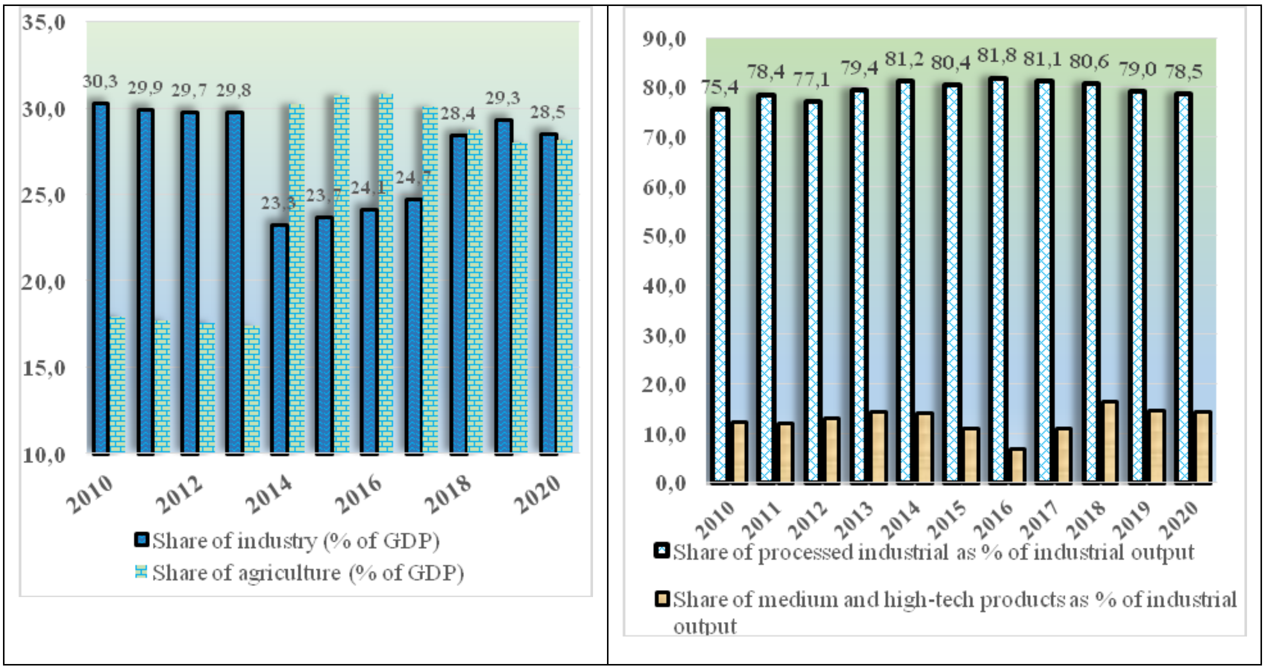
[5] https://stat.uz/images/uploads/docs/eiz_dek_2020_ru.pdf
[6] Electronic source http://www.lex.uz/docs/3107042
[7] : http://info.worldbank.org/governance/wgi/

Above mentioned changes in the regulatory and legal framework, economic reforms, and improvement of the management system in recent years have been reflected in *structural and qualitative shifts***.** First of all, there has been an upward trend in the economic structure since 2017, with the share of industrial sector rising to nearly 30% of GDP in 2019 (see Figure 3 left-hand side), up from 23.3% in 2014. This reflects the implementation of targeted development programs for various industries adopted since 2014 (see below).

At the same time, there was a moderate decline in the share of agricultural sector, from 33.3% in 2014.[8], to 28.2% in 2020, which reflects the process of optimization of cultivated areas, the flow of population to urban agglomerations, the creation of new forms of agriculture (clusters, multipurpose farms,).

As a whole, these two industries have accounted for 54~ 57% of total GDP in recent years, which indicates the preservation of the industrial-agrarian orientation of the national economy, established since the early 1990s.

Fig.3. Structural shifts in the real sector of the economy over the period 2010-2020.



Source: State Statistics Committee, Central Bank, World Bank estimates

The level of diversification of the economy, the ability to provide the population with new sustainable jobs largely depends on the scale of development of the *manufacturing sector* of industry. The sector's share in the volume of industrial production has not changed in the last 10 years (see Fig. 3, right-hand side). Its slight growth from 75.4% in 2010 to 81.8% in 2016 was replaced by some decrease to 78.5% in 2020. This demonstrates the remaining reserves for deepening the processing of the rich natural and mineral resources that the republic possesses, and the need to use them as soon as possible through the introduction of new innovative and digital technologies.

[8] The low estimates of the share of agriculture before 2014 (2010-2013, 17-17. 5%) are explained by the recalculation and refinement of GDP indicators according to the new methodology performed by the Statistical Committee in 2018 for all its accounts for the period from 2014 to 2017.

In recent years, there has been *no noticeable progress in expanding the medium- and high-tech sector* (production of computers, optical equipment, electrical engineering, other machines and mechanisms). The share of this sector in the volume of industrial production had an unstable dynamics, varying from 12% to 16.4%. This indicates that the investment by itself, does not guarantee the sustainable development. Hence, it is necessary to create macroeconomic and institutional prerequisites for development of this most promising sector for the republic. These prerequisites include:

- Provision of property guarantees to investors and businessmen
- Elimination of corruption and shadow economy
- Necessary level of macroeconomic stability
- Modern infrastructure
- Mechanisms for accumulation of national professional competences
- Creation of modern scientific, technological and design base for development of new economic sectors
- Sharp increase in the quality of technical education
- Creation of modern logistical and marketing systems for promotion of these products in foreign markets

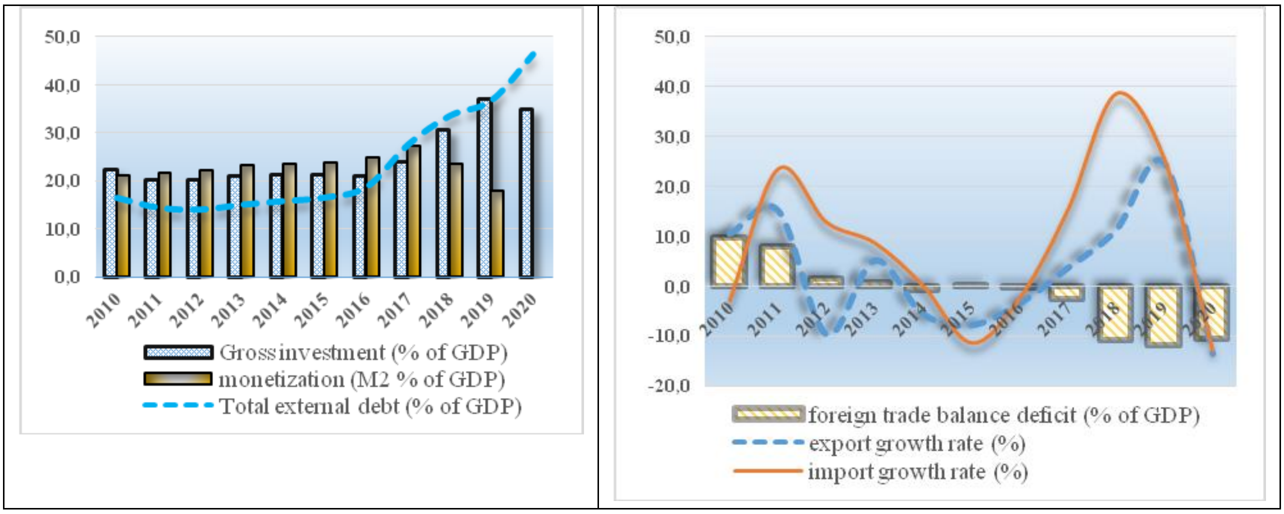
Changes in level of macroeconomic stability and risks to sustainability

The acceleration of economic liberalization, which began in 2017, was reflected in the growth of investment and foreign economic activity. However, the liberalization of the foreign exchange market and the subsequent devaluation of the national currency became one of the main factors of increasing risks to *macroeconomic stability*. While in 2010 the GDP deflator did not exceed 10%, in 2017 its value rose to almost 20%, and in 2018 the increase in prices for the economy as a whole was 27%, with its subsequent reduction to 19% in 2019 and 11% in 2020.

Inflation occurred against the backdrop of almost two-fold devaluation of the national currency in 2017 (from almost 4,000 soums per dollar to 8,000 soums) with high devaluation rates continuing in subsequent years - 28% in 2018, 9.5% in 2019 and 13.4% in 2020 (year-on-year using average monthly exchange rate estimates for the year). Given the large share of imported products in the consumption of households and intermediate consumption of the real sector, this devaluation could not but lead to an acceleration of inflation.

The growth of investment activity manifested itself starting from 2018, when the value of gross investment rose to 30.6% of GDP (against an average of 21.4% in 2010-2017), with a subsequent increase to 37.1% in 2019 and 34.8% in 2020 (see Fig. 4, left part).

Fig. 4. Dynamics of indicators of investment and foreign economic activity in 2010-2020.



Source: Data of the State Statistics Committee of the Republic of Uzbekistan

At the same time, the level of monetization (the ratio of broad money M2 to GDP) of the economy remained at a low level, significantly below the world average estimates for the developing world (from 50% to 100%), which made it difficult for the national banking sector to credit investment projects. As a result, foreign lending became the main source of financing, which led to a rapid growth of external debt (left side of Fig. 4).

Analysis of key macroeconomic indicators over the past 10-15 years shows that there is a limit to investment growth, determined by the assets and other capabilities of the financial sector, large enterprises, and household incomes, exceeding which can destabilize the economic situation. In 2011-2016, investments were at the level of long-term values (21-23% to GDP), and external debt grew slightly (7.5%-14.6% to GDP). The investment boom of 2017-2020 led to a rapid growth of total external debt up to 46% of GDP, due to increased external borrowing for construction and other capital-intensive industries, weakly related to both resource saving and green development.

The same situation is also inherent in foreign trade. Exceeding the investment threshold, as well as the large-scale illprepared liberalization of foreign trade changed the ratio between exports and imports. While in 2011-2016 the foreign trade balance was positive (average estimate +1.6% of GDP), in the last 4 years it has become deficit and decreased to minus 10-12% of GDP in 2018-2020. (Fig.3 right-hand side).

High risks for macroeconomic stability are also carries *a significant level of capital intensity of economic growth***.** While in 2000-2005 each sum of investment (in the current year and in two preceding years with weights of 0.7, 0.2 and 0.1, respectively) exceeded 7 sum of GDP (in 2010 prices), by 2010 this indicator went down to 4 sum. The rapid growth of investments in 2018-2020 has further reduced the return on capital (to 3.4 soums in 2018 and 2.5 soums in 2020, a preliminary estimate). Thus, the return on investment has fallen almost three (3) times since the early 2000s.

As calculations show, maintaining capital productivity at the level of 2.5 soums of GDP/1 soums of investment will aggravate the macroeconomic situation. Maintaining economic growth even at the level of 3-4% per year in 2021-2025 in conditions of low capital productivity will require the volume of investment (40-41% of GDP), significantly higher than the threshold value (21-23% of GDP). In this case the dynamics of external debt will intensify and may reach 45-

50% of GDP in the coming years with a growing impact on the growth of the state budget deficit due to increasing interest payments on debt. It may also accelerate the depreciation of the national currency and limit the possibility of taking large-scale measures to combat poverty.

The high rates of depreciation of the national currency in relation to the growth of the economy and the population had a negative impact on the position of the republic in the international ratings on the criterion of the level of development. While back in 2015-2016 the GDP per capita exceeded $2,000, in 2018 it fell to $1,532, and has remained at a low level for the last two years ($1,725 and $1,763 in 2020, preliminary estimate). This situation jeopardizes the goal of taking the country out of the 40 poorest countries of the world and into the group of countries with an above-average level of development (with GDP per capita above $5,000) in the context of high population growth rates and increasing risks and barriers to development (climatic, pandemic, conjunctural, etc.).

Conclusion

There is a need for *a critical review of established principles and approaches to economic reform* - the dominance in economic policy of standard recommendations of international organizations on mass privatization and accelerated liberalization of the economy as the main factors to improve its competitiveness and solve social problems, the use of the GDP indicator as the main criterion of success, etc. There is a need for a transition to a new economic model, focused primarily on domestic sources of development, resource saving, increasing the contribution of economic growth in solving social problems, including the fight against poverty and the shadow economy, reducing the burden on natural capital, the revision of criteria for the success of economic reform.

The main mechanisms for the transition to the new model are the new industrial policy, which creates conditions for the expansion of sustainable employment and the development of new medium-and high-tech sectors of the economy. As part of the formation of a new labor market and the restriction of shadow employment – expanding access to professional vocational education and strengthening the guarantees of entrepreneurs ' property, regulating labor migration – are needed in agricultural industry- measures to support multi-profile agricultural producers, improving their availability of water resources – are required.