Uzbekistan

Country Economic Update
Summer 2019

Toward a New Economy

WORLD BANK GROUP

Macroeconomics, Trade & Investment
Global Practice

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Toward A New Economy

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Government Fiscal Year:	January 1 – December 31
Currency Equivalents:	Exchange Rate Effective as of May 8, 2019
	Currency Unit = Uzbekistan Som (UZS)
	US$1 = 8,448.89 UZS
Weights and Measures:	Metric System

Abbreviations and Acronyms

CAR	Capital Adequacy Ratio
CBU	Central Bank of Uzbekistan
CPI	Consumer Price Index
FDI	Foreign Direct Investment
FRD	Fund for Reconstruction and Development
GDP	Gross Domestic Product
IMF	International Monetary Fund
M2	Broad Money
NPL	Nonperforming Loan
PEFA	Public Expenditure and Financial Accountability
PPPs	Public-Private Partnerships
PPP	Purchasing Power Parity
SOE	State-Owned Enterprise
TFP	Total Factor Productivity
WTO	World Trade Organization

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Foreword

This edition of the *Country Economic Update* is part of a semi-annual series designed to monitor recent economic developments in Uzbekistan. The report presents a broad overview of the country's macroeconomic, social, and structural developments in 2018. The Special Focus section discusses economic growth and job creation.

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Overview

Uzbekistan's economy is reaping the benefits of structural reforms

Uzbekistan is implementing ambitious market-oriented economic reforms. The authorities unified the exchange rate and liberalized the foreign exchange market starting in September 2017, began price and trade liberalization,[1] and made significant cuts to tax rates for both firms and individuals from January 2019. The country's opening to the world included elimination of entry visas to promote tourism and business and a renewed commitment to join the World Trade Organization (WTO). The government has expanded social safety net coverage and substantially improved the availability of economic statistics. Uzbekistan's progress has been impressive and as a late reformer it can also benefit from the lessons learned by other transition economies.

Growth has picked up and the medium-term outlook is favorable, albeit with elevated inflationary pressures

A surge in investment and a pickup in consumption boosted real GDP growth from 4.5 percent in 2017 to 5.1 percent in 2018 and further to 5.3 percent year-on-year in the first quarter of 2019. Growth is projected to rise to 6 percent in 2021, supported by market reforms to address production bottlenecks and liberalize the economy. Twelve-month inflation peaked at 20 percent in early 2018 before declining to 14.3 percent by December, resulting in an annual average rate of 17.5 percent for 2018. The consumer price inflation eased further to 13.7 percent year on year by April 2019. Inflationary pressures are likely to persist in 2019–20 due to: (i) the continued liberalization of administrative prices, including of energy and water; (ii) increased policy lending via state-owned banks to support investment growth, and (iii) public wage increases. Tightening of monetary and credit policies will be required for inflation to moderate by 2021.

Fiscal and current account deficits are projected to decline, and external buffers remain comfortable

Imports of machinery and equipment to modernize production and imports of consumer goods to meet pent-up consumer demand widened the current account deficit in 2018. The deficit is likely to narrow over the medium term but will remain large. The external deficit is likely to be financed by increased donor support and a gradual increase in inflows of foreign direct investment (FDI). External buffers are likely to remain comfortable in the medium term, with foreign exchange reserves above 13 months of import cover. Gross external debt is projected to decline modestly to about 39 percent of GDP by 2020. The government budget excluding policy-based lending is forecast to shift from a surplus to a small deficit of about 1 percent of GDP over the medium term following a significant reduction in excise, income, and payroll tax rates, and increased public spending on investment, pensions, and low-income allowances. Public debt is likely to increase to about 25 percent of GDP in 2020. Steady growth of remittance inflows and the robust economic growth are expected to contribute to a modest reduction in the poverty rate.

Reforms are critical for growth and job creation

The economic liberalization measures introduced by the authorities since 2017 are helping address important binding constraints to business, such as the lack of foreign exchange, high import duties, and elevated tax rates. The government is advised to continue realigning the state's role in the economy, while addressing the remaining constraints to private sector development. Measures to address these constraints include: (i) increasing access to credit and improving the investment cli-

[1] Uzbekistan's average import tariff was reduced from 15 percent in August 2017 to below 3 percent in June 2018. However, it was raised modestly in December 2018.

mate; (ii) fully implementing the tax administration reform; (iii) ensuring the transparency of state budget operations—particularly regarding inefficient implicit subsidies to state-owned enterprises (SOEs); (iv) reforming land user and ownership rights in the industry, services, and agriculture sectors; (v) restructuring monopoly SOEs and strengthening their corporate governance and financial reporting requirements; and (vi) providing state support to export-orientation (including ISO quality certification, export risk mitigation, diversification, and WTO accession). Over the medium term, upgrading of infrastructure—in particular power and transport and improving access to quality higher education will help underpin a stronger economic potential.

A. Recent Socio-Economic Developments

Recent Events

The government has initiated bold reforms

The authorities have undertaken ambitious reforms that have delivered improvements to Uzbekistan's business and investment climate and are likely to boost economic growth over the medium term. Reforms include changes to the currency and tax systems, the lifting of state monopolies in some sectors (for example, fruit and vegetable exports), and the opening of the banking sector to foreign investors[2]. The government has also opened the previously-closed borders with Uzbekistan's neighbors and has initiated regional transport links to foster new trade and investment opportunities in Central Asia. The government's medium-term economic reform priorities through 2021[3] include improving the business environment for the private sector; introducing public-private partnerships (PPPs)[4]; strengthening the corporate governance of state-owned enterprises (SOEs) and subsequently carrying out selected privatizations; reforming agriculture (reducing land under cotton cultivation, introducing direct contracts for cotton farms with textile companies, prohibiting the use of forced labor); improving statistics; strengthening the independence of the central bank and implementing banking sector reforms; deepening trade liberalization and resuming efforts for Uzbekistan's accession to the WTO; reforming tax policy and tax administration; and enacting public procurement, administrative, and social service reforms.

Reform implementation gained momentum in 2018 and early 2019

Significant tax reforms, which were implemented on January 1, 2019, included the establishment of a unified tax rate of 12 percent for personal income tax, corporate income tax, and payroll tax for both large and small firms. Other changes included the reduction of the unified tax rate for small firms to 4 percent, the property tax rate from 5 percent to 2 percent and the dividend tax from 10 percent to 5 percent.

[2] According to Presidential Resolution #pp-4300 dated April 29, 2019 "On measures to further improve mechanisms of attracting foreign direct investment into the economy of the republic", 25 percent of state shares in each of the three commercial banks ("Alokabank", "Turonbank", and "Asia Alliance Bank") and in the "Kafolat" insurance company have been put on auction for foreign investors. This resolution also put for sale to foreign investors the shares (from 35 to 100 percent of stakes) in twenty-five SOEs in chemical, oil and gas, electricity, and food processing industries.

[3] In February 2017, President Mirziyoyev and the new government announced a dramatically different policy course—the "Strategy for action on five priority development areas of the Republic of Uzbekistan for 2017–21." These five areas are governance, judicial, social safety net, security and foreign policy, and economic reforms to boost development.

[4] The Law "On public-private partnerships" was approved by the Parliament of Uzbekistan on May 3, 2019.

New strategies will guide the government's priorities

The government adopted the Strategy for Innovative Development in September 2018, which includes quantitative targets for 81 indicators to be achieved through 2030.[5] The Strategy prioritizes human development as a key factor in competitiveness, emphasizes basic and tertiary education, and removes administrative barriers for business and the private sector. Recently, the government has approved the Sustainable Development Goals (SDGs) to national needs, including plans to help vulnerable groups, with 16 national SDG goals with 127 related targets, as well as the coordination council and roadmap to achieve that[6]. The additional spending needs for achieving SDGs are estimated by IMF at around 9 percent of GDP each year until 2030[7].

Price liberalization continues

To reduce the high cost of trading across borders, the government abolished export permit and licensing requirements for wholesale traders in October 2018. During the second half of 2018, the government liberalized bread prices and increased energy prices for firms closer to cost-recovery levels. Broad-based increases were made to the country's energy tariffs in November 2018: electricity prices were raised by 9.3 percent for individuals and by 40 percent for businesses; natural gas tariffs were increased by 10.9 percent for households and by 100 percent for businesses; prices for petroleum products were also raised. The next energy price increase is scheduled for June 2019. Tariffs on cold water were increased in April 2019 by 23.5 percent for households with centralized supply and by 16.3 percent for households with non-centralized supply.

Entry visas eased to promote tourism and business

On February 1, 2019, the government introduced a visa-free regime for citizens of 45 economies, including many European and Western countries. On March 1, the government introduced a new type of three-year visa for investors and their family members that can be renewed without leaving Uzbekistan. Investors who invest a minimum of $3 million in Uzbekistan can obtain a 10-year residency permit.[8]

Strengthening of regional economic ties is contributing to enhanced regional political stability

Uzbekistan's diplomatic and economic relationships with its neighbors have improved. Kazakhstan president Tokayev visited Uzbekistan in April 2019 to reaffirm Kazakhstan's commitment to boosting bilateral trade to an annual $5 billion by 2020 and to set up an international center for trade and economic co-operation on the Kazakh-Uzbek border. Kazakhstan's parliament ratified in March a bilateral agreement whereby Uzbekistan would supply gas to southern Kazakhstan in return for oil delivery from Kazakhstan. Together with Kazakhstan, Uzbekistan launched a program dubbed the Silk Visa in February 2019, which allows foreigners with visas issued by either of the two countries to travel in both countries. Other examples of improved regional relations include Uzbekistan's March 2018 decision to drop its

[5] These targets for 2030 in the Uzbekistan Strategy for Innovative Development include all six World Bank governance indicators and half of the *Doing Business* indicators (starting a business, getting credit, paying taxes, resolving insolvency, and protecting minority investors) as well as other useful indicators for private sector development (market capitalization, intensity of local competition) and education (government expenditure on education as percentage of GDP; expenditure on R&D; assessment of reading, math and science abilities; tertiary enrollment; firms offering formal training; females with advanced degrees). The strategy also includes measures of logistics performance, GDP per energy use, ISO environmental certificates, intellectual property protection, and ICT per capita, among others.

[6] Cabinet of Ministers Resolution #841 dated October 20, 2018 "On measures to implement the nation goals and tasks on the sustainable development for the period of 2030"

[7] IMF Country Report No.19/129 – Republic of Uzbekistan 2019 Article iv Consultations – Press Release and Staff Report, May 2019, p.50.

[8] Furthermore, those living in Uzbekistan on an investors visa or residency permit now have the same right as Uzbek citizens to healthcare and education.

objections to Tajikistan's construction of the Rogun Dam, and the 27 agreements signed during the Uzbek President's visit to Tajikistan, including on the delimitation of the long-disputed border between the two countries, the restoration of flights between Tashkent and Dushanbe, and an agreement on mutual visa-free travel for stays of up to one month. Tajikistan's electricity exports to Uzbekistan resumed in April 2018 after a 9-year hiatus and Uzbek natural gas exports to Tajikistan rose in 2018. Bilateral trade between the two countries totaled $389 million in 2018, significantly higher than the 2017 total of $238 million.

Development cooperation is deepening

Progress has been made on multiple fronts regarding development cooperation with international financial institutions. In May 2018, the World Bank agreed to provide Uzbekistan with loans totaling nearly $940 million for new projects in agriculture, energy efficiency, and emergency medical services, and $500 million in development policy operations (DPO) in 2018 and $500 million in 2019 as budgetary support for reforms. The Asian Development Bank (ADB) approved $300 million in policy-based loans in 2018 to help improve economic management and an additional $3 billion for the next three years to improve Uzbekistan's water supply and sanitation, transport infrastructure, energy, and housing projects. In November 2018 the ADB approved a $197 million loan to expand the horticulture sector by establishing agro-logistic centers in the regions of Andijan and Samarkand. Following a 10-year break, the European Bank for Reconstruction and Development (EBRD) resumed operation in Uzbekistan in 2017 with loans totaling $420 million in 2018. After launching operations in Uzbekistan a year ago, the European Investment Bank (EIB) allocated loans of €200 million ($224 million) to improve water supply, wastewater collection and treatment, as well as the energy efficiency of local enterprises. On March 1, 2019, Uzbekistan's Senate approved the ratification of the ILO Convention №144 on trilateral consultations to facilitate the application of international labor norms (Geneva, 21 July 1976). The approval of the legislation should allow for the eventual end of the textile boycott of Uzbekistan. On February 25, 2019, the Uzbek President signed a decree on measures to improve the position of Uzbekistan in international ratings and indexes, including a national system for monitoring and evaluating Uzbekistan's position in such ratings and ongoing reforms for compliance with international standards. The Presidential resolution of April 29, 2019 offered 15 investment projects of US$1.7 bn for public-private partnership, including in airports and infrastructure sectors.

Growth and Inflation

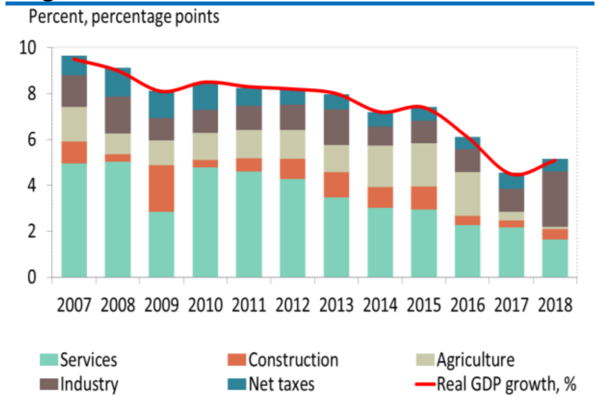
Economic growth increased in 2018 and first quarter of 2019

Real GDP growth rose to 5.3 percent year-on-year in the first quarter of 2019 from 5.1 percent in the first quarter of 2018, supported by strong investment growth of 29.9 percent year-on-year[9]. On the supply side, economic activity picked up in industry by 6.8 percent, construction by 5.9 percent, services by 5 percent, and agriculture by 2.5 percent. Industrial growth came from growth in manufacturing by 7.6 percent, mining by 4.8 percent and other industries by 5.5

[9] Total fixed investment grew by 29.9 percent y/y in the first quarter of 2019, including an increase in centralized investment (state budget, Uzbekistan Fund for Reconstruction and Development, government external borrowing, and Fun of water and sewage development) and in investment of population; the investment declined in such non-centralized sources as accounts of firms, domestic bank loans, and FDI. Investment in Q1 2019 was mainly in the energy, petrochemicals, and irrigation and water supply infrastructure.

percent. This followed 5.1 percent growth in 2018 and 4.5 percent in 2017 (Figure 1). On the demand side, while the contribution of net exports dampened GDP growth by an estimated 7.1 percent in 2018, domestic demand contributed 12.2 percent, mostly because of high fixed investment growth. The latter in turn benefited from substantial increases in government lending to fund capital investments, mostly via SOEs. On the supply side, economic activity picked up in the industrial and construction sectors (by 10.4 percent and 9.9 percent, respectively), but decelerated in agriculture (mainly cotton and wheat) to 0.3 percent (see Table1). Authorities attribute the slowdown in these agriculture subsectors to input bottlenecks, including shortages of water and unfavorable weather conditions.

Figure 1. Sectoral Contribution to GDP Growth



Source: World Bank staff calculations based on official data.

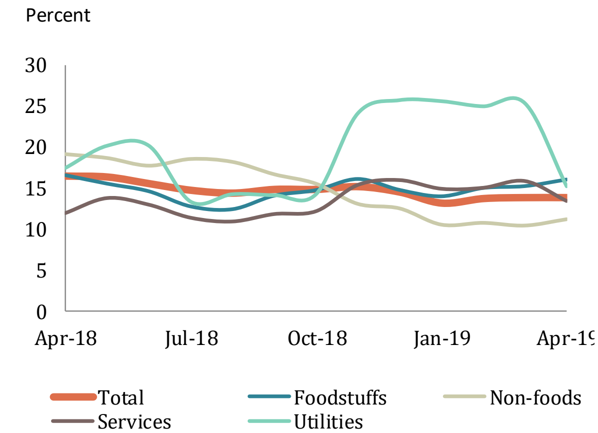
Inflation has eased but remains high

Consumer price inflation has been on a downward trend. After peaking at 20.5 percent at the beginning of 2018,[10] twelve-month inflation eased to 14.3 percent by December 2018 and further to 13.7 percent by April 2019 (Figures 2 and 3). Most price increases remain in low double-digits, including food (up 16 percent y/y in April 2019), services (up 13.3 percent y/y), and non-food (up 11.1 percent y/y). In services, the highest increase in April 2019 was for education (23.1 percent), following the 20 percent increase in contract-based tuition fees for higher education institutions in September 2018. Inflationary pressures in 2018 mainly reflected increases in administrative prices for energy and food[11] and utilities, wage increases to certain public employees, and exchange rate depreciation.

[10] See Uzbekistan: Staff Concluding Statement of an IMF Staff Visit, November 20, 2018, available at https://www.imf.org/en/News/Articles/2018/11/20/ms112018-uzbekistan-staff-concluding-statement-of-an-imf-staff-visit.

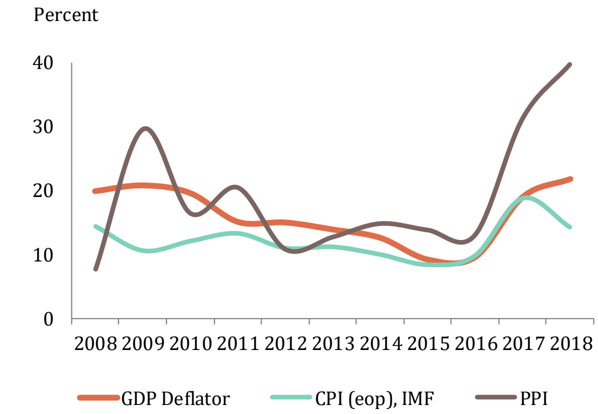
[11] According to the Cabinet of Ministers Resolution #731 dated September 13, 2018, *"On measures to reliably provide the population and the economy with grains, flour and bread on the basis of competition and the introduction of market mechanisms,"* the wholesale price of grade 1 flour (UZS 1,400) was increased and free prices were introduced for bread sold to the population.

Figure 2. Consumer Price Inflation



Source: Uzbekistan authorities.

Figure 3. Key Inflation Measures



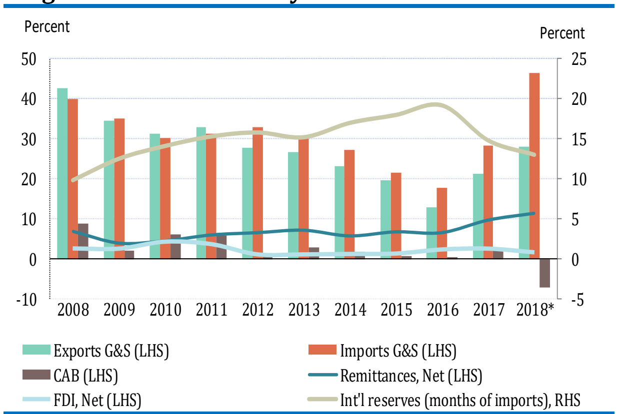
Sources: Uzbekistan authorities; IMF databases.
Note: CPI – consumer price index, PPI – producer price index

External Sector

The current account shifted into deficit in 2018

High investment growth supported by stepped-up directed lending and pent-up consumer demand helped shift the current account from a surplus of 1.4 percent in 2017 to a deficit of 7.1 percent in 2018. A significant reduction in import duties[12] in June 2018 and October 2017 also added to import growth (Figure 4). Exports of goods and services increased by 14 percent (led by foodstuffs, natural gas, textiles exports), while imports rose by 42 percent. Total remittance inflows to Uzbekistan remained broadly stable in 2018 in nominal terms (at $5.7 billion) but grew as a share of GDP owing to exchange rate devaluation. Remittances came mostly from

Figure 4. Balance of Payments



Source: World Bank staff calculations based on official data.

12 In the aftermath of the exchange rate unification, import tariff rates for about 8,000 of 10,800 total items were reduced (for about 5,000 items tariffs were reduced to zero) to mitigate the adverse effects on import-intensive companies (and prices) and improve the competitiveness of the economy. As a result, many tariffs on industrial inputs were lowered from about 30 percent to 10 percent, with the weighted-average import tariff falling from 15 percent in September 2017 to 5.9 percent in October 2017, and further to 3 percent in June 2018. However, from January 2019, import tariffs on 443 goods were increased from zero rate to 5-30 percent. These increases impacted utensils, furniture, office goods, household and climate equipment, and auto parts. The reduction of import duty affected only eight types of goods, including new and used tractors, yarn from silk waste, and filter fabrics. Excise taxes on tobacco and cigarettes were reduced from $60 to $40 per 1,000 pieces. Excise tax increased from zero to 10-20 percent on nine imported items of confectionary, four items of plastics, as well as household ovens, stoves, water heaters, washing machines, irons, vacuum cleaners, and LCD TVs.

Russia (77 percent of the total), Kazakhstan (6 percent), the United States (4 percent), Turkey (4 percent), the Republic of Korea (2 percent), and Israel (1 percent).

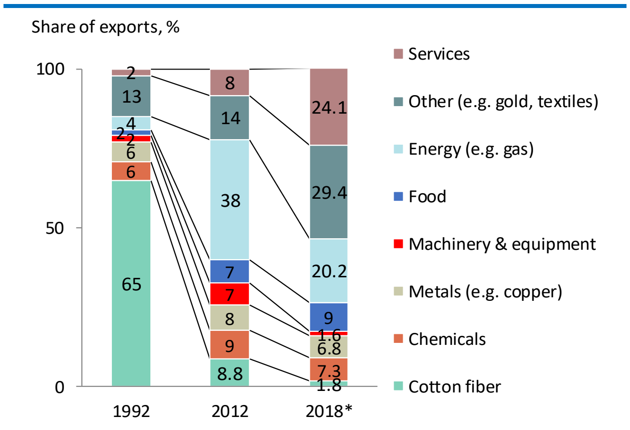
Imports continued to outpace exports in the first quarter of 2019

Imports rose by a third from a year earlier in January-March 2019, faster than the one-fifth rise in exports, widening the trade deficit to 10.5 percent of GDP.[13] In the first quarter of 2019, the Central Bank of Uzbekistan sold 6.2 tons of gold and became the world leader in gold sales. The bulk of imports during the period consisted of machinery and equipment, including parts and accessories (42.5 percent of the total), chemicals and related products (13 percent), and ferrous metals and related products (8 percent).

Uzbekistan's export structure has seen significant shifts in recent years

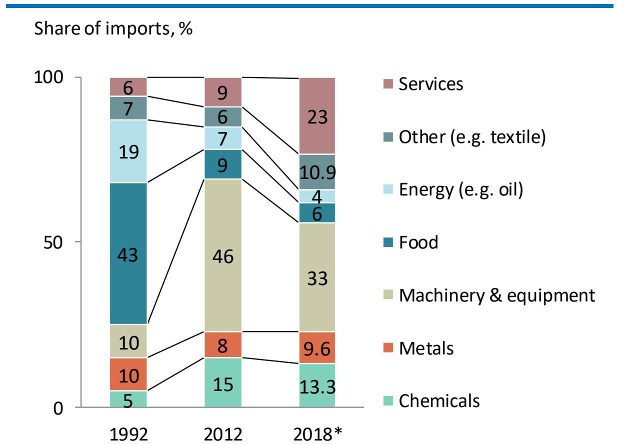
The share of commodities in exports fell from about 90 percent in 1992 to 77 percent in 2012 and 2018. Natural gas and gold made up about half of total exports in 2012 and 2018, with more gas than gold in 2012 and more gold than gas in 2018. Cotton export fell sharply as Uzbekistan increased internal processing of cotton fiber from 7 percent in 1991 to 60 percent in 2018. Trade in services (mainly transport, communications, and tourism) has expanded substantially in recent years, to nearly one-quarter of total exports in 2018, primarily owing to a surge in foreign visitors to the country. About 6.4 million foreigners visited Uzbekistan in 2018, up from just 2.8 million visitors in 2017. Non-commodity exports—manufacturing goods and foods (for example textiles, fertilizers, foodstuffs, cars, and home appliances) have expanded from about 10 percent of total exports in 1992 to about 23 percent in 2012 and 2018, evidence of export diversification in the economy (Figure 5). Uzbekistan has diversified its trade partners away from Russia (from 55 percent of trade in 1992 to 29 percent in 2012 and 17 percent in 2018) to China (19 percent in 2018) and other Commonwealth of Independent States (CIS) economies (15 percent in 2018), the European Union (7 percent), Turkey (6 percent), and Korea (6 percent). The country's import structure remains dominated by capital and intermediate goods, but the share of services also rose sharply in 2018 (Figure 6).

Figure 5. Export Structure



Sources: Uzbekistan authorities; World Bank staff calculations.
Note: * - preliminary data.

Figure 6. Import Structure



Sources: Uzbekistan authorities; World Bank staff calculations.
Note: * - preliminary data.

[13] Exports of fruits and vegetables totaled $179 million (up 68.5 percent in value terms year on year). Exports on textile products totaled $369 million (up 16.5 percent in value terms year on year).

Ample reserves provide a buffer against shocks

Uzbekistan's sizeable foreign exchange reserves and low debt levels provide a buffer against macroeconomic shocks. Reserves fell in 2018, but at US$27.1 billion (13 months of import cover) they remain adequate to ensure sustainability and stability of external accounts. Just over half of reserves are held in gold and the rest in convertible foreign currencies.

Financial Sector

Financial sector indicators are sound

Twenty-nine commercial banks operate in Uzbekistan, including five state-owned banks, 13 partly state-owned joint-stock banks, five banks with foreign capital, and six private banks. In April 2019, the value of total bank assets was equivalent to $27.6 bn. Included in this amount are the assets of the three largest state-owned banks, which together hold $15 bn. Reported financial sector indicators suggest that the banking system is sound, despite challenges related to deteriorating asset quality. Nonetheless, the dominant state-owned banks—with 85 percent of system-wide assets and 89 percent of total loans and a large amount of directed lending—distort competition and weigh on the creditworthiness of private banks. The sector has grown rapidly. Total lending by the country's commercial banks rose by about 103 percent in 2017 and by 51 percent in 2018. A lot of the increase is due to policy lending – funds the state-owned banks receive from the government and the FRD and on-lend at below-market rates to SOEs. Overall, the banking sector appears to be well capitalized, with a capital adequacy ratio (CAR) of 15.4 percent in the first quarter of 2019 (Figure 8). Banks reported an average return on assets of 2.1 percent in 2018 and 2 percent in Q1 2019 and return on equity of 16.2 percent in 2018 and 16.4 percent in Q1 2019 (down from 17.9 percent in 2016).

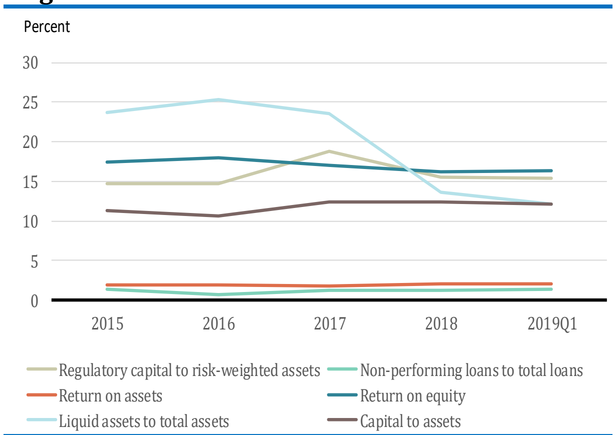
Reported NPLs are low, but may trend higher

Nonperforming loans (NPLs) increased from 0.4 percent of total loans in 2015–16 to 1.3 percent at end-2018, according to central bank data. Capital support from the state in late 2017 and early 2018 provided robust loss absorption capacity for 2018 and the first half of 2019

Vulnerabilities warrant monitoring

Uzbekistan's banking system has been rated 'stable' by Moody's since 2010. The rating was again retained in 2018, reflecting robust economic growth, stabilizing problem-loan trends, the earnings performance of Uzbek banks, and significant foreign currency reserves to cushion against external shocks. Nevertheless, loans held by banks with state shares are highly concentrated in single bor-

Figure 7. Selected Financial Indicators



Source: World Bank staff calculations based on official data.

rowers —SOEs, in particular—as their credit risk is mitigated either by ministry of finance guarantees or anticipated state support owing to their systemic importance to the economy.

Employment, Job Creation, and Poverty

Job demand greatly exceeds supply

Robust economic growth has not translated into substantial employment generation. The total number of jobs offered on the domestic labor market in 2018 was estimated at 1,061,100.[14] However, this is well below the number of jobs needed (more than 1.3 million).[15]

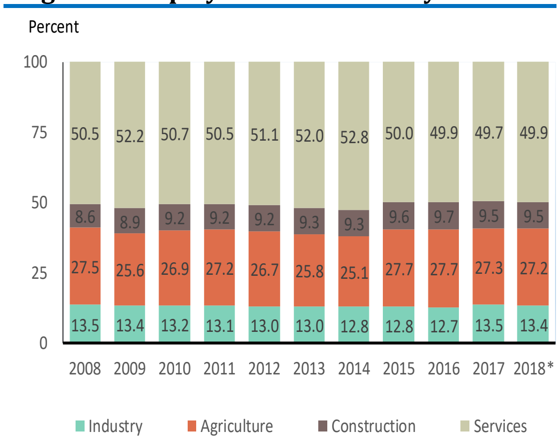
Formal job creation is moderate

Uzbekistan's labor force was 18.8 million in 2018, consisting of an economically-active population of 14.6 million and an economically-inactive population of 4.2 million. A total of 13.2 million people was employed, of which 5.3 million held jobs in the formal sector and 7.9 million (or 59.3 percent of total employment) were employed informally. Of the 7.9 million jobs in the informal sector, the number of workers employed in seasonal and temporary informal jobs was 1.6 million; labor migrants finding jobs abroad totaled 2.6 million in 2018.[16]

Unemployment stood at 9.3 percent at end-2018

Uzbekistan's sectoral employment structure has remained relatively unchanged in the last decade (Figure 8). Under a revised official methodology, the unemployment rate stood at 9.3 percent at end-2018, down from 9.7 percent in the first quarter.[17] Unemployment is highest in the provinces of Ferghana (10 percent), Andijan (9.9 percent), and Surkhandarya (9.9 percent), and lowest in Tashkent city (7.8 percent). At end-2018 the youth unemployment rate (16-25 years of age) was 17 percent, and unemployment among women was 12.9 percent.

Figure 8. Employment Structure by Sector



Source: World Bank staff calculations based on the official data.

[14] This includes about 152,500 job vacancies, 188,000 vacancies owing to death or illness, 169,500 seasonal or part-time job vacancies, 48,000 jobs reserved for socially-vulnerable workers, and 155,800 opportunities for self-employment in small-holder land plots and dehqan farms.

[15] There were an estimated 484,500 graduates from all educational institutions in 2018 looking for work; also, an estimated 851,900 working-age people were unemployed, and 26,100 people classified as socially-vulnerable were seeking jobs.

[16] These data are from Uzbekistan's Ministry of Employment and Labor Relations.

[17] The rise compared to previous years is due to the methodological change and does not suggest an actual increase in unemployment.

The poverty rate has fallen substantially

Although lack of access to official microdata since 2003 makes it difficult to confirm the poverty trend, it is estimated that the national poverty rate declined from 27.5 percent in 2001 to 11.5 percent in 2018 (Figure 9).[18] Estimates of the PPP-adjusted poverty rate (at the lower-middle income countries' line) was 9.6 percent in 2018. Poverty is higher than the national average in eight of Uzbekistan's provinces,[19] especially in the remote and sparsely populated rural provinces of Karakalpakstan, Khorazm, Jizzakh, Namangan, and Surkhandarya, where most households are employed in agriculture, and few receive remittances. Meanwhile, densely populated urban areas with remittance-receiving households—such as Tashkent city and Tashkent, Fergana, Bukhara, Samarkand, and Andijon provinces—have poverty rates below the national average. Income distribution has become more equitable over time in recent years—the official Gini coefficient fell from 0.39 in 2001 to 0.29 in 2013. School enrollment is universal, and electricity and natural gas networks reach households nationwide. Safe drinking water is available to 100 percent of the urban population and 85 percent of the rural population.

Expansion of micro- and small business played a key role in poverty reduction, among other factors

The trend of poverty reduction reflects robust GDP growth, rising incomes of micro- and small businesses, regular minimum wage increases (above inflation in 2004–14 and in-line with inflation in 2015–18), remittance inflows during the commodity boom episode, and the government's targeted safety net programs. In particular, the expansion of micro- and small businesses seems to have played a central role in these dynamics. According to official data, these entities accounted for 59.4 percent of GDP and 78 percent of total jobs (both formal and informal) in 2018.[20] Net remittance inflows—averaging $4.3 billion in 2016 and $5.7 billion in both 2017 and 2018—also contributed to falling poverty rates. Based on the government's household budget survey, remittances accounted for 7 percent of household income among the bottom 40 percent of the income distribution in 2013, and 12 percent of household income in the top 60 percent. However, the elasticity of poverty reduction to GDP growth in Uzbekistan has been low: a 1 percent increase in per

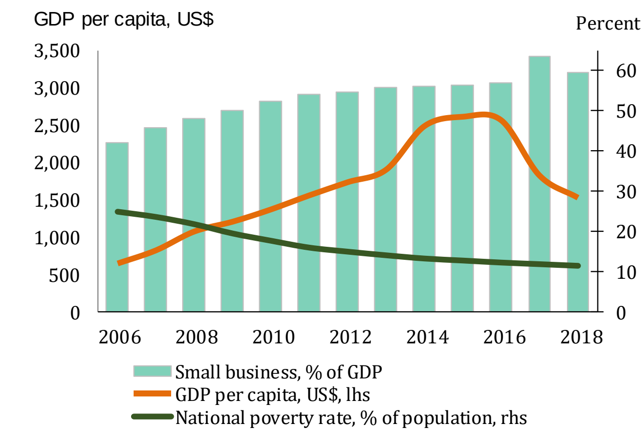
[18] As estimated and measured by the Uzbek national poverty line of minimum food consumption equivalent to 2,100 calories per person per day. The household budget surveys are conducted every year by the national statistics agency, but not published and not available to the general public or donors. The Bank team believes that Uzbekistan's official poverty estimate does not take into account non-food items and the use value of assets. In 2000–01 the World Bank recommended a methodology of measuring poverty and computing a poverty line in Uzbekistan using 2,100 calories per person per day given the multiple exchange rates at that time; however, in order to obtain robust poverty estimates the application of this methodology to Uzbekistan (now a lower-middle-income country) needs to be updated by correcting for spatial and time price differences, and including non-food expenditures.

[19] Chepel, S. 2014. *Systemic Analysis and Modeling of Prospects for Sustainable Development of the National Economy of Uzbekistan.* Tashkent: Institute of Forecasting and Macroeconomic Research.

[20] The official statistics estimated the size of informal employment (defined as those working without official labor contracts) at about 38 percent of total employment in 2013, including 46.2 percent in services, 41.4 percent in industry and 3.5 percent in agriculture. In recent years, the government took efforts to formalize some of informal sector employment.

capita GDP is associated with a 0.5 percent decrease in the poverty rate—below the average for developing economies.[21] Reasons for this could include a relatively small number of working adults per family, insufficient job creation, regional disparities, and low productivity growth in agriculture (which employs one-quarter of total labor and most of the poor but is subject to implicit taxes and restrictions on exports).

Figure 9. GDP per Capita, Poverty, Small Business Share in GDP



Sources: Ministry of Economy, World Bank staff estimates.

B. Macroeconomic Policies and Key Structural Reforms

Fiscal and Debt Policies

Budget deficit is set to narrow in 2019

With a planned decline in policy lending, the overall fiscal deficit (including policy-based lending) is projected to tighten to 1.6 percent of GDP in 2019. Part of the tightening would come from capital spending, which is forecast at $2.2 billion in 2019 (down from $3.5 billion in 2018). This follows overall general government deficit of 2.1 percent of GDP in 2018 and 1.9 percent of GDP in 2017. Policy lending rose to 3.6 percent of GDP in 2017 and further to 4.3 percent of GDP in 2018 because of rising lending to SOEs, debt write-offs, and state bank recapitalization (Figure 10). New public works programs were also included in the budget. Total debt was 34.5 percent of GDP (Figure 11) and public debt remained low at 20.6 percent of GDP in 2018. As such, debt sustainability is not an immediate concern.

Tax cuts are expected to stimulate consumption and investment

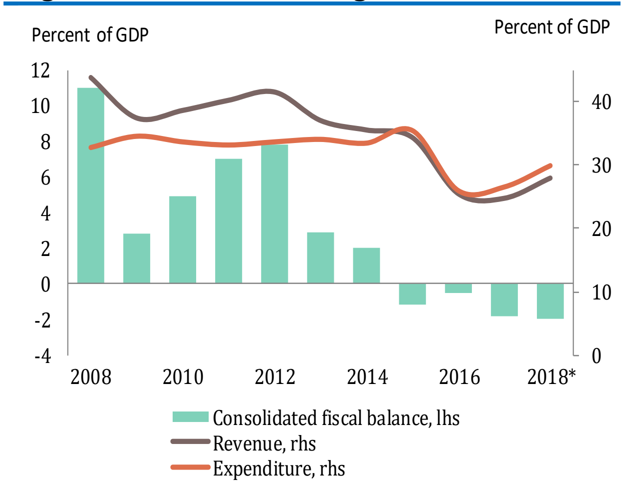
The government's 2019 budget, which the cabinet approved in November 2018, projects a significant tax cuts which took effect in January 2019 that are expected to boost consumption and investment.[22] A reduction in the maximum

[21] Ravallion M. (2001, Growth, Inequality and Poverty: Looking Beyond Averages, Policy Research Working Paper #2558, World Bank, Washington, DC.) found that a 1 percent increase in average household income or consumption will cause the poverty rate to decline by between 0.6 and 4.3 percent, depending on inequality. World Bank (2005, Pro-Poor Growth in the 90s: Lessons and Insights from 14 Countries. Washington, DC) found that in countries that experienced economic growth between 1990 and 2003, a 1 percent increase in GDP per capita reduced the poverty headcount rate by an average of 1.7 percent.

[22] On October 30, 2018, the President announced that in 2019 Uzbekistan would continue its policy of raising wages, pensions and benefits at a rate no lower than inflation. He indicated his administration's plans to raise the pay of social workers in 2019, including raising the salaries of medical workers by 26.5 percent and employees of institutions of higher education and science by 150 percent. Furthermore, spending on social benefits is set to rise by 20 percent and the share of wages and payments in the State budget will increase from 49 percent to 54 percent.

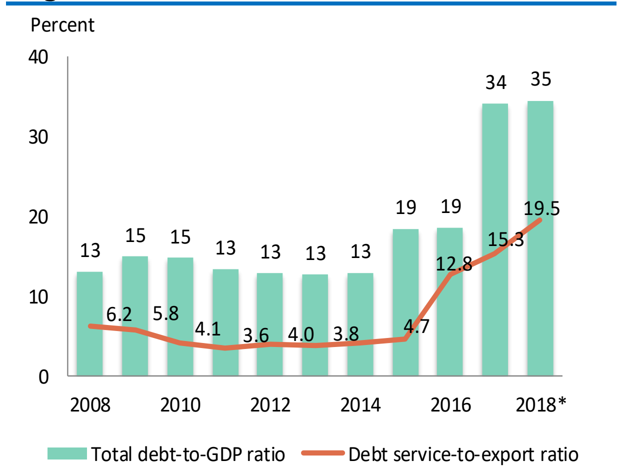
personal income tax rate and the abolition of the 8 percent employee contribution to Pension Fund will boost household income. Because of lower corporate property tax rates and corporate income tax rates, the single tax payment for small firms, and payroll taxes, an additional 2 trillion som are projected to remain at the disposal of entrepreneurs. Lower labor taxes are likely to increase formalization of jobs. With the fiscal revenue loss in mind, the government is taking measures to reduce the budget deficit and increase revenues in 2019. In particular, the implementation of systematic work on the legalization of the number of employees and wages. Future tax reform will also need to address the fiscal risk of an eventual decline in revenue collections from SOEs; with SOEs beginning to lose long-standing tax privileges and their profitability falling, tax revenue collection from SOEs will be put under increasing pressure. The government's tax reform could lead to an expansion of the tax base. In addition, rates for value added tax (and other indirect taxes)—the government's largest revenue source—remain unchanged.

Figure 10. Consolidated Budget



Source: Uzbekistan authorities.
Note: "lhs" is left-hand side; "rhs" is right-hand side.

Figure 11. Debt and Debt Service



Source: Uzbekistan authorities, World Bank staff calculations.
Note: External debt includes public, publicly-guaranteed, and non-guaranteed debt.

Monetary and Exchange Rate Policies

Monetary tightening has been ongoing since late 2017

Consumer price inflation averaged 17.5 percent in 2018 owing to devaluation pressure on the som, the removal of price controls on food, and higher energy prices. Following the unification and the liberalization of the exchange rate in late 2017, the som depreciated by 58 percent in 2017, by 2.7 percent during 2018 and by 4.6 percent from January to April 2019. With average inflation at 17.5 percent in 2018, the average real effective exchange rate was about 9 percent lower in 2018 as compared to 2017. The central bank increased the refinancing rate from 14 percent to 16 percent in September 2018 to help stabilize the exchange rate and reduce inflation. The transmission mechanism from policy rates to credit growth is not strong. Combined with high dollarization and a shallow capital market, the substantial policy-based lending to SOEs constrains the effectiveness of monetary policy. Credit growth to the economy slowed to

50.8 percent in 2018 from 103 percent in 2017 but remained much higher than in previous years (at 27 percent on average in 2011-2016).[23]

Monetary policy framework continues to develop

The Central Bank of Uzbekistan (CBU) gained more powers in 2018 to conduct monetary policy and improve banking supervision. The central bank continues to improve its liquidity management tools. Inflation targeting is due to be formally introduced by 2021. Creating a strong monetary transmission mechanism for monetary policy, improving CBU's analytical capacity, and communicating policies are essential pre-conditions for adopting inflation targeting.[24] Bringing inflation down and supporting macroeconomic stability will depend on improved policy coordination and progress on broader structural reforms to reduce the state's role in the economy and improve the quality of Uzbekistan's institutions.[25]

First Eurobond successfully issued in February 2019

Uzbekistan issued its first dollar-denominated bonds on February 14, 2019. The issuance included two tranches of $500 million each, with one maturing in five years (4.75 percent yield) and the other in 10 years (5.38 percent). The bond was heavily oversubscribed, with demand from investors exceeding $8.5 billion. Most of the Uzbek Eurobonds on the London Stock Exchange were purchased by investors from the United Kingdom. Demand was strong despite international credit rating agencies rated the country's sovereign credit BB- (non-investment-grade speculative) in January 2019. Nevertheless, the high demand for the Eurobond suggests that there is a strong appetite among emerging-market investors for Uzbekistan which is engaged in a market reforms program. Uzbekistan has no pressing need to raise revenue. In issuing the bond, the government is pursuing broader goals.

Key Structural Reforms

Reforms in key areas are ongoing

Uzbekistan relied heavily on a state-driven, import-substitution growth model from the early 1990s to 2016, with mixed outcomes for job creation and living standards. In 2017, Uzbekistan changed course, placing the country on track to build a more open and market-oriented economy. The most notable reforms include the liberalization of the foreign exchange market gradual price liberalization, reducing import tariffs and excise taxes on imports,[26] reinitiating Uzbekistan's commitment to WTO accession, liberalizing visitor visa requirements to promote openness and tourism, expanding social safety net coverage, granting the central bank more independence, improving macroeconomic statistics, and reducing tax rates for both firms and individuals.

Reforms in business climate and

The country's business climate for small firms has also improved. As a result, Uzbekistan's position in the World Bank's Doing Business ranking improved by

[23] According to the IMF, the monetary policy in Uzbekistan is not effective.
[24] See "Uzbekistan: IMF Staff Concluding Statement on the 2018 Article IV Consultations," available at https://www.imf.org/en/News/Articles/2018/03/14/ms031418-uzbekistan-staff-concluding-statement-of-the-2018-article-iv-mission.
[25] See "Uzbekistan: IMF Staff Concluding Statement of the 2019 Article IV Mission," available from https://www.imf.org/en/News/Articles/2019/03/05/msc030519-uzbekistan-staff-concluding-statement-of-the-2019-article-iv-mission.
[26] The average import tariff was cut from 15 percent in August 2017 to below 3 percent in June 2018; it was increased in December 2018.

SOEs maintain reform momentum

nearly 80 positions in five years, to 76 of 190 economies in Doing Business 2019. Improvements were made in the indicators measuring starting a business, registering property, paying taxes, protecting minority investors, getting credit, and trading across borders. In March 2019, Uzbekistan transferred the state-owned shares of 13 banks to the State Assets Management Agency, which was recently established within the finance ministry. Uzbekistan also established the Economic Council (with international experts) to ensure the implementation of the country's structural reform roadmap in 2019–21.[27] The tax code has also been revamped, and state-owned enterprises are being restructured with a view to eventual privatization. The management of Uzbekistan's airports and the state-owned airline is being separated, for example, as are the generation, transmission, and distribution of electricity.

The reform Roadmap was approved in 2019

Key immediate reform priorities include further price liberalization, competition policy, land reform for both agricultural and non-agricultural land, ensuring better access to credit and raw materials, and strengthening trade liberalization. With World Bank support, the government approved the Reform Roadmap in January 2019 that focused on (i) maintaining macroeconomic stability, through better data quality, institutional coordination, fiscal policy, tax administration reform; (ii) improving the efficiency of land and capital, by removing restrictions on land use in agriculture, more flexibility and transparency in land allocation, and strengthening property rights, deepening financial markets, and connecting to global markets (WTO accession), ICT sector reform, aviation sector; (iii) removing constraints to private sector development by adopting a competition law, regulating anticompetitive firm behavior, strengthening commercial dispute resolution, reducing the cost of doing business, improving energy efficiency, and expanding utility services; (iv) enhancing social protection, including pension reform, social safety nets, labor market reforms, health, education, and the justice system; and (v) strengthening the state for its new role in a market economy, including SOE reform, public-private partnerships, public administration reform, strengthening local governance, anti-corruption, better reform coordination, citizen engagement; and (vi) strengthening environmental sustainability, via water resources and irrigation, environmental fees and fines management, and so on.

Public finance and governance reforms are key

On January 28, 2019, the President strengthened parliamentary control over the Cabinet of Ministers[28] prescribing that from April 1, 2019, Parliament must provide approval for candidates for the posts of deputy prime minister, ministers, and chairpersons of state committees. Under the legislation, candidates will now be required to present action plans to Parliament; the prime minister and government members are required to submit quarterly progress updates on the implementation of the state program. Other newly-enacted reforms are designed to improve the quality of government services for firms and citizens, enhance public accountability, and strengthen transparency through more comprehensive disclosure requirements.[29] New laws expanded the legislature's control over the executive branch allowing legislative review of the resolutions issued by the President,

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[27] Presidential Decree #up-5614 of January 8, 2019,*"On additional measures to ensure the further development of the economy and increase the effectiveness of economic policy."*

[28] Presidential Decree of January 28, 2019, *"On priority measures to increase accountability of the Cabinet of Ministers on the effectiveness of implementation of strategic tasks of social and economic development of the country."*

[29] Law of March 29, 2018, *"On State Procurement"* and regulations of September 27, 2018, to enact this Law; Law of January 3, 2017: *"On combating corruption"*; Law of December 9, 2015: *"On e-Government"*; Cabinet resolution #320 of November 6, 2015: *"On implementation of measures on enacting the Law on transparency of state bodies."*

the prime minister, and the cabinet of ministers, as well as the introduction of parliamentary investigations.[30] Furthermore, all draft laws and presidential and cabinet resolutions since 2017 are now available to the public on the government's website.[31] Uzbekistan has also implemented the recommendations of the Enhanced General Data Dissemination System (e-GDDS) by publishing critical macroeconomic and financial data through the National Summary Data Page (NSDP)[32] that serves as a one-stop publication vehicle for essential macroeconomic data. The NSDP is posted on the website of the State Statistics Committee and is accessible on the IMF's Dissemination Standards Bulletin Board.[33] The NSDP page contains links to statistics published by official data producers, namely the State Statistics Committee, the central bank (monetary statistics and balance of payments), and the finance ministry (state budget statistics). The finance ministry also completed its transition to modern Debt Management and Financial Analysis System ("DMFAS 6.0") so that Uzbekistan became one of 57 developing economies—and one of only six countries in the Europe and Central Asia region—with this software in 2018.[34] In January 2019 the finance ministry also introduced three-year budgeting for the period 2019–21. In May 2019 the government decided that the public investment program is to be prepared for three years starting from 2020[35]. A Single Treasury Account has been effective since 2012, and two consecutive Public Expenditure and Financial Accountability (PEFA) reports[36] have confirmed that the budget is comprehensive and good monitoring mechanisms are in place to ensure budgetary control and fiscal stability. Since 2015, all firms submit their tax, customs, and statistical reports online, and all public procurement is executed through a computerized system. The finance ministry updated its public financial management reform program through 2020 in November 2016.

C. Economic Outlook and Risks

The economic outlook is generally favorable

Despite a slowdown relative to historical averages, Uzbekistan's economic outlook remains positive, with real GDP growth projected at 5.3 percent in 2019, 5.5 percent in 2020, and 6 percent in 2021 (Table1). Market reforms are expected to address production bottlenecks and liberalize high-potential growth sectors of the economy, such as horticulture, tourism, food processing, textile, and chemicals. These reforms will be supported by a significant reduction in the business tax burden. Inflationary pressures would persist in 2019–20 due to further price liberalization and wage increases, but the effects are expected to moderate by 2021. The current account deficit is expected to narrow from its 2018 level but remain in deficit as the economy continues to import significant levels of capital and machinery to modernize production. Increased donor support and a gradual increase in FDI would finance the deficit. External buffers are projected to remain comfortable over the medium term, with foreign

[30] Law "On Parliament Control" of April 11, 2016.
[31] See https://regulation.gov.uz/.
[32] See https://nsdp.stat.uz/.
[33] See http://dsbb.imf.org.
[34] These six economies are Albania, Armenia, Georgia, Moldova, Romania, and Uzbekistan.
[35] Presidential Decree of May 14, 2019 #5717 "*On measures to transit to a new system of preparation and implementation of the Investment Program of the Republic of Uzbekistan*".
[36] Uzbekistan's first PEFA assessment was completed in 2012; a second PEFA report was published in January 2019.

exchange reserves remaining above 13 months of import cover. Gross external debt is expected to decline modestly by 2020, to about 34 percent of GDP, while total public debt is expected to increase to near 25 percent of GDP.

Excessive credit growth may threaten stability

The main risk to macroeconomic stability is that a prolonged credit boom could aggravate inflationary pressures and feed into a higher external deficit. The government is expected to curtail directed lending to maintain fiscal discipline. The central government balance (excluding policy-based lending) is expected to remain in a lower surplus of about 0.5 percent of GDP over the medium term due to significant reductions in excise, income, and payroll tax rates, and increased spending to maintain public investment, pensions, and low-income allowances. However, with policy-based lending (which is projected to decline) the overall state budget deficit would decline to about 1.7 percent of GDP on average in the medium-term. Steady economic growth and remittance income are expected to contribute to a modest pace of poverty reduction. Changes in government policies may further expand support programs to poor and vulnerable households and reduce poverty. For 2019, the government has increased the budget allocation for social protection by 50 percent.

Table 1. Baseline Scenario: Selected Macro-Fiscal Indicators, 2018–21
(In percent, unless otherwise indicated)

	2018e	2019f	2020f	2021f
GDP, at constant market prices	5.1	5.3	5.5	6.0
Private Consumption	3.8	3.9	4.0	4.2
Government Consumption	1.4	1.4	2.3	2.6
Gross Fixed Capital Investment	18.1	15.2	10.2	10.1
Exports, Goods and Services	10.7	8.2	2.2	2.5
Imports, Goods and Services	25.8	18.4	7.1	6.8
GDP, at constant factor prices	5.1	5.3	5.5	6.0
Agriculture	0.3	2.9	3.2	3.4
Industry and construction	10.4	6.4	6.3	6.7
Services	4.7	5.9	6.3	7.0
Inflation (Private Consumption Deflator)	17.5	14.8	14.1	11.0
Current-Account Balance (% of GDP)	-7.1	-6.6	-5.6	-4.7
Overall Fiscal Balance, incl. UFRD (% of GDP)	-2.1	-1.6	-1.8	-1.8
Debt (public, % of GDP)	20.6	23.2	24.7	24.6
Primary Balance (% of GDP)	-1.7	-1.2	-1.4	-1.4

Source: World Bank staff calculations based on official data and IMF calculations.

Risks are weighted to the downside

Prospects are favorable for higher commodity prices and accelerated private investment (including FDI) owing to Uzbekistan's bold reform agenda. Overall, however, risks are tilted to the downside. These risks include weaker-than-forecast economic growth in Uzbekistan's main trading partners—Russia, China, and Kazakhstan—potential delays in additional structural reforms to reduce the State's role in the economy, and rising inflation. The risk to the domestic economy of external instability is modest due to a comfortable cushion of foreign exchange reserves and low levels of external (mostly concessional) public debt. While market reforms have begun to address the role of the State in the economy, the next phase of reforms aims to tackle more complex issues such as SOEs and the financial sector, agricultural reforms, and the privatization of non-agricultural land. These reforms are critical to economic transformation and to sustaining economic growth and job creation. They also carry significant economic and social risks that will need to be carefully monitored and managed. In addition, the reform agenda is expanding rapidly, and the authorities recognize the need to prioritize reforms that address the economy's most acute distortions first.

D. Focus Section: Growth and Job Creation[37]

Significant challenges exist in the labor market

The Uzbek economy creates about 280,000 new jobs per year on average (on a net basis) compared to the 600,000 jobs demanded each year for demographic reasons alone. The economy needs to double the number of jobs created each year only to absorb new entrants. Most jobs will have to be created by establishing new firms, with some created by expanding existing firms. Other structural weaknesses in Uzbekistan's labor market include disincentives to work, skills gaps and a limited supply of training in technical skills, high youth unemployment, high economic inactivity and long-term unemployment, and limited labor mobility.

Economic growth drives job creation

Creating productive jobs is the key to economic growth and improvement in living standards. The two key factors contributing to growth in GDP per capita in Uzbekistan are growth in labor productivity and growth in employment. The economies that today have the highest incomes per capita are also those that have shown the most impressive increases in labor productivity growth over the past two centuries. This increase in productivity has led to the creation of 'better', or higher-paying, jobs. GDP per capita is, in fact, a measure of the population's productivity, and differences in GDP per capita between high-income and low-income economies largely reflect differences in their levels of labor productivity. The driving force behind the rapid growth in labor productivity in advanced and rapidly developing economies has been a combination of investment in the quantity and quality of human capital, physical capital, technological progress, and organizational capital at the firm level, and institutions (such as markets, the state, a national innovation system, and the legal framework) that determine the allocation of resources.

Rising labor productivity has driven GDP growth

Uzbekistan recorded a cumulative increase of 165 percent in GDP (value added) per capita between 1996 and 2016, which is equivalent to an average growth rate of 5 percent per year. Total output per worker (or labor productivity) increased by about 150 percent over this period. The growth in value added per capita can be decomposed into growth in labor productivity, growth in employment, and growth in demographic factors (such as changes in the economically-active population and the working-age population) using the Shapley decomposition method. The growth in value added per capita over this period was driven by rising productivity (explaining 91 percent of the increase in value added per capital) and by demographic change (22 percent of the increase). These positive effects were mitigated by decreases in the labor force participation rate and in the employment rate over the same period.

[37] This chapter summarizes the key messages of the World Bank report "Uzbekistan Growth and Job Creation: An Indepth Diagnostics" (2019).

Labor productivity growth came mainly from within sectors

Rising capital per worker and a modest increase in total factor productivity (TFP) played a positive role in the within-sector changes in labor productivity. Due to high growth in investment, the capital in the economy increased 18-fold between 1996–2016 and the capital per worker ratio increased almost 12-fold. TFP (net of inter-sectoral shifts) rose by only 16.4 percent during the same period, and the inter-sectoral shifts, on the whole, had a slightly negative effect on growth of value added per capita in that period. This is because some inter-sectoral shifts were productivity-enhancing, whereby workers moved from below-average-productivity sectors and subsectors (for example, cotton and wheat agriculture) to above-average-productivity subsectors (for example, transport and telecommunications services, and trade and catering). However, other inter-sectoral shifts involved workers moving from above-average-productivity subsectors (such as manufacturing and mining, for example) toward below-average-productivity sectors or abroad, or from below-average-productivity subsectors (such as agriculture) to other below-average productivity subsectors (for example 'other services' and construction).

Job creation has lagged population growth

The 'Uzbek model' of economic development used between 1996 and 2016 was unable to ensure sufficient job creation for the rapidly-growing population. Total formal employment rose from 8.2 million in 1996 to 12.3 million in 2016 (a 50-percent increase). However, as a result of the simultaneous growth in the economically active population (and the working-age population), the employment rate declined by 0.52 percent per year on average between 1996 and 2016. Job creation in the manufacturing subsectors has been a particular challenge, especially in labor-intensive subsectors such as food processing, light industry, apparel, and other manufacturing. Manufacturing employment in Uzbekistan was only about 9 percent of total employment in 2016, having declined during 1996–2016 despite government policies to support the sector, and contrary to the government's expectations. The industrial sector (mining and manufacturing, excluding construction and utilities) is the least-important employer in Uzbekistan's economy, accounting for just 13 percent of total employment. This share was lower than in comparator countries in 2016—45 percent in Turkmenistan, 32 percent in Belarus, 25 percent in Ukraine, 22 percent in the Kyrgyz Republic, 21 percent in Kazakhstan, 17 percent in Tajikistan, and 14 percent in Azerbaijan.

Simultaneous employment and labor productivity growth is ideal

Many of Uzbekistan's sectors and subsectors experienced simultaneous growth in employment and labor productivity. This was the case in construction, chemicals and petrochemicals, wholesale and retail trade and catering services, transport and communications, and other services subsectors. While the electricity industry and two subsectors of the mining sector (the fuel industry and the metallurgical industry) created jobs, they also experienced a decline in labor productivity.

Uzbekistan has a competitive advantage in food processing, textiles, and apparel

The ratio of value added to total output when calculated in international prices (for both inputs and outputs) is significantly higher than the same ratio calculated in domestic prices for the food processing and textiles and apparel industries. For some industries (such as chemicals and petrochemicals and construction materials), however, this ratio is higher in domestic prices than in international prices—although, for some subsectors of the chemicals and petrochemicals industry the ratio is higher in international prices than in domestic prices. The large differences between domestic and international prices, among other things, show the level of price distortions in Uzbekistan's economy. In addition, there is still a large productivity gap in manufacturing between Uzbekistan and the upper-middle-income countries (by 2.2 times in manufacturing overall, including almost 6 times in the chemical industry), but only a 50-percent gap in the food processing industry, a 30 percent gap in the apparel industry, a 10 percent gap in the textile industry, and no gap in general in the machinery building industry. These gaps show untapped potential for productivity growth in Uzbekistan's manufacturing subsectors that is possible to use by addressing the existing constraints to the business climate and productivity growth at macroeconomic, sectoral, and firm levels.

Small manufacturing firms are more productive but employ fewer workers

Enterprise surveys show that small manufacturing firms in Uzbekistan are, on average, much more productive than large firms—which are mostly state-owned or state-controlled enterprises—but that large firms employ relatively more employees than small firms. The average labor productivity in five manufacturing subsectors of Uzbekistan was about twice as high in small firms ($75,000 per employee, compared to $34,000 in large firms) in 2014 and 2016. Meanwhile, the average number of jobs created per unit of capital in 2016 was higher in large manufacturing firms (35 jobs per million U.S. dollars of capital, compared to 12 jobs in small firms). In a market economy in the long-run, firms with higher productivity can pay higher wages and should attract more employees. However, until 2018, Uzbekistan experienced the opposite; perhaps because there was high inertia in the manufacturing sector owing to limited information flows on wage differences between large and small firms, and a lack of market forces in the economy[38] that explains weak reallocation processes in the economy in general.

The business climate hinders firm and job creation

The economic literature shows that, in most economies, young firms can be a more important source of net job creation than existing (incumbent) firms.[39] However, the average number of newly-registered firms per 1,000 of the working-age population over the 2006–16 period indicates that Uzbekistan (with 0.72 new firms) has the second-lowest business density of all CIS countries (higher only than Tajikistan with 0.35 new firms), and less than half the CIS average (1.67 new firms). Business density is also lower than the average for the lower-middle-income group of countries to which Uzbekistan belongs (1.99 new firms per 1,000 of the working-age population), and lower than the average for Europe and Central Asia (4.63 new firms) in 2014.[40] The Uzbek people are known for their entrepreneurial abilities; it is primarily business climate constraints that are restricting an increase in the rate at which new firms and jobs are created. Uzbekistan was ranked 76 of 190 economies in the World Bank's 2019 Doing Business ranking; its most challenging areas were trading across borders, dealing with construction permits, resolving insolvency, paying taxes, getting credit, and registering property.

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[38] More market forces were added at the end of 2017 with the introduction of convertibility of the national currency, a reduction in import tariffs, and the launch of the free trade of 27 key raw materials on the commodities exchange.

[39] World Bank. 2012. *World Development Report 2013: Jobs*. World Bank, Washington, DC.

[40] One caveat of this indicator is that it includes only businesses registered as legal entities, even though in 2016 about 210,000 individual entrepreneurs were operating in Uzbekistan without registering as legal entities and, so, were not captured by the indicator. Thus, the number of actual entities in Uzbekistan that create jobs, relative to the population, is slightly higher than this indicator would suggest.

Physical infrastructure deficiencies result in losses

Interruptions in physical infrastructure result in significant losses in potential manufacturing output each year. Small firms suffer more than large firms from interruptions of electricity, gas, and water supply, and from a lack of territory or high lease rates on land for expanding output production. Total self-estimated loss from all interruptions in physical infrastructure was 42 percent of potential output in large firms in 2012, 24 percent in large firms in 2016, and 38 percent in small firms in 2016. By improving infrastructure services, the authorities can increase both output per worker and employment in firms.

Authorities' demands on firm time and resources hinder productivity

Firm productivity is also constrained by the authorities diverting managers' time and firms' financial resources toward non-productive activities. About 31 percent of managers' time in large firms and 26 percent in small firms is lost on various non-productive bureaucratic activities such as dealing with central government ministries, local authorities, industry parastatal associations, or former line ministries concerning tax, customs, inspections, sanitary, and environmental issues. As a result, less time is available for more important work like improving their firms' productivity, efficiency, skills, technology, and profitability. Firms reported that 32 percent of employees in large firms and 30 percent in small firms participated in cotton picking or were distracted to other public works in 2016. About 23 percent of large firms and 11 percent of small firms said that local authorities requested "additional spending" from firms without compensation. In 2016, about 13 percent of large firms and 7 percent of small firms made unofficial payments to various authorities to get things done, and 8 percent of large firms and 6 percent of small firms knew in advance how much to reserve for illegal payments to local authorities. About 61 percent of large firms' total output and 46 percent of small firms' total output was subject to central distribution by a line ministry or industry association in 2016, rather than being decided by firms and the free market.

Structural reforms must improve allocative efficiency, encourage business-to-business spillovers, and strengthen firm capability

Uzbekistan needs to tap into the potential productivity gains associated with the cross-sectoral reallocation of labor from below-average to above-average productivity sectors. This process should be complemented by intra-sectoral reallocation from lower-productivity firms to higher-productivity firms within each sector. In the medium term, there is strong potential for economic growth from accelerating shifts of labor toward economic subsectors with above-average productivity (that would be expected to have higher wages), such as from agriculture to manufacturing, mining, transport, and services (financial and business services and telecommunications, for example) and within the agriculture sector (from cotton and wheat to horticulture). Reallocating labor from less- to more-productive subsectors of the economy will require policy interventions, including to mitigate the social impact of economic restructuring. Currently, the lack of appropriate unemployment insurance and poorly targeted social assistance undermine the effectiveness of existing policy instruments.

Firms need reforms that eliminate binding constraints to business

The government has already removed two top binding constraints to business by implementing two reforms: unifying exchange rates in September 2017 and cutting taxes in January 2019. The reforms demanded by manufacturing firms show that at this stage of Uzbekistan's economic development most firms are preoccupied with resolving simple constraints related to firm survival—such as lack of access to inputs and lack of access to markets for outputs. Addressing these issues can improve allocative efficiency and firm capabilities. The next phase of reforms would, therefore, need to focus on the next set of binding constraints such as (i) ensuring an uninterrupted supply of electricity and natural gas; (ii) improving access to high-quality, affordable raw materials for all; (iii) improving access to credit (lower inflation, affordable interest rates and terms, and lower collateral requirements); (iv) providing additional territory (land) to allow production to expand (for example by developing markets for land user or ownership rights in the industry and services sectors); (v) increasing the availability of skilled personnel (workers, engineers, and top managers); (vi) improving regular provision of information to all firms in all sectors about the available new technologies and equipment (to help firms with capital rehabilitation and technology upgrading) and state support for exporting (such as ISO quality certification and export risk mitigation, promoting diversification, WTO accession, organizing trade fairs, providing regular information on foreign demand for products, and so on); and (vii) reducing the degree of domestic market monopolization by state-owned enterprises (SOEs) and banks, industrial holdings, and associations.

Easing business regulations, marketization, and removing barriers to entry and exit is expected to accelerate private sector development

Removing barriers to market entry and exit, easing business regulations, lifting remaining price controls, strengthening private property rights, and tackling inefficiencies in the SOE sector would further improve overall productivity. A valuable lesson for Uzbekistan[41] is that reducing government participation in productive activity, deregulating, and removing barriers to entry and exit can spur organizational change at the firm level (such as more efficient management and additional research and development activities) and contribute to the growth of GDP per capita. Competitive pressures can boost technology absorption and innovation if firms have access to financial markets, raw materials, and other inputs. Business registration in Uzbekistan is relatively easy (Uzbekistan ranked 12 globally for starting a business in Doing Business 2019), but informal barriers and government failures—opaque regulations and a lack of adequate protection of property rights (for example land ownership and intellectual property)—remain significant. These constraints limit Uzbekistan's ability to attract foreign direct investment (FDI) and absorb technology. Exiting the market is costly as bankruptcy procedures are slow or poorly developed. Measures to tackle these challenges could be accompanied by moving to international accounting and reporting standards (IFRS) in the real sector, hardening the budget constraints for SOEs, strengthening corporate governance and restructuring and privatizing SOEs and banks, further liberalizing prices and sustaining trade liberalization, enhancing competition policy and demonopolization, and improving banking competition and liberalizing interest rates. Addressing market distortions slowly and selectively could exacerbate, rather than alleviate, them.

[41] India and China significantly liberalized their trade and import tariffs on manufactured goods. India halved import tariffs on most tradable goods and eliminated quantitative controls between 1990 and 1997. China has been moving away from the very restrictive regulation of 30 years ago. SOEs in China have been operating more like private sector firms following the governance reform, which expanded managerial independence and decoupled the SOE ownership function from other aspects of government policy making.

Annex

Table 1A. Selected Macroeconomic and Social Indicators, 2016–21

	2016	2017	2018	2019	2020	2021
					Projections	
National Income and Prices						
Nominal GDP (LCU), UZS trillion	243	303	408	523	643	759
Nominal GDP per capita (US$)	2,568	1,828	1,532	1,805	2,067	2,370
Real GDP growth (percent)	6.1	4.5	5.1	5.3	5.5	6.0
Gross investment growth (percent)	4.1	19.4	18.1	15.2	10.2	10.1
Consumer price inflation, average	8.8	13.9	17.5	14.8	14.1	11.0
Nominal official exchange rate change, average	2,965	5,114	8,070	...	...	...
Real effective exchange rate (2015=100) (decrease = depreciation)	84.3	65.9	60.2	...	...	...
External Accounts						
Merchandise exports, USD billion	8.6	10.1	11.4	12.4	12.8	13.4
of which (percent of total merchandise exports):						
Cotton fiber	7.4	4.7	2.0	2.5	1.2	0.5
Energy (natural gas, electricity)	19.8	18.9	23.4	21.0	22.3	22.2
Food	8.0	8.6	9.6	11.4	12.8	13.1
Gold	32.5	32.1	25.6	30.3	30.1	29.5
Other exports of goods	32.3	35.7	39.4	34.8	33.6	34.7
Merchandise imports, USD billion	11.0	12.4	18.3	20.3	21.1	21.9
Current-account balance (percent of GDP)	0.4	2.5	-7.1	-6.6	-5.6	-4.7
Foreign direct investment, net (percent of GDP)	2.5	2.1	1.3	1.8	2.1	2.7
Total official international reserves, USD billion	26.5	28.1	27.1	27.5	27.9	27.6
Total official international reserves, months of imports	19.2	14.4	12.8	12.3	12.0	11.2
Total external debt (percent of GDP)	18.6	34.1	34.5	34.0	33.5	32.2
Consolidated Fiscal Accounts (percent of GDP)						
Overall fiscal balance (incl. UFRD balance)	-0.5	-1.9	-2.1	-1.6	-1.8	-1.8
Pubic debt	8.6	20.2	20.6	23.2	24.7	24.6
Monetary Accounts (percent of GDP)						
Broad money	21.5	24.1	20.5	19.3	19.0	19.0
Credit to the economy	21.8	35.5	39.7	38.7	37.9	38.0
Policy rate (percent)	9	9	14	16	..	..
Social Indicators						
Population, total, mid-year (millions)	31.9	32.4	33.0	33.5	34.0	34.6
Population growth (percent)	1.8	1.6	1.8	1.6	1.6	1.6
Unemployment rate (percent of labor force)*	8.0	9.0	9.3	9.3	9.2	9.2
Poverty rate, national (percent of population)**	12.3	11.9	11.5	11.3	11.1	10.9
Inequality – Gini coefficient	0.28	0.28	0.30	0.31	0.32	0.33
Life expectancy (years)	68.5	68.5	71.3	71.3	71.3	71.4

Sources: World Bank staff calculations and estimates based on official data published and provided by the authorities and IMF data.
Note: * The Ministry of Employment and Labor Relations of Uzbekistan changed its methodology for calculating unemployment in 2018.
** Estimated and measured by the Uzbek national poverty line of minimum food consumption equivalent to 2,100 calories per person per day. Household budget surveys are conducted every year by the national statistics agency, but not published and not available to the public or donors. The Bank team believes that Uzbekistan's official poverty estimate does not take into account non-food items and the use value of assets.

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