Privatization of Corporations in Uzbekistan in Comparison with Transition Economies of Central and Eastern Europe

Kakhkharov, Jakhongir

2003

Privatization of Corporations in Uzbekistan in Comparison with Transition Economies of Central and Eastern Europe

INTRODUCTION

The demise of the Berlin Wall and the collapse of the USSR signaled a rush to privatization in Central and Eastern Europe and the former Soviet Union. The governments of these countries are trying to privatize i.e. transfer state-owned-and-operated enterprises to private owners and/or managers in order to create a viable private sector, capital markets and other institutions and processes, which describe a free market capitalist system. However, the pace of privatization has not been the same across the board. Whereas some of the Central and Eastern European countries are considered to be far ahead in privatization process, Uzbekistan lags behind their former peers from socialist camp – Czech and Slovak Republics, Hungary, Poland, Estonia and some others[1]. This paper argues that despite the fact that there were similarities at the starting point of transition, the differences in initial conditions and reform agenda of governments in Central Eastern Europe and Uzbekistan accounted for Uzbekistan's slower pace of privatization. The next section of this paper is devoted to analysis of differences in initial conditions at the outset of transformation in Central Eastern Europe and Uzbekistan. Section III provides an overview of goals of reformers in respective countries. And section IV draws conclusions.

[1] Progress in privatization of medium-size and large-scale enterprises is measured by EBRD's transition indicators in EBRD Transition Report 1997. p. 90

There is no historical precedent for the kind of transition from a central-planning socialist economy to a free-market economy that is now occurring in the republics of the former Soviet Union and Central Eastern Europe. Political structures and processes are changing at the same time as economic institutions and processes. Given this and social upheaval in these countries, it is not surprising that the privatization process has been inconsistent in application, chaotic, and generally difficult. Different approaches, techniques and mechanisms have been employed with varying degrees of success and results.

The Uzbek government considers that it has adopted a unique transition strategy of gradual, state-guided development, in which stability and equality are principal objectives and approach to large-scale privatization is mainly case-by-case and opportunistic. Pomfret and Anderson (1997) characterize Uzbek economic policies as "inconsistent gradualism", which have appeared, in many circumstances, reactive, rather than part of a consistent strategy. Despite earning a name of a "slow reformer"[2], Uzbekistan is a transition country that has achieved certain significant changes in development of a market-oriented economy and a privatization process in comparison to the point when it started its existence as a sovereign state.

II INITIAL CONDITIONS AND THEIR INFLUENCE ON THE PRIVATIZATION PROCESS

[2] Classification of Uzbekistan and Central Eastern European countries as slow/fast reformers based on rankings produces by World Bank staff (de Melo, Denizer and Gelb, 1996). Also see Desai ed. (1998), Wolf, H (1999, p. 5)

The introductory essay in Earle, et. al. (1993) argues that the diversity in the formulation and implementation of the privatization process across Central and Eastern Europe stems from differences in the economic and political development of these countries under socialism[3]. Disenchantment with central-command system led to creation of property like entitlements for managers and workers in Hungary and Poland in the 1980s. After the fall of communism, the desire of the insiders to convert these entitlements into formal ownership rights influences significantly the structure and the process of privatization. In Hungary, by the time the first post-communist government came to power in 1990, most property-like entitlements to "socialized assets" had already devolved to enterprise and company management – a process termed "spontaneous" privatization. Both large and small-scale privatization in Poland is marked by special treatment of insiders - thanks to the "privileges" won by Solidarity in fighting against Communist authorities in 1980s. It is at that time Solidarity succeeded in shifting control over "socialized enterprises" from the authorities to insiders/workers. By contrast, different levels of greater centralization of economy before the collapse of communism in Czechoslovakia and Romania resulted in the authorities taking full control over the privatization process. This significantly limited the role of insiders in privatization in these countries. However, despite similar centralized approaches in Czechoslovakia and Romania, the degrees of success measured by speed, revenues, and post-privatization economic development are notably different in these two countries.

[3]For details see Earle, J., Frydman, R. and Rapaczynsky, A, (1993*). Privatization in the transition to a market economy: studies of preconditions and policies in Eastern Europe*. London : Pinter

Privatization and post-privatization economic development in the CIS, including Uzbekistan, is in even less favorable, compared to the Central European countries, conditions because of the following reasons:

- Memory of capitalism is much weaker in the CIS, because it is further removed in time;
- Deeper militarization of the economy in the former USSR. This increases the number of steps to be undertaken before privatization to include restructuring of military complex enterprises – a daunting task by itself;
- Collapse of the COMECON market is accompanied by the dissolution of the former Soviet Union and disruption of almost all the horizontal and vertical economic ties of the enterprises;
- Worldwide economic recession in 1989\91 coincided with the political revolutions in the Former Soviet Union. For example, Michael Kaser points out that in 1993 the United Nations Economic Commission for Europe (ECE) found that restrictive actions against eastern imports had been taken by Western governments against Central Europe (12 cases) and Former Soviet Union (8 cases)[4]. These actions were taken in response to the economic recession;
- Another important factor was the geographic remoteness from the attractive Western markets;
- Reliance on exports of oil, gas, metals and minerals in the USSR led to the creation of unbalanced economies for the newly independent states.

[4] Kaser, M. (1995) *Privatization in the CIS.* London: Russian and CIS Programme, Royal Institute of International Affairs.

These negative factors resulted in economic decline, which was much larger in the CIS than in CEE. According to EBRD, while for all the transition countries of CEE and former USSR output decline was 29 per cent, in the CIS only, this figure was equal to 44 per cent.[5] Although Uzbekistan's GDP in 1997 stood at 87 per cent of 1989 level, – smallest decline for the former Soviet Republics, it is clear that major decline had been prevented mainly due to particularities of the Uzbek economy based on exploitation of natural endowments. Uzbekistan was able to sustain in a due level production of raw materials and minerals, which contributed major part of GDP. It is common knowledge that production of raw materials and minerals is much less complex and does not suffer from disruption of economic ties as much as production of more complex products does.

Uzbekistan's starting position is quite different from the conditions of other former USSR republics. For instance, at independence, Uzbekistan was the third, in terms of population, and the second poorest republic of the former Soviet Union[6]. For the Soviet economy, Uzbekistan served as a supplier of raw materials (cotton) and minerals (gold and uranium). In most of Central Asia no modern institutions of market economy ever existed, while Central Europe and Baltic states had experienced market system before communist rule. Even Russia and Ukraine had been briefly "exposed" to capitalism before 1917.

Furthermore, prior to gaining independence none of the Central Asian countries had exercised significant influence over their economy. For example, Kazakhstan government claims that before 1991, 90% of its industry was controlled from Moscow via all - Union Ministries. Therefore, at independence, there were no national institutions

---

[5] From EBRD table published in *Financial Times* 5 August, 1998

[6] According the data collected by Pomfret (2000, p. 736)

with experience of developing and managing industrial policy or of supervising state owned enterprises [7]. Before embarking into reform process, Uzbekistan, as well as other Central Asian countries, had to start with formation of sovereign state[8], creating government institutions able to grasp fully the economy of the country. This inescapably led to a new list of problems on top of the "usual" list, the reformers engaged in privatization in transition states face.

Another key factor is the structure of economy that the Uzbek government inherited from the Soviet Union. The volume of industrial production in Uzbekistan remains very low in both absolute and per capita terms[9]. Reliance on cotton, gold, and minerals make it possible for the government to put privatization lower in the priority list of reform steps. Since the share of industrial sector, with which privatization is mostly associated, is not as big as in most of the Central Europe (see Table 1 below), it is, apparently, more difficult for it to win closer attention of policy-makers compared to sectors engaged in production of cotton and gold.

Table 1. Structure of the GDP and Work Force (in per cent)[10]:

Country	Indicator	Sector	1990	1991
Uzbekistan	Share of GDP	Agriculture	33.1	37
		Industry	22.4	22.4

[7] Henley, J., (1995) *Restructuring large scale state enterprises in the republics of Azerbaijan, Kazakhstan, the Kyrgyz Republic and Uzbekistan: the challenge for technical assistance*
[8] B. Islamov (1998), "State-Led Transformation and Economic Growth in Central Asia: From Plan to Industrial Policy". *Hitotsubashi Journal of Economics;* 39(2), December 1998, pp. 102.
[9] Rumer, Boris and Stanislav Zhukov eds. *Central Asia: Challenges of Independence*. Armonk, NY and London: Sharpe, 1998
[10] Sources: Rumer, Boris and Stanislav Zhukov eds. *Central Asia: Challenges of Independence*. Armonk, NY and London: Sharpe, 1998 and EIU country reports.

		Construction	10.5	10.5
		Services	34.0	26.5
Kazakhstan	Share of Share of GDP	Agriculture	34.5	28.1
		Industry		20.8
		Construction		12.0
		Services		32.7
Kyrgizstan	Share of GDP	Agriculture	33.7	37.0
		Industry	27.0	28.5
		Construction	7.9	6.6
		Services	31.4	27.9
Czech Republic	Share of GDP	Agriculture	7.2	5.6
		Industry	50.0	54.9
		Construction	8.6	6.3
		Services	34.5	33.1
Slovakia	Share of GDP	Agriculture	7.4	5.7
		Industry	49.9	52.7
		Construction	9.2	7.4
		Services	33.5	34.5
Hungary	Share of GDP	Agriculture	12.5	8.0
		Industry	26.7	26.9
		Construction	6.0	5.1
		Services	54.8	60.0
Poland	Share of GDP	Agriculture	8.5	9.3

		Industry	43.6	39.2
		Construction	9.5	10.9
		Services	38.4	40.6
Russia	Share of GDP	Agriculture	19.9	
		Industry	42.2	
		Construction	12.7	
		Services	25.2	

Since Uzbekistan has to start from such a low base, it seems hardly possible for the government to afford a more ambitious privatization program a la Central European countries. Thus, not only initial conditions play a crucial role in shaping up ownership profile of privatized enterprises, but they also determine the pace and the speed of privatization as well. However, initial conditions are not the only determinants of privatization progress in Uzbekistan. Government's formulation of goals for privatization also influenced the privatization process.

III. GOALS OF PRIVATIZATION IN CENTRAL EASTERN EUROPE AND UZBEKISTAN

Former Prime-Minister of the Czech Republic Vaclav Claus maintains that privatization in Western countries, e.g. Thatcherian privatization in the UK, has almost nothing to do with the task that Central and Eastern Europe is facing. On the one hand, privatization in Central and Eastern Europe is a process of establishment of property rights structure that previously either did not exist, or was very strange. On the other hand, in the West, the privatization could be viewed as a reform process when a standard shift of property rights between well-defined economic agents takes place[11].

As to objectives of the governments in the privatization process, these include, first of all, a complex economic transformation, rather than the maximization of the proceeds from the sale of its assets. The speed of the process is absolutely essential. The slower the pace of privatization, the lower is the proceeds from privatization. Hence, the main goal of privatization is restructuring of the economy. In other words, the principle goal of privatization is to improve resource allocation. The individual restructuring of enterprises will follow after privatization.

Similarly, Colin Jones, comparing privatization programs in Central and Eastern Europe, industrialized countries and developing nations, concludes that in Central and Eastern Europe and the Former Soviet Union privatization is a part of the process of creating afresh a market economy and all its legal, commercial, financial and institutional infrastructure. Moreover, private ownership and private property rights are perceived to be a bedrock of a democratic society. By contrast, in industrial countries, privatization is a marginal adjustment in ownership rights in established economies.

Unlike the central planning, market economy based on private ownership disperses the risks and reduces the magnitude of the consequences of an error. Private ownership also subjects businesses to the threat of bankruptcy or take-over and so fosters competitive environment. Furthermore, the resources are likely to be allocated more

---

[11] See Bohm, A., and Simoneti, M. (1994) *Privatization in Central and Eastern Europe.* Ljubljana: C.E.E.P.N. p. 8.

efficiently by decentralized competition, rather than by the bureaucratic processes of centralized planning.

However, Colin Jones opposes hasty privatization schemes. Since privatization is a part of the process of economic transformation, it will succeed only when accomplished in complex with other economic reform measures. Privatization is not feasible without prior macroeconomic stabilization and creation of the legal and institutional infrastructure for a market economy. In other words, first step is demand adjustment: liberalization of prices and foreign trade; establishment of realistic exchange rates and internal convertibility of the local currency; and tightening of the monetary and fiscal policy. The next step is creating a framework of civil and commercial law; independent judicial system; competitive banking and financial system[12].

However, almost all the CIS countries, unlike Poland and Czechoslovakia, introduce only price decontrol at a stroke - and the Russian government is alone in adding in current account convertibility and mass privatization to their respective programs of transition[13].

Financial and legal infrastructure for trade in property remains undeveloped throughout the CIS. High proportion of shares held by management and workers protects employment, defers restructuring and foreign investment.

Martin Spechler's (Iatridis, Hopps 1998) conclusion on the pace and goals of privatization is different to that of Colin Jones and Vaclav Claus. According to him, a gradual mixed strategy of transition and privatization would be more acceptable to more

---

[12]See Jones, C. (1992) *Privatization in Eastern Europe and Former Soviet Union.* London : Financial Times Business Information

people that would doctrinaire of shock therapy[14]. Slow approach, sensitive to hardships of people, would make a privatization scheme more popular among ordinary citizens and gain support of a population. Wide support and less severe consequences on the people will improve the results of privatization and restructuring.

It seems that Martin Spechler's approach is somewhat similar, in certain instances, to the Uzbek government's strategy of economic reform. The creation of a socially oriented market economy and step- by- step transition are parts of state–led reform agenda in Uzbekistan (I. Karimov, 1992, p. 37). It is based on the five principles formulated by President I. Karimov:

- The economy has priority over politics;
- The main agent of reform is the state;
- Priority is to be given to law and legal obedience;
- Adherence must be given to a strong social policy, which takes into account the demographic structure of the nation;
- Transition to a market economy must come through evolutionary means[15];

Privatization policy based on this strategy has accentuated the general privatization process. In Uzbekistan, small-scale private activity, both legal and illicit, had been quite well developed[16]. Therefore, the government's first priority, at the inception of privatization process, became small privatization. From late 1992 until mid –

---

[13] See Kaiser, M. (1995) *Privatization in the CIS.* London: Russian and CIS Programme, Royal Institute of International Affairs.

[14] Iatridis, D. and Hopps, J. (1998) Privatization in Central and Eastern Europe : perspectives and approaches. Westport, Conn.; London: Praeger.

[15] I. Karimov, Uzbekistan – sobstvennaya model perekhoda na rynochnie otnoshenia, Tashkent, 1993 p.p. 37-38

1994 53 000 businesses had been sold or leased to mainly to employees. By the end of 1996 small privatization had been complete.

However, the first wave of privatization has not led to a logical next step – large-scale privatization. The mass privatization launched in 1996 has not given controlling stakes in industrial companies to private owners. Private Investment Funds (PIFs) are bidding for minority stakes not exceeding 30% in 150 medium-to-large size companies.

Within the past two years the Uzbek government has indicated several times its intent to move more decisively to attract foreign investments. In 1998, Uzbekistan announced international tenders for some of its largest industrial assets. However, only one large chemical plant had been sold. In 1999, tender for Almalyk copper plant, one of the largest and potentially profitable enterprises in Uzbekistan was cancelled[17]. Pace of large-scale privatization still remains slow. There are many problems, which slow down privatization process in Uzbekistan, such as, unrealistic price expectations, difficult investment environment, non-convertibility of the local currency, and slump in commodity prices. However, the main reason for this, in addition to difficult initial conditions, seems to be the perception of privatization goals by Uzbek reformers. While for Central European reformers the speed of the process is the main objective, Uzbek reformers seem to be more concerned with maintaining control over the enterprises being privatized, which, in fact, contradicts to the idea of privatization itself.

IV. CONCLUSION

---

[16] A definition used by Kaiser, M. (1997) *The Economies of Uzbekistan and Kazakhstan*. London: Russian and CIS Programme, Royal Institute of International Affairs.
[17] See for details EBRD Transition Report, 1999.

Privatization will play crucial role in the ongoing transformation process in Central Eastern Europe and Uzbekistan. Through privatization the governments can create incentives for enterprises to increase production and improve quality fuelling economic growth. Privatization should create political constituency of new owners and commercial lenders who would exert political pressure for putting in place governance mechanisms.

Whereas some of the Central European and former Soviet republics are almost finishing up their privatization programs, Uzbekistan has been often criticized for the lack of political willingness to press ahead with large-scale privatization in fear of higher unemployment and bankruptcies. However, evaluation of Uzbek privatization performance should be considered in the context of initial conditions at the outset of transition and policy objectives, which, sometimes, determined by these conditions. Initial conditions remarkably slowed down large-scale privatization in Uzbekistan at the start of reforms. They not only influenced policy goals of privatization notably at a later stage, but also, to certain extent, limited options for Uzbek reformers. As Uzbek government declared adherence to socially oriented market economy and a strong social policy, which takes into account the demographic structure of the nation, it has become increasingly reluctant to give up ownership control over large enterprises and determined to increase privatization revenues[18]. Apparently, Uzbek government perceives that by maintaining ownership control over enterprises, it could avoid increase in unemployment. It seems that Uzbek government also expects that a privatization windfall would assist in easing budget deficit and help meet increasing amount of external debt obligations.

[18] It should be noticed that the two tasks do not seem to reconcile with each other well. One can not have their cake and eat it.

BIBLIOGRAPHY

1. Bohm, A., and Simoneti, M. (1994) *Privatization in Central and Eastern Europe.* Ljubljana: C.E.E.P.N..
2. De Melo, M. C. Denzier and A. Gelb (1996), “Patterns of transition from plan to market”, *World Bank Economic Review*, 10, 397-424.
3. P. Desai ed. (1997), “Going global: Transition from plan to market in the world economy”. Cambridge and London: MIT Press.
4. EBRD Transition Report, 1997, London.
5. EBRD Transition Report, 1999, London.
6. Earle, J., Frydman, R. and Rapaczynsky, A.(1993*).* ***Privatization in the transition to a market economy: studies of preconditions and policies in Eastern Europe*.** London: Pinter.

7. Iatridis, D. and Hopps, J. (1998) *Privatization in Central and Eastern Europe: perspectives and approaches.* Westport, Conn.; London: Praeger.

8. B. Islamov (1998), “State-Led Transformation and Economic Growth in Central Asia: From Plan to Industrial Policy”. *Hitotsubashi Journal of Economics;* 39(2), December 1998, pp. 101-25

9. Havrylishyn, O and D. McGettigan (1999) *Privatization in transition countries-sampling of literature*, IMF Working Paper. 99/6

10. Henley, J., (1995) *Restructuring large-scale state enterprises in the republics of Azerbaijan, Kazakhstan, the Kyrgyz Republic and Uzbekistan: the challenge for technical assistance*. Edinburgh: University of Edinburgh, Dept. of Business Studies.

11. Jones, C. (1992) *Privatization in Eastern Europe and Former Soviet Union.* London : Financial Times Business Information
12. Karimov, I (1993) *Uzbekistan – sobstvennaya model perekhoda na rynochnie otnoshenia*, Tashkent.

13. Karimov, I (1992) Uzbekistan: svoi put obnovlenia i progressa, Tashkent.

14. Kaser, M. (1995) *Privatization in the CIS.* London: Russian and CIS Programme, Royal Institute of International Affairs.

15. Kaser, M. (1997) *The economies of Kazakhstan and Uzbekistan.* London: Royal Institute of International Affairs, Russia and Eurasia Programme.

16. Pomfret, R and K. Anderson (1997) *Uzbekistan: Welfare impact of slow transition*, Helsinki: UN University, World Institute for Development Economics Research.

17. Pomfret, R. (2000) The Uzbek model of economic development, 1991-99, *The Economics of Transition*, 8(3), 2000, p.p. 733-748.

18. Rumer, B and S. Zhukov, eds. (1998), “Central Asia: The challenges of independence”. Armonk, N.Y. and London: Sharpe.

19. Wolf, H (1999) Transition strategies, choices, and outcomes*, Princeton Studies in International Finance* 185 Princeton NJ: International Finance Section, Princeton University, June.