

COMPASS Policy Brief

TOWARDS SUSTAINABLE ECONOMIC GROWTH: EVIDENCE FROM UZBEKISTAN

Saidkhonov Saidislombek

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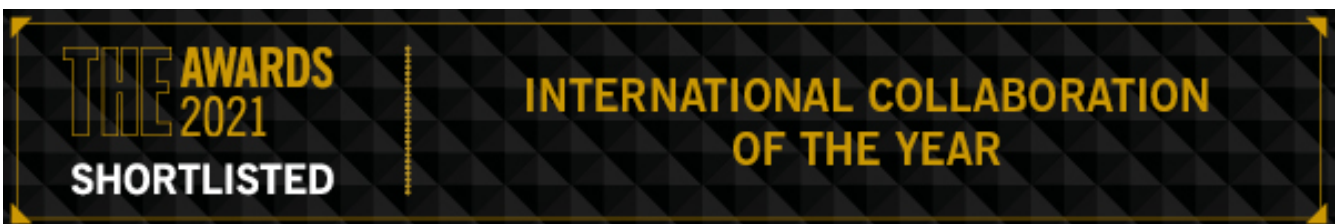
Saidkhonov Saidislombek

Authors' Information

Saidislombek Saidkhonov received his BS degree in economics and finance from the University of Westminster, UK, in 2014 and Masters' degree in Public Policy from KDI School of Public Policy and Management, Republic of Korea. Currently, Mr Saidkhonov works in the Ministry of Finance as Head of division of the Macro-fiscal Department in the Republic of Uzbekistan. He is also a senior lecturer at Management Development Institute of Singapore in Tashkent and teaches Microeconomics, Macroeconomics, and Statistics. Mr Saidkhonov has been granted a full scholarship with stipend to pursue his PhD in Development Policy by KDI School of Public Policy and Management.

GCRF COMPASS project (ES/P010849/1, 2017-21) is an ambitious UK government capacity-building funding initiative, aiming to extend UK research globally and to address the challenges of growth and sustainability in developing countries. Notably, the COMPASS project led by the University of Kent, in partnership with the University of Cambridge, seeks to establish the '**hubs of excellence**' at the top-level Higher Education Institutions in Azerbaijan, Belarus, Tajikistan and Uzbekistan, to enable them to become the centres for knowledge-sharing and transfer for *research integration, impact governance, and sustainable communities*.

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TOWARDS SUSTAINABLE ECONOMIC GROWTH: EVIDENCE FROM UZBEKISTAN

EXECUTIVE SUMMARY

This policy brief provides a snapshot of Uzbekistan's key development challenges and highlights a path towards sustainable economic growth to inform the country's development decisions. The current reform process has been described with a view to understand the development path for Uzbekistan. In addition, the COVID-19 pandemic has introduced new challenges to the economies all over the world. Reduction in forecast indicators of the economy, slowdown in production, decrease in the service sector, oil price reduction, decrease in tourism revenues, higher unemployment, decrease in international trade turnover to name but a few. These challenges must be taken into account when thinking of the future of Uzbekistan's economic development. To overcome negative consequences of pandemic it is not only crucial to have timely and balanced fiscal and monetary policy but it is also essential to emphasize on social policy.

Keywords:

Sustainability, reforms, debt, dollarization, COVID-19, inclusive growth, liberalisation, export, import, international ratings.

Abbreviations: IMF, International Monetary Fund; CIS, Commonwealth of Independent States

BACKGROUND

The Action Strategy for the Republic of Uzbekistan for 2017-2021 identifies **five priority areas** for the development of Uzbekistan, each of which reflects specific measures to further deepen and ensure the effectiveness of democratic reforms at a new stage in the country:

- **Improvement of state and social construction**, aimed at strengthening the role of parliament and political parties in deepening democratic reforms and modernizing the country, reforming the public administration system, developing the organizational and legal foundations of public service, improving the "electronic government" system, improving the quality and efficiency of public services, practical implementation of public control mechanisms, strengthening the role of civil society institutions and the media;
- **ensuring the rule of law and reforming the judicial system** aimed at strengthening the true independence of the judiciary and guarantees of reliable protection of the rights and freedoms of

citizens, improving administrative, criminal, civil and economic legislation, increasing the efficiency of the system of combating crime and preventing offenses, full implementation of the principle of adversarial litigation, improvement of the system of rendering legal aid and legal services;

- **development and liberalization of the economy** aimed at strengthening macroeconomic stability and maintaining high rates of economic growth, increasing its competitiveness, modernizing and intensive development of agriculture, continuing institutional and structural reforms to reduce the presence of the state in the economy, strengthening the protection of rights and priority development of private property, stimulating development of small business and private entrepreneurship, comprehensive and balanced socio-economic development of regions, districts and cities, active attraction of foreign investment in the economy and regions of the country by improving the investment climate;
- **development of the social sphere**, aimed at consistently increasing employment and real incomes of the population, improving the system of social protection and health protection of citizens, increasing the socio-political activity of women, implementing targeted programs for the construction of affordable housing, developing and modernizing the road transport and engineering and communication infrastructure, development of education, culture, science, literature, art and sports, improvement of state youth policy;
- **ensuring security, interethnic harmony and religious tolerance**, implementing a balanced, mutually beneficial and constructive foreign policy aimed at strengthening the independence and sovereignty of the state, creating a belt of security, stability and good-neighborliness around Uzbekistan, strengthening the country's international image.

As the year draws to a close, the question naturally arises: "Are the reforms carried out over the past 5 years producing the expected results?"

Certain shifts have become noticeable in different fields. Steps aimed at optimizing processes in the field of price and macroeconomic stability, inflation, tax reforms, efficient use of budget funds, attracting investment, creating a favorable environment for entrepreneurship, banking reforms, and developing transport infrastructure have also become indicators of ongoing transformations. This paper serves as a barometer of reforms in aforementioned fields as well as captures ex-ante and ex-post condition in Uzbekistan.

ANALYSIS OF THE ISSUE

Sustainable macroeconomic development can be defined as development which “meets the needs and wants of the present without sacrificing the capability of future generations to meet their own needs”.¹ It is also a common stereotype that macroeconomic sustainability refers to real output increasing over time. Sometimes, such economic growth may create a number of significant environmental problems such as depletion of natural resources like oil which in turn lead to global warming or in financial and economic terms excessive level of public debt, and the like. In other words, sustainable economic growth means a rate of growth which can be maintained without creating other significant economic problems, especially for future generations and having inclusive growth. It is important to note that the state budget sustainability plays an important role in ensuring macroeconomic sustainability, which is why starting from 2019, Uzbekistan has been establishing limits on budget deficit and public debt in its legal framework for the 2021 budget.

Over the last few years, the Republic of Uzbekistan has undergone a number of ambitious market-oriented economic reforms to achieve macroeconomic stability with sustainable growth. The main target of these reforms is curbing the inflation level to a one-digit number, achieving economic growth this year at the level of not less than 5%, keeping the budget deficit no more than 5,4% of GDP in 2021 with its subsequent reduction in the medium term. Currently, the inflation level relative to December of the last year accounted for 4.8%. According to the forecast of the main macroeconomic development indicators in the law on the state budget, in 2021 the inflation rate is expected at the level of 9-10%, in 2022, 10-11%, in 2023, 7-8%. This contrasts with forecasts by the Central Bank, which plans to bring inflation down to 8% in 2022 and 5% in 2023. The budget deficit in 2021 is planned at 17.3 trillion soums (2.5% of the forecasted GDP for 2021 - IF), in 2022 - 8.7 trillion soums, in 2023 - 4.1 trillion soums. Regarding the foreign exchange market, the main objective is de-dollarization of the economy, particularly, decreasing the proportion of the foreign currency loans while raising the share of international bonds issued in national currency. Additionally, these reforms include diversification of the economy, reorganization and privatization of state-owned companies, improvement of the business climate, the promotion of the export of Uzbek enterprises, currency liberalisation, trade and prices liberalisation, reduction in the tax burden and a simplification of the tax system and integration of Uzbekistan's economy into the global trading market. It would be accurate to say that macroeconomic stability is an essential factor of a country's successful sustainable economic growth. Reaching aforementioned objectives such as curbing excessive inflation, safe public debt level and controlling excessive

¹ The concept of sustainable development was described by the 1987 Brundtland Commission Report: <https://en.unesco.org/themes/education-sustainable-development/what-is-esd/sd>

dollarization of the economy tend to stimulate economic entities to grow and create stable expectations for business entities and investors, which is truly crucial for doing business.

Last but not the least financial conditions for food security are important to discuss here. Food security includes ensuring the supply for the domestic market with all the necessary food products, mitigating sharp fluctuations in food prices and preventing food products shortages. In 2020, as a measure to address the challenges of the COVID-19 pandemic, some economies imposed restrictions on food exports. Uzbekistan imports important food products for the population, such as wheat, flour, vegetable oil and raw materials for its production, raw materials for the production of sugar. Consequently, trade barriers imposed by other countries such as Kazakhstan and Ukraine have created additional pressures in providing the nation with food. As a result of measures taken on time, the government managed to minimize the shortages of necessary food products in the domestic market. In 2021, the measures aimed at achieving food security will be broadened. For instance, an extension of the whole year's exemptions for customs duties on some imported foods will help prevent food shortages and sharp market fluctuations which will also stabilize inflation.

1. Domestic sector

Up until 2020, Uzbekistan had a stable economic growth of above 5% (excluding 2017, when the cost of imports increased and final consumption expenditures declined due to the currency liberalization) with services making up the largest share of GDP (36.1% in 2019).² However, due to the impact of the COVID-19 pandemic, namely, the economic crisis due to disruption of the supply chain, manufacturing activities, and suppressed demand, as well as the quarantine measures and a decline in tourism, Uzbekistan's GDP growth slowed down but remained positive at 1.6 % and is expected to accelerate in 2021 up to 5 % along with the global economic recovery.³

During 1991-2020, the structure of the economy has changed dramatically with the size of the agriculture in the gross value added reducing from 37% to 28.2 %. In 2020, the gross value-added of services amounted to 36,3 percent, industry – 28,5 percent and construction – 7 percent. As of 2020, Uzbekistan has a workforce of 14.8 million people, 13.2 million of which are employed (81% in the private sector, 19% in the public sector).⁴

² The State Committee of the Republic of Uzbekistan on Statistics.

³ The Ministry of Economic Development and Poverty Reduction of the Republic of Uzbekistan.

⁴ The State Committee of the Republic of Uzbekistan on Statistics.

Agriculture

Agriculture plays a major role in the economy by employing 26.9 % of the total employed population. The most important agricultural products of Uzbekistan, apart from cotton are fruits, vegetables and grains (wheat, rice and corn). Poland, Russia, and the Netherlands have strengthened agricultural relations with Uzbekistan. According to data provided by the State Statistics Committee of the Republic of Uzbekistan⁵, the country's agriculture sector was the least affected by the COVID-19 pandemic, along with both the forestry and the fishing industries with a growth rate 3 % (in 2019, the agriculture sector grew by 3,1%) and its value added amounted to 15.3 trillion soums.

Industry

Industry accounts for 28.5% of the value-added and employs 13.5% of the total employed population. The main manufacturing products include metallurgy, mining, textiles, food processing, machine building, chemicals and etc. The country is also rich in gold, coal, zinc, copper, tungsten, uranium, and silver. As part of the implementation of the Development Strategy for 2017-2021, the process of reducing the level of state participation in the industry is being carried out, new production facilities are being put into operation, and the process of updating and technological re-equipment of industrial enterprises is underway. There are qualitative changes in the main indicators of industrial development. The share of industry in GDP from 2016 to 2019 increased from 20.6% to 29.3%. The industry sector, second only to services, has been affected the most by the COVID-19 pandemic and the quarantine measures with the real declined down to 0.7%.

Services

The services sector accounted for 36.3% of the value added and employs 50% of the total employed population. Key services include transportation and tourism. According to the United Nations World Tourism Organization, Uzbekistan was the fourth fastest growing country for tourism in 2019, receiving 6.7 million tourists. However, in 2020, the tourism industry was strongly affected by the COVID-19 pandemic and the closure of the borders with the real growth declining down to 0.1%, particularly the hospitality and the food services sectors were negatively impacted. Nevertheless, tourism is expected to resume growth in 2021 and 2022 along with the vaccine dissemination.

⁵ The State Committee of the Republic of Uzbekistan on Statistics.

Construction

The construction sector is relatively small, in comparison to the other three sectors and accounts for 7% of the value-added by employing 9.6% of the total employed population but it has been among the major drivers of Uzbekistan's economic growth over the past ten years. In 2020, the total value of construction-assembly works fulfilled was 87 trillion soums, representing a 9.1% increase as compared to 2019. Over the last decade, the country's construction output surged in real terms. Strong growth in the construction industry in Uzbekistan has provided decisive support for domestic production of building materials, particularly in terms of cement.

Aforementioned changes in the sectors of the economy undoubtedly affects not only economic growth but also have impact on the price level and international trade turnover.

Inflation

Low and stable inflation supports a healthy demand in the marketplace, while a high inflation creates uncertainty and increases the risk premiums. That's why Uzbekistan has started the gradual transition of monetary credit policy to an inflation-targeting regime starting from January 1 2020, to decrease the inflation level to 10% in 2021 and with the long-term goal of maintaining the inflation level at 5% in 2023. The inflation rate in 2020 was formed within the approved forecast parameters and amounted to 11.1% (forecast 12.5-13%).⁶ At the same time, food prices rose by 15.3%, by 8.8% in non-food products and by 7.1% in services.. The food that contributed the most to overall inflation were meat products (1.8%), bakery products (1%), fruits and vegetables (.9%), milk (.4%) and eggs (.3%).⁷

2. External sector

As a result of measures aimed at the development of international trade and export potential of domestic companies, abolishing of trade barriers and price liberalization, by 2019 the foreign trade turnover reached 41.7 bln USD, while exports of goods and services amounted to 17,5 bln.USD, imports of goods and services amounted to 24.3 bln USD. As a result, the trade balance amounted to 6.8 bln USD. In 2020, foreign trade turnover amounted to 36.3 billion USD, a decrease of 13.1% compared to 2019. At the same time, export decreased by 13.4% and import by 12.8%. The decline in export was mainly due to a sharp decline in export of energy resources and petroleum products by 73.9%.

In the medium term, Uzbekistan intends to reduce the trade deficit by improving customs policy aimed at stimulating the growth of domestic exports, expanding the export potential of the economy through

⁶ The Central Bank of the Republic of Uzbekistan.

⁷ The State Committee of the Republic of Uzbekistan on Statistics.

the privatization of export-oriented state-owned enterprises, development of production based on high-tech processes, increasing the attractiveness of the economy for foreign direct investment with the creation of a favourable business environment for investors in order to ensure the growth of exports and the entry of the country's economy into global and regional value chains. The low level of public debt relative to GDP indicates that the government will be able to flexibly use its tax revenues to meet domestic needs instead of paying foreign creditors. In addition, low public debt allows for a soft fiscal policy during a crisis. However, due to the COVID-19 pandemic, in 2020, the total external debt of the Republic of Uzbekistan amounted to 33.8 bln USD (an increase of 37.4% or 9.2 bln USD in comparison with 2019), of which 21.3 bln USD was in the public sector, and 12.5 bln USD in the private sector.⁸

There are a number of ratings and indices which capture the broader array of factors that influence on the social, economic, legal and financial sustainability of economies. For example, the World Bank's Human Development Index, World Government Indicators, Ease of Doing Business Index and others. Improving the position of the Republic of Uzbekistan in international economic and political-legal rankings and indices, effective coordination of relevant ministries and agencies, further enhancing the position of Uzbekistan in the international arena, systematic cooperation with foreign rating agencies and achieving the effectiveness of comprehensive reforms is set as a goal. For example, Uzbekistan in Transparency International's Corruption Perception Index, Uzbekistan achieved 26 (out of a 100) according to the report for 2020. Uzbekistan has ranked 8th in CIS countries, and 146th worldwide, an improvement by 7 positions in world rankings since 2019 (153rd), and increased its score by 1. In the World Bank's Ease of Doing Business Index Uzbekistan scored 69.9 in the 2020 report (out of 100) and listed as a top 20 country-reformers. Uzbekistan made it easier to protect minority investors, pay taxes, enforce contracts and trade across borders.

The slowdown in the average annual dynamics of industrial development in the second half of 2020 is the result of difficult conditions caused by the coronavirus epidemic and, as a result, quarantine and border closures, and disruption of logistic ties. 2020 turned out to be extremely difficult for almost all CIS countries. Mutual trade between the countries decreased significantly, by 12.5% compared to 2019. Large-scale lockdowns introduced in most countries triggered a recession in the global economy. The slowdown and recession in economic growth, the suspension of production, the closure of borders in the largest foreign trade partners and the CIS countries themselves led to a decrease in industrial production of almost all states participating in this integration association.

⁸ Ministry of Finance of the Republic of Uzbekistan.

Over the last years, it has not been possible to ensure significant progress in expanding the sector of medium and high-tech products (production of computers, optical equipment, electrical engineering, other machines and mechanisms). The share of this sector in the volume of industrial production had unstable dynamics, varying in the range from 12% to 16.4%. This indicates that the investment factor in the development of this sector does not in itself provide the necessary guarantees for achieving sustainable results. It is necessary to create all the necessary macroeconomic and institutional prerequisites for the development of this most promising sector for the republic, including modern infrastructure and mechanisms for the accumulation of national professional competencies, the creation of a modern scientific, technological and design base for the development of new sectors of the economy, a sharp increase in the quality of technical education, the creation of modern logistics and marketing systems for promoting these products to foreign markets.

The acceleration of the process 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, the soum, became one of the main factors in increasing risks to macroeconomic stability. If in 2017 the devaluation accounted for 20%, and in 2018 the figure made up 27%, followed by its reduction to 19% in 2019 and 11% in 2020, which indicates a gradual decrease in the level of devaluation of the national currency and the positive effect of monetary policy measures.

Reducing the level of corruption, the shadow economy, ensuring property guarantees for investors and businessmen, and the required level of macroeconomic stability are also important prerequisites for sustainable economic growth.

POLICY RECOMMENDATIONS

The paper has analyzed sustainable growth conditions in Uzbekistan. It emphasizes that:

- 1) Sustainable growth is more complex than economic growth. Sustainable growth can have trade-offs. Quantitative economic growth is being considered in many economies as a major prerequisite for increasing standards of living, job-creation, stimulating trade and others.
- 2) Economic growth and production expansion can lead to a number of environmental burdens and can thus be harmful. Thus, Uzbekistan is focusing and should continue to focus on inclusive and sustainable growth.

This will ensure that Uzbekistan strives for not only quantitative economic growth but also a qualitative one.

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