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SELECTED ISSUES

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THE SPEED AND SEQUENCING OF REFORMS IN TRANSITION ECONOMIES: IMPLICATIONS FOR THE CASE OF UZBEKISTAN

Uzbekistan has made significant progress in its transition to a market economy since 2017. Key areas of progress are macroeconomic stabilization, trade and exchange rate liberalization, price liberalization, and small-scale privatization where the speed and sequencing of transition reforms are similar to that of other successful transition economies. There are nevertheless challenges with the reform and privatization of large state-owned enterprises, the establishment of a competitive environment with easy market entry and exit, and the reduction and transformation of the role of the state in the economy. Reforms going forward should focus on entrenching macroeconomic stability, completing price and trade liberalization, hardening budget constraints for state-owned enterprises (SOEs) and state-owned commercial banks (SOCBs), strengthening SOE and SOCB corporate governance, accelerating SOE and SOCB privatization, and refocusing the state's role as an enabler of an environment conducive to private sector development.

A. Introduction

1. **Uzbekistan has made significant progress in its transition to a market economy since 2017.** Key achievements were the unification of the official and parallel market exchange rates and elimination of foreign exchange restrictions; the deregulation of prices for most goods and services; the liberalization of trade, including significant progress towards World Trade Organization (WTO) accession; and the commencement of energy sector reform that saw tariff increases combined with protection of the vulnerable. Notable achievements also included tax policy and tax administration reform to reduce the tax burden on the private sector; an expansion of the coverage of the social safety net; the introduction of comprehensive public financial management reforms to strengthen fiscal transparency and discipline; and the strengthening of monetary policy transmission and central bank governance.

2. **As a late reformer, Uzbekistan can benefit from the experiences of other transition economies.** Important aspects of these experiences are reform sequencing and the speed of reform implementation. Appropriate reform sequencing and pacing can reduce the risk of unintended consequences and reform reversals. They can also help ensure that necessary basic institutional reforms are put in place to support economic transformation while preventing vested interests from perpetuating costly inefficiency and protraction in reform processes, leading ultimately to better and more inclusive growth outcomes.

3. **In this context, this paper seeks to compare the speed and sequencing of reforms of Uzbekistan's transition with that of other transition countries to inform its reform process going forward.** The paper draws on the academic literature and transition country experiences in implementing key transition reforms to identify strengths and weaknesses that could help guide the

focus of reform implementation in Uzbekistan going forward. Section II discusses insights from the academic literature on the transition process and on the speed and sequencing of reform implementation. Section III discusses the latter in a sample of 23 transition countries covered by the European Bank for Reconstruction and Development (EBRD) transition indicators. Section IV compares Uzbekistan's recent transition experience with that of other transition economies, and Section V concludes with policy implications.

B. Academic Literature on the Transition Process and Sequencing and Speed of Reforms

4. Havrylyshyn (2001) describes the basic transition conceptual model from selected seminal writings. These include Kornai (1994) who highlights two key changes that are needed for the transition from a centrally planned economy to a market one to occur: (1) forcing a move from a sellers' market to a buyers' market (via the implementation of economic reforms such as price liberalization), and (2) enforcing a hard budget constraint on state-owned enterprises (SOEs) and banks (SOCBs) (i.e., eliminating various forms of government support, such as budget subsidies, directed low-cost loans, and tax exemptions, to ensure SOEs and SOCBs are viable without support) while implementing institutional reforms such as large scale privatization. These changes provide incentives for profit-maximizing market behavior which then lead to what Blanchard (1997) describes as the core processes through which transition occurs. These are reallocation of resources from old to new activities (via closures and bankruptcies combined with establishment of new enterprises); and restructuring within surviving firms (via labor rationalization, product line change, and new investment).

5. Fisher and Gelb (1991) identify in more detail the key economic and institutional reforms needed to stimulate the transition process described above. Economic reforms refer to macroeconomic stabilization, price liberalization, trade and foreign exchange liberalization, and small-scale privatization. Institutional reforms refer to more complex reforms which require stronger institutional development for implementation. These are large-scale privatization, governance and enterprise restructuring, establishing a competitive environment with easy market exit and entry, and reducing and transforming the role of the state. More specifically:

- **Macroeconomic stabilization** is the process by which inflation is brought under control and lowered over time. The process usually requires fiscal consolidation, discipline over the growth of money and credit, and progress towards a sustainable balance of payments.

- **Price and market liberalization** refers to eliminating restrictions, controls, or the direct setting of prices of goods and services in the economy so that they can be determined by supply and demand forces. This allows prices to incentivize an efficient allocation of resources and encourage investment.

- **Trade liberalization** refers to reducing international trade barriers such as tariffs, quotas, and other non-tariff barriers more generally such as cumbersome customs procedures for export and imports and payment restrictions. **Exchange rate liberalization** means allowing the exchange rate to be determined by the supply and demand for foreign exchange, facilitating international trade. Both these reforms help increase competition from international markets, improve economic efficiency, and encourage investment.

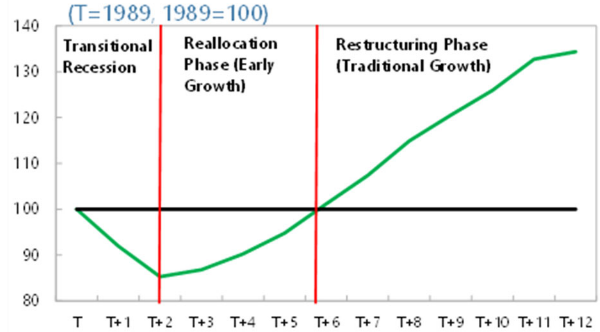
- **Restructuring and privatization of state-owned enterprises.** Restructuring refers to the process of reforming SOEs and SOCBs to create commercially oriented non-financial and financial enterprise sectors that produce goods and services that can be sold in free markets. Privatization refers to the sale of SOEs, SOCBs, and state assets more generally to private owners. Privatization helps increase the importance of the private sector in the economy, which by responding efficiently to price signals, contributes to improve the allocation of resources.

- **Establishing a competitive environment with easy market entry and exit.** This includes reforming key markets in the economy such as product markets, labor markets, and those in key network industries—such as transportation, telecommunications, energy, and finance—so that competition and easy entry and exit prevail in as many markets as possible while appropriately regulating markets as warranted (e.g., natural monopolies). The competitive environment gives restructured and privatized enterprises incentives to operate efficiently and allows non-economically viable businesses to exit the market so that resources can be efficiently rechanneled to viable ones.

- **Reducing and transforming the role of the state.** The state has to be transformed from a central planner overseeing all aspects of the economy to an agent supportive of an environment conducive to private sector growth. The latter role involves providing macroeconomic stability, a stable legal framework, enforceable property rights, and occasionally, acting to correct market imperfections including through the provision of public goods. In order to ensure such provision, the state needs to raise revenue efficiently and spend productively. Legal reforms, such as those establishing the rule of law and introducing appropriate competition policies, are also needed to redefine the role of the state.

6. The implementation of these transitional reforms has implications for the path of growth during transition. First, the state-owned firms initially dominating the economy and producing goods and services not desired by households will face a decline in sales. Hard budget constraints will force them to respond to the change in relative prices generated by price liberalization by reducing production, triggering an output decline in the economy (i.e.,

Stylized Transition Process
(T=1989, 1989=100)



the transitional recession)[1]. Further elimination of waste, which typically precedes the creation of the new private sector, compounds the output decline. Second, the growth of new private firms will not be significant until the new incentives are in place and made credible. Therefore, the sooner prices are liberalized and hard budget constraints established, the sooner the reallocation of resources, the restructuring of state-owned firms, and the creation of new private sector production can occur. The lag between the time prices are liberalized and budget constraints hardened and the coming on stream of the new private sector production can be attributed to the "disorganization" effect of Blanchard and Kremer (1997), as central planning mechanisms are not immediately replaced by market coordination mechanisms. Third, because of this process which starts with the transitional recession, growth early in the transition tends to arise primarily from efficiency gains from the reallocation of existing resources (i.e., recovery of unutilized capacity and optimization of production, use of factor inputs, and consumption) and later on from traditional factor accumulation in the restructuring phase which requires significant investment.

7. The transition literature debates what the most appropriate speed and sequence of transition reforms are. The goal is to minimize the depth and duration of the transitional recession and ensure sustained and inclusive growth thereafter. The debate on sequencing stems from an inability to eliminate all distortions simultaneously due to adjustment costs and/or political, institutional, and administrative constraints. This forces a decision on which reforms are better to implement first and which later and an assessment of the extent to which one reform is a pre-condition for another. The combination of adjustment costs and constraints, which vary from country to country, determine the speed at which reforms can be implemented. The speed and sequencing of reforms in the transition literature were usually discussed in terms of whether a shock therapy approach (also referred to as Big Bang) or a gradualist approach to reform implementation was more desirable:

- **The Shock Therapy approach** consists of rapid implementation of a comprehensive package of economic reforms and basic institutional reforms (i.e., the building of essential market institutions), to enhance credibility and leverage momentum for rapid change. Credibility is enhanced by pursuing a comprehensive reform package because measures are complementary, offsetting negative effects of other measures in the package (e.g., adverse price liberalization effects on inflation may be offset by tight fiscal and monetary policies). Sachs (1996) posits that immediate liberalization can lead to faster economic recovery and growth but has higher risks of social backlash which may lead to reform reversal. Other authors such as Nsouli, Rached, Funke (2005) highlight the risk that gradualism could contribute to the buildup of vested interests that may make implementing reforms more difficult or even lead to reform reversals and failure.

[1]The depth of the transitional recession depended in part on the initial conditions faced in a given transition economy. The higher the degree of specialization of production (i.e., the existence of a large industrial sector producing few outputs and depending exclusively on inputs from other soviet republics) and the lower the availability of exportable commodities (e.g., agricultural commodities or natural resources) which could soften the impact of the Soviet Union collapse, the higher the likelihood of a larger transitional recession, all other things constant.

Therefore, they view the shock treatment as having political economy advantages in terms of not allowing time for such counterproductive vested interests to develop.

- **The Gradualist approach** argues for a step-by-step approach to transition, allowing for adjustments based on outcomes and learning over time. In particular, authors such as Roland (2000) highlights the importance of implementing institutional reforms as a precondition for successful market reforms while others such as North (1990) notes the importance of institutions to help mitigate risks associated with rapid changes. Blanchard and Kremer (1997) argue that gradual reforms can lead to more stable transitions given that they reduce the risk of reform reversal.

8. The sequencing of the several economic and institutional reforms is also discussed in the academic literature in the context of emerging and developing countries more broadly. Agenor and Montiel (2015) provide a survey of this literature and, while there is no one size fits all reform sequence for all countries[2], they broadly suggest the following stylized sequence of desirable reform implementation:

- **Macroeconomic Stabilization.** This reform is usually considered a necessary condition to successfully implement and/or credibly sustain other reforms and therefore is implemented first. For example, financial and trade liberalization cannot be credibly implemented and risk reversals, if financial repression or trade tariff revenue is relied upon to finance fiscal imbalances. The relative price signals from price liberalization may not be easily interpreted by economic agents if inflation is high. Opening the capital account, which would allow households and banks to invest in foreign assets, may also not be desirable if the inflation tax is needed at least temporarily to finance the government as it would erode the inflation tax base, making inflation stabilization more difficult. In addition, macro instability could also result in capital outflows with damaging effects. Fiscal strength is usually needed to buffer external shocks, implement reforms such as cleaning up bank balance sheets as part of a comprehensive financial sector reform, or fund severance packages for redundant SOE employees.

- **Trade liberalization.** This reform should ideally be accompanied by a real exchange rate depreciation that stimulates exports and dampen imports to compensate for the impact of the liberalization and ensure the export sector is not hurt. It should therefore normally precede the opening of the capital account of the balance of payments which in many circumstances is accompanied by capital inflows that typically lead to a real exchange rate appreciation, especially since financial markets adjust faster than goods and services markets. Trade liberalization should also normally precede financial sector reform as it increases competition and contributes to eliminate price distortions that could lead to credit misallocation.

[2] The Theory of Second Best implies that the optimal reform sequence for each country will ultimately depend on the nature of the distortions each country faces in key markets as the elimination of a distortion can make another one worse more than offsetting the benefits from eliminating the initial distortion.

- **Financial liberalization.** This refers to freeing domestic interest rates, increasing reliance on indirect instruments of monetary policy, and strengthening financial institutions including with proper regulation and supervision. The reform should ideally start by strengthening regulation and supervision given that they take time. Moreover, it helps reduce the risk of over-intermediation and moral hazard once interest rates are market determined and the capital account is opened. Financial sector reforms should ideally be preceded by real sector reforms, such as restructuring and privatization of SOEs so that financial institutions face lower credit risk, and price liberalization, to limit price distortions that could lead to credit misallocation.

- **Capital account liberalization.** This refers to opening the capital account of the balance of payments to portfolio investment and short-term capital flows (opening to trade related financing and FDI may happen earlier together with trade liberalization). This reform should ideally happen after all the other reform types discussed above are implemented for the following reasons:

- *The adverse impact of financial sector distortions may be amplified by capital flows.* Repressed interest rates and uncertainty about sustainability of reforms may lead to capital outflows and capital inflows may result in magnification of resource misallocation and over-intermediation. Insufficient financial development would also make the management of inflows and outflows harder (e.g., sterilization) and increase the risk of boom-and-bust cycles.

- *The success of trade liberalization may be undermined and could lead to undesirable external borrowing.* As discussed earlier, capital account liberalization could lead to a real exchange appreciation and may put pressure to reverse trade liberalization. If trade liberalization is not credible and thus viewed as temporary, capital account liberalization may lead to unsustainable borrowing.

9. To summarize the above discussion, the academic literature tends to highlight trade-offs involved with reform speed and provides some guidance on how to sequence reforms:

- Shock therapy proponents argue for faster and more comprehensive reform implementation to achieve faster growth, as too slow of a reform pace may facilitate capture of the reform process by vested interests risking not only reform reversals but even reform failure. They usually acknowledge though the risk of social backlash in the near term. The gradualists instead emphasize the importance of building up institutions which would lead to a more gradual growth pickup and but one that is more likely to be durable and less subject to reform reversals.

- While in theory the optimal sequence of reforms depends on what the relevant distortions are, there is some consensus in the literature that macroeconomic stabilization should ideally be implemented first, reforms that liberalize the real sector (i.e., price liberalization, trade liberalization, restructuring and privatization of state enterprises) should be implemented before reforms that liberalize the financial sector, and the latter before capital account liberalization.

C. Speed and Sequence of Transition Reform Experiences

10. This section uses EBRD transition indicators to measure the speed and sequence of implementation of transition reforms. EBRD transition indicators are widely used because they are available continuously from the start of transition in 1989 and in many cases until 2014 or 2016 depending on the indicators with relatively minor changes in the methodology, providing a consistent picture of reform during the first 25 years of transition. Indicators range from 1 to 4.3, with 1 representing little or no change from a centrally planned economy and 4.3 representing the standards of an industrialized market economy.

11. The indicators cover progress with both economic reforms and institutional reforms (Figures 1-3). Economic reforms covered are price liberalization, trade and foreign exchange liberalization, and small-scale privatization. Institutional reforms covered are large scale privatization, governance and enterprise restructuring, competition policy, banking reform, reform of securities markets and non-bank financial institutions, and infrastructure reforms.

12. Following Havrylyshyn (2016), the country grouping reflects the speed of transition in the first years after the collapse of central planning. The Baltic and some Central and Eastern European countries (CEE) were among the early shock therapy reformers—they are labelled "Sustained Big Bang" but are included in two separate groups (see text table). Other CEE countries started from a more advanced position but did make not as much progress in the early years as the above two groups. However, they later caught up and are included in the "Advanced Start/ Steady" reform group. The remaining three groups of transition countries capture countries that aborted shock therapy approaches to reform, that were gradualist reformers, and that implemented limited reforms throughout the first 25 years of transition.

Table 1. Uzbekistan: Typology of Transition Economies Depending on their Initial Transition Strategies

Sustained Big Bang (CEE)	Sustained Big Bang (Baltics)	Advanced Start/Steady	Aborted Big Bang	Gradual Reforms	Limited Reforms
Czeck Republic	Estonia	Croatia	Albania	Azerbaijan	Belarus
Poland	Latvia	Hungary	Bulgaria	Armenia	Uzbekistan
Slovakia	Lithuania	Slovenia	Macedonia	Georgia	Turkmenistan
			Kazakhstan	Kazakhstan	
			Russia	Ukraine	
				Tajikistan	
				Romania	

Source: Havrylyshyn (2016)

13. Transition indicators suggest the following stylized facts about the outcomes of different reform approaches (Figures 1-3):

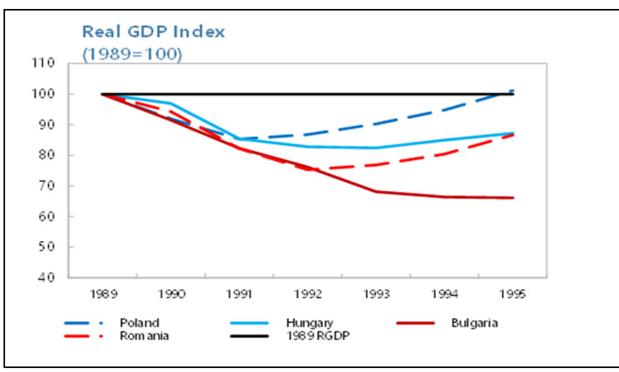
- **With the exception of limited reforms countries, transition countries completed economic reforms first irrespective of the reform approach although with significant differences in speed.** Sustained shock therapy and advanced start countries had already largely completed these reforms (i.e., achieving a score of about 4) by 1995 while those that aborted shock therapy reforms completed them by the end of the 1990s. It took gradualist countries one more decade than the sustained shock therapy transition countries to complete these reforms.

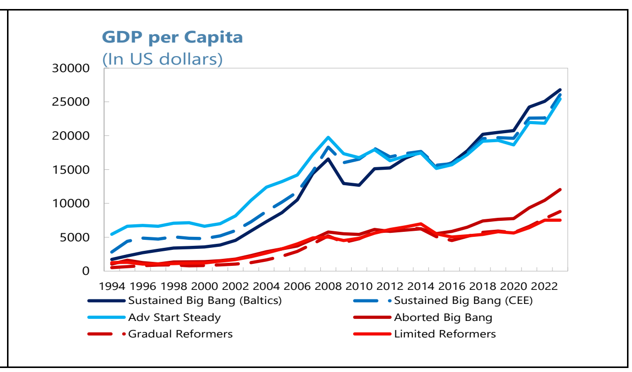
- **Institutional reforms were significantly more difficult for transition countries to complete than economic reforms.** Data show that even the most successful transition economies had not come close to achieving scores in this area as impressive as they achieved in the area of economic reforms in the period covered. It took about 10 years, on average, for the most successful sustained shock therapy countries since they started their transition to complete large scale privatization and about 20 years or more to get close to completing governance and enterprise reform, competition policy reforms, banking sector reform, and infrastructure reform. Progress in reforming the non-bank financial sector was the slowest with advanced economy standards still not achieved by the end of 2016.

- **Countries that were the most successful in implementing economic reforms were also the most successful in implementing institutional reforms.** While institutional reforms were more difficult for all transition countries, sustained shock therapy countries, advanced start countries, and even aborted shock therapy countries tended to outperform gradualist reform countries in achieving institutional reform progress. In fact, the data suggest that gradualist reform countries never caught up with shock therapy countries in terms of institutional reforms.

- **There are sharp divergences in terms of reform implementation between the most successful reformers (i.e., shock therapy) and the slower ones (i.e., gradualism and limited reforms).** While most ex-central planning countries covered in this paper started from a similar position and far from that of a market economy, by the mid-1990s the differences among them were already large and did not shrink over time. Countries that led from the start continued to move resolutely forward, while the more gradual reformers could not catch up.

14. The significant differences in reform implementation during transition are mirrored by differences in GDP per capita outcomes. Successful early implementation shock therapy approach countries tended to have shallower recessions and were the first to experience an economic recovery, minimizing the social costs of transition over time (left text chart). Their more rapid reform pace reduced central planning-related inefficiencies the fastest and helped them achieve the highest GDP per capita increases (right text chart). Moreover, Havrylyshyn (2016) argues that this





overperformance is also mirrored in non-GDP measures of outcomes over time such as the UN human development index and other social outcome indicators, such as income inequality and poverty ratios.

15. The aborted big bang country cases further highlight the risks that incomplete reform packages pose to the effectiveness of big bang reform implementation. Beyond the fact that successful shock therapy countries had more comprehensive reform packages, cases studies within aborted big bang countries provide examples of incomplete reform packages that include privatization without elimination of soft budget constraints and inadequate rule of law, and subsidy reform with inappropriate support for the vulnerable. These illustrate how incomplete reform packages can derail macroeconomic stabilization, facilitate capture by vested interests, and/or generate resistance by groups that, if sufficiently powerful, can derail reform.

D. Uzbekistan's Transition Progress

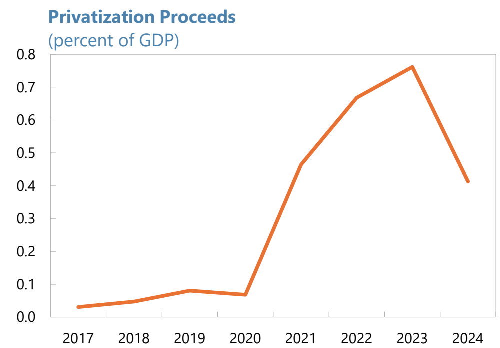
16. The strengths of Uzbekistan transition progress since 2017 are in the area of economic reforms. These reforms are proceeding in a broadly similar pace and sequence as that pursued by successful transition economies:

- **Macroeconomic stabilization.** Growth has been rapid and resilient while inflation has been gradually brought down thanks to tight monetary policy and fiscal consolidation with headwinds from still ongoing necessary price liberalization. The current account deficit has grown in recent years mainly reflecting robust capital flows funding investment, but also due to some distortions created by temporary reductions in custom duties and some financial sector programs that incentivized car and machinery imports. The latter have been appropriately mitigated with macroprudential measures and the current account deficit declined to 5 percent of GDP in 2024 and is expected to remain around these levels over the medium term.

- **Trade and Exchange rate liberalization:** In 2017, the official and parallel market exchange rates were unified, foreign currency surrender requirements were abolished, existing exchange rate restrictions were eliminated, and trade barriers were reduced. In particular, the average tariff was reduced by 50 percent, mixed and compound tariffs were replaced by ad valorem ones, some discriminatory excises on imports and export permit requirements for most goods were eliminated, customs procedures were rationalized to reduce clearance times, and the WTO accession process has gained momentum and is currently advancing rapidly.

- **Price liberalization:** Prices of most goods and services have been liberalized with the exception of energy, public transport, and utility prices, including water and heating tariffs. These tariffs, along with electricity and gas tariffs, have been raised in recent years, but they still remain administratively determined and below cost recovery.

- **Small scale privatization.** Before the acceleration of Uzbekistan's transition to a market economy in 2017, the EBRD small scale privatization indicator was at 3.3 in 2014 as compared to 4, which signifies a largely completed process. Moreover, data available since 2017 indicate significant increase in privatization proceeds, which also capture progress with the sale of other types of state assets such as buildings and non-agriculture land.



Source: Mininstry of Economy and Finance

17. There are nevertheless challenges with institutional reforms which are proceeding slower than in other successful transition economies (World Bank (2021)):

- ***Reform and Privatization of large state-owned enterprises.*** SOEs are dominant in strategic sectors—including oil and gas refining, power generation and transmission, transportation (airlines, railways, public transportation), metallurgy, mining, telecommunications, and the automobile industry—and operate in sectors that are primarily private in market economies, such as agriculture, chemicals, metal production, and machine building. While some SOEs in energy, railways, and chemicals sectors went through institutional restructuring to separate regulatory and operational activities, and their exclusive rights to certain markets were removed, the dominant position that major SOEs still benefit from allows them to exercise monopoly power and limit the entry of private firms in their sectors.

  Large-scale privatizations remain limited. While newly adopted legislation[3] implied that privatization of major enterprises in several sectors (energy, natural resources, chemicals, vehicle manufacturing, transportation, agriculture, and financial) is possible, few large SOEs and SOCBs were privatized. Notable cases include Coca-Cola Bottlers Uzbekistan, Ipoteka Bank, "Ferganaazot", a major fertilizer producer, and Qizilqumsement and Ferghana Oil Refinery Plant. The overall process has faced challenges, with concerns over its pace, fairness, and transparency. While the privatization strategy 2021-2025 aimed to reduce the number of SOEs by 75%[4], the overall number of SOEs (i.e., Joint Stock Companies, Limited Liability Companies) remained largely unchanged[5], leading to the adoption of new measures to accelerate the process in February 2025[6]. Delays in restructuring, capacity constraints, and external shocks (i.e., the COVID-19 pandemic and the war in Ukraine) have complicated privatization of major enterprises. The process of privatization has therefore been slower than in other successful

[3] Article 19 of the Law "On state property management" (No. LRU-321 dated 09.03.2023) approved the list of state assets not to be privatized.

[4] See UzSAMA description of the main elements of the SOE reform strategy.

[5] Report of the State Assets Management Agency of the Republic of Uzbekistan on the activities in 2024 regarding the management of state-owned enterprises, privatization of state assets, and other areas, page 12 Link

[6] See UzSAMA description of new measures to reduce the number of entities with state participation.

transition economies as large-scale privatization has barely begun 7 years after the acceleration of transition began[7].

SOCBs operate as agents of government programs and disproportionately lend to SOEs in sectors considered strategic, crowding out access to credit to sectors that are not. SOCBs conduct only a limited assessment of borrowers' repayment capacity when originating preferential loans, mostly checking compliance with program eligibility criteria. This practice reflects the government mandate to grant those loans and SOCBs rely on frequent capital replenishment by the state when liquidity or capital shortfalls emerge. Even though Ipoteka and 2 small SOCBs were privatized in 2023-24, the financial sector remains dominated by SOCBs (9 of 36 banks), accounting for about 65 percent of commercial banks' assets.

Corporate governance remains problematic in both SOEs and SOCBs as it enables significant government intervention in their decisions and operations. Supervisory boards of major SOEs and SOCBs commonly include high-level government officials and representatives of relevant ministries. Moreover, these boards do not appear to have operational autonomy in appointing members of the management board and the company CEO, which ultimately need the approval of the highest levels of government (e.g., Cabinet of Ministers). The concept of an independent board director was introduced with a target of achieving 30 percent of independent board members by end 2025[8]. Nevertheless, the impact this had on operations remains unclear. More generally, despite significant progress in introducing a formal governance structure, there exist multiple further governance mechanisms and policies that significantly influence the performance and day-to-day operations of SOEs and SOCBs. The existence of such mechanisms likely restricts the ability of SOEs and SOCBs to flexibly use their resources and effectively react to market signals.

- ***Establishing a competitive environment with easy market entry and exit.*** The degree of competition in Uzbekistan's product markets is perceived as weak compared with key peers. The entry of new firms remains well below the averages for Europe and Central Asia and is lower than predicted by its income per capita. Post-entry firm performance has also been sluggish, with formal private firms staying small as they age. SOEs often enjoy advantages over private firms such as preferential access to land (e.g., highly prospective mining exploration land is retained by mining SOEs), cheap domestic and foreign finance (e.g., directed lending by SOCBs to SOEs and the extension of government guarantees to facilitate SOE international borrowing) and exclusive rights to certain markets not allowing a level playing field with private firms.

[7] In Estonia and Poland, the first year of transition was dedicated to market liberalization, small scale privatization, the building of essential market institutions, and controls on medium/large SOEs to forestall asset stripping. During years 2-3, market institutions were further developed and medium/large privatizations started. During year 4, large/medium privatization continued, and best corporate governance practices were introduced for all remaining SOEs.

[8] No. 166 of 29.03.2021. On approval of the Strategy for the Management and Reform of State-owned Enterprises for 2021-2025

While the private sector has expanded in recent years, there are no reliable statistics on its actual share in the economy as official figures classify SOEs as private companies. The private sector is largely composed of small firms including due to tax system incentives for firms to split as it favors SMEs. Moreover, given the SOE dominance of many sectors, private companies are focused on their relationships with SOEs, are insufficiently exposed to international trade, and are not well integrated in global supply chains thus limiting technology transfer and productivity growth. Foreign ownership of private businesses has increased by 26 percent over the last five years, though at end 2024, the combined number of foreign enterprises (10,906) and joint ventures (3,965) still remains low at 3.5 percent of total number of operating enterprises[9]. The fact that firms are struggling to grow suggests that their productivity and performance are not being rewarded. This reflects the existence of a distortive business environment that impedes the allocation of resources toward firms with higher productivity and growth potential likely linked to the still large role of the state in the economy and insufficient progress with restructuring of SOEs and privatization. A large informal sector is also signaling that firms do not have sufficient incentives to become formal. Kaufmann and Johnson (2000) in their study of informal sectors in transition economies suggest that high levels of informality are usually correlated with overregulation, weak legal systems, and corruption.

- ***Reducing and transforming the role of the state.*** The large role of SOEs in the economy combined with the direct government intervention in the operations of SOEs and SOCBs and ad hoc interventions in the economy more broadly suggests that significant progress is needed to transform the state into an agent that uses policy levers and regulation to indirectly support a growth friendly business environment.

E. Policy Implications for Reform Implementation Going Forward

18. After significantly advancing economic transition reforms since 2017, Uzbekistan needs to complete their implementation and accelerate the implementation of institutional reforms. The experience of the most successful transition countries illustrates the enormous costs in terms of GDP per capita and welfare more broadly of delays in implementing transition reforms. Developments so far and the insights from the academic literature and transition experiences suggest the following policy implementation priorities going forward:

- **Entrenching macroeconomic stability.** In a context of strong economic activity, the planned fiscal consolidation should be fully implemented and sustained. It should be complemented by restrictive monetary policy to lower inflation to the CBUs 5 percent target and address inflation pressures from the need to continue liberalizing remaining administered prices that remain below cost recovery levels. This macro-policy mix should be accompanied by key fiscal structural reforms (discussed in the fiscal policy section of the staff report) and by institutional reforms that drive SOEs and SOCBs to operate commercially irrespective of whether they are expected to be privatized or remain in the state portfolio. These measures, combined with an acceleration of

[9] Information on demography of enterprises and organizations in the Republic of Uzbekistan, Statistics Agency under the President of the Republic of Uzbekistan, December 2024, link, page 26.

privatization of large state-owned enterprises, will contribute to reduce fiscal risks that threatened consolidation plans in other transition economies.

- **Completing price liberalization and trade liberalization.** The remaining administered prices should be increased to cost recovery levels and then adjusted based on proper regulation. The WTO accession process should also be completed as it will facilitate the reduction of trade barriers and thereby increase external competitive pressure on the economy, contributing to increased efficiency. However, price and trade liberalization reforms may have significant distributional effects. As the recent experience of adjusting electricity and gas prices illustrated, providing compensation to those who may be adversely impacted temporarily by reform as needed, especially the vulnerable, is critical for successful reform implementation.

- **Hardening budget constraints for SOEs and SOCBs to incentivize resource reallocation and restructuring.** The diverse forms of support to SOEs and SOCBs should be made transparent and be gradually phased out to put pressure on these enterprises to restructure and improve their efficiency. SOEs should also not receive any form of soft loans and recapitalization of SOCBs should only be provided conditional on them implementing a restructuring plan that ensures their viability and avoid further recapitalization needs. This is essential to level playing field with the private sector. At the same time, the cost of public service obligations that SOEs and SOCBs are carrying out of behalf of the state should be fully quantified and appropriately compensated by the budget and transferred to it over time. If as a result of the quantification the extent of support is not affordable, these public service obligations should be appropriately phased out.

- **Strengthening the corporate governance of SOEs and SOCBs and eliminating state intervention in their operations.** Supervisory board autonomy should be strengthened and the process to appoint members to SOEs and SOCBs supervisory boards should be reformed to ensure that qualified and independent professionals are appointed with a mandate to ensure that the entities are run on a commercial basis. SOE and SOCB managements should be in charge of the operations focused on meeting well defined commercial objectives in their corporate plans without any form of direct state intervention. Proper financial reporting and performance management mechanisms in the largest SOEs should continue to be strengthened. Any instrument of direct state control should be abolished.

- **Accelerating the privatization of large SOEs and SOCBs following international good practices.** This refers to: (1) selling enterprises in an open, transparent manner with valuation procedures that correspond to international standards of practice; (2) involving internationally recognized financial advisers; (3) fully disclosing all relevant information to all bidders with no restriction on the number or nationality; and (4) after the sale, posing no restrictions on the buyers such as taking over labor and social obligations because the cost of not restructuring is way higher for growth. The new owners should have full control of their companies so that they can restructure them appropriately.

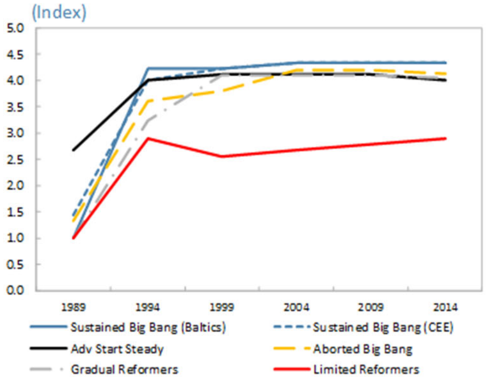
- **Stimulating the growth of a vibrant private sector by facilitating entry and exist, reducing incentives for informality, and promoting a sound business environment.** Barriers to entry of new domestic and foreign private sector firms such as bureaucratic hurdles, complex laws and regulations, and lack of access to bank credit should be addressed. This would also improve incentives for firms to operate in the formal sector. Administrative reform needs to deepen, and the various state agencies need to coordinate better to free the private sector from having to deal with a multitude of regulatory bodies and contradictory regulations. Effective bankruptcy procedures should be put in place to facilitate exit and allow unprofitable firm resources to be efficiently reallocated. Artificial tax disincentives to firm growth should also be eliminated. A vibrant private sector is essential to facilitate restructuring of state-owned enterprises by facilitating the reemployment of displaced workers.

- **Reducing and transforming the role of government.** The state must leave behind discretionary direct intervention and controls and become an effective regulator and provider of market supporting institutions. This essentially amounts to creating an environment conducive to the efficient functioning of market forces, which is critical to fostering the growth of the private sector and shrinking the informal economy. This also helps reduce the perception of risk, thereby helping to attract foreign direct investment. The state's efforts to create sound laws and regulations to achieve these objectives is one important aspect of what needs to be done. The other is ensuring that there is sufficient institutional capacity in courts and in public institutions to implement them effectively so that they achieve their intended goals.

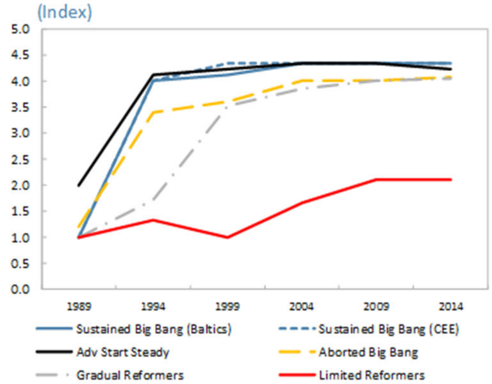
- **Implementing the above structural reforms with strategies that increase the odds of success.** IMF (2023) suggests these strategies are: (1) implementing complementary reforms together; (2) front-loading gains where possible to generate social and political buy in for deeper reforms; (3) addressing distributional impacts by providing targeted support to adversely affected groups; (4) strengthening communication by engaging stakeholders early and explaining benefits clearly; and (5) building capacity to enhance administrative capabilities to implement reforms.

Figure 1. EBRD Core Transition Indicators, 1989-2014

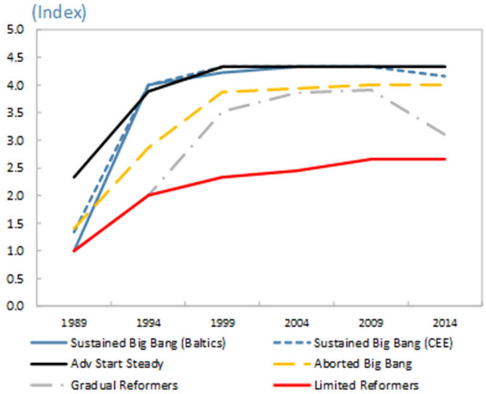
Price Liberalization
(Index)



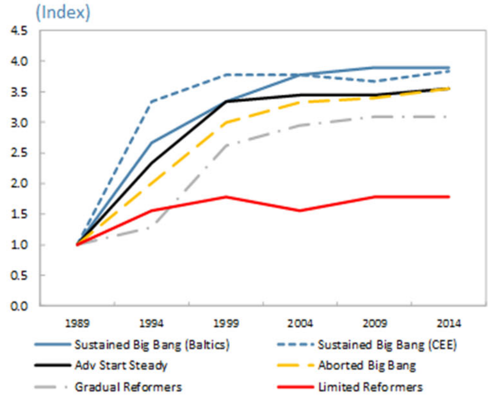
Trade and Exchange Rate Liberalization
(Index)



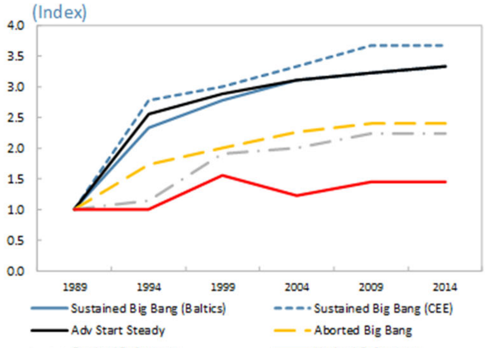
Small Scale Privatization
(Index)



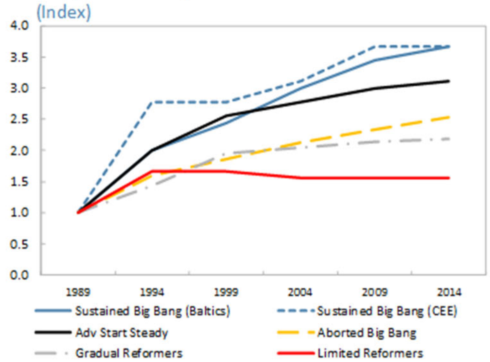
Large Scale Privatization
(Index)



Governance and Enterprise Restructuring
(Index)



Competition Policy
(Index)

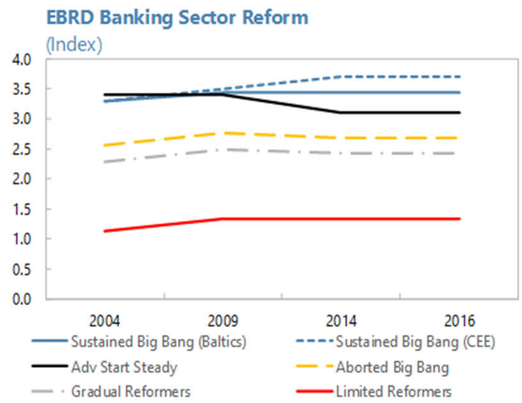


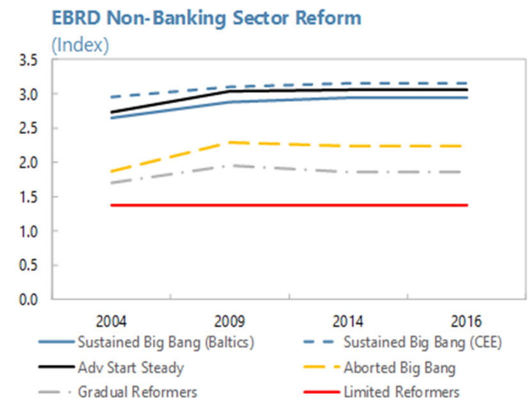
Source: EBRD and IMF Staff calculations.

Figure 2. EBRD Infrastructure Reform Indicators

Source: EBRD and IMF Staff calculations.

Figure 3. Financial Sector Reform Indicators





Source: EBRD and IMF Staff calculations.

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UZBEKISTAN AND PUBLIC-PRIVATE PARTNERSHIPS: COUNTRY LESSONS

Public-Private Partnerships (PPPs) can take advantage of private sector expertise, better risk sharing, improved management efficiency, and private financing to improve public investment projects. However, international experience shows that these benefits are accompanied by risks at both the project and macroeconomic levels. At the project level, risks can include poor project selection, optimism bias, off-budget financing, and renegotiation. Practices that manage these risks include integrating PPP projects into the public investment management system, conducting scenario analysis to stress key assumptions, evaluating costs and risks of PPP projects during the selection process, and creating a framework that minimizes renegotiation of PPP contracts. At the macroeconomic level, explicit and implicit guarantees can create risks if PPP projects perform poorly or accumulate too rapidly. One way countries can avoid and mitigate macroeconomic risks is by implementing an annual cap on new PPP projects and/or a cap on the stock of PPP projects. Having in place a robust system to monitor PPPs also helps ensure their effective implementation and guard against the realization of contingent liabilities.

A. Introduction

1. **Uzbekistan has only recently begun to use Public-Private Partnerships (PPPs) to finance and operate investment projects, but they have grown rapidly.** The value of signed contracts reached 27 percent of GDP, and the authorities estimate that direct and contingent liabilities reached 15 percent of GDP at end-2024. The government also plans to implement significant new PPP projects over the next few years.

2. **While PPPs can help harness the benefits of private sector knowledge and efficiency, international experience also shows that they can create significant risks.** It is therefore important to properly identify and manage these risks to have successful PPPs. This paper discusses key features of PPPs, describes Uzbekistan's framework for PPPs, and their growth in Uzbekistan. The paper also examines some challenges that arise when implementing PPPs, examples from other countries that may be relevant for Uzbekistan, and methods to deal with these challenges to inform current efforts of the authorities to better identify and manage fiscal risks from PPPs.

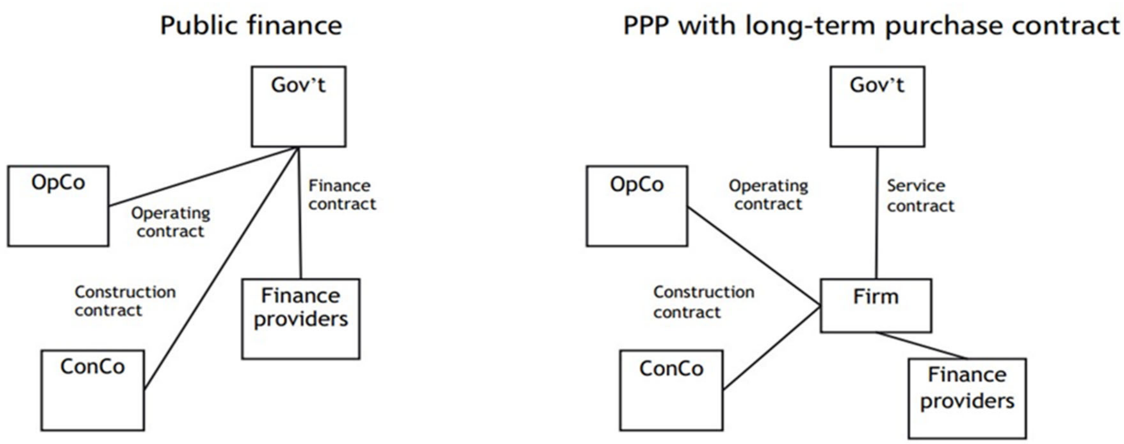
B. The Nature of Public-Private Partnerships

3. **In contrast with the traditional approach where the government handles all stages of a project, under the PPP approach the public and private sectors cooperate to invest and provide services.** Some differences between the public and PPP approaches include:

- **Public:** Under the traditional approach, the government carries out all stages of a project, including obtaining financing, building infrastructure, and operating the project. While a private entity may be contracted to build the infrastructure, the government manages and operates the project over the long term. Funding is provided from budget revenues or borrowing.

- **PPPs**: Under this approach, the government partners with a private entity to finance and manage a project, sharing risks and rewards. The government and private partner usually set up a firm or special purpose vehicle. The PPP firm may bring or attract financing, build the infrastructure, and operate the project (Figure 1). The firm takes advantage of the expertise, financing, and operational efficiencies of the private partner. The PPP receives income from users (e.g., a toll road) or from the government (e.g., an electricity project where the government is the main purchaser).[1] PPPs generally involve long-term contracts (e.g., 25 years). The private partner may or may not have an obligation to transfer ownership to the government at a future date.[2] PPPs have become a popular approach to investment and have been used to build and operate hospitals, schools, prisons, transportation infrastructure, and energy projects, among others.

Figure 1. Structure of Public Investment vs PPPs



Source: Polackova Brixi et al. (2005). "Managing Fiscal Risks in Public-Private Partnerships," p. 142

Benefits of Public-Private Partnerships

4. PPPs have several potential benefits, including by bringing private sector expertise, risk sharing, management efficiency, and additional financing.

- **PPPs can take advantage of private sector expertise**. This can be at the design phase and other phases, for example in providing services, potentially resulting in higher operating efficiency.

- **PPPs share project risks between the public and private sectors**. With public investment the government bears most of the risk (although some risk can be borne by the contractor, e.g., through performance provisions). In principle, the party that has an advantage in dealing with a risk should manage it. Examples include design, input costs, maintenance, and operation.

[1] Fouad, M et al. (2021). *Mastering the Risky Business of Public-Private Partnerships*, p. 10.

[2] Akitoby. et al (2007). *Public Investment and Public-Private Partnerships. International Monetary Fund*, p. 8.

- **PPPs may be attractive because they involve lower near-term financing requirements**. Examples include initial financing for a project, the transfer of land, expenditures on resettlement, the cost of providing infrastructure to the project site, required payments for the goods and services of the PPP, or subsidies.

Drawbacks of Public-Private Partnerships[3]

- **PPPs tend to be more complex than traditional public investment projects**. They involve many stakeholders, entail complex project arrangements, and have special rules or government benefits creating specific costs and risks (Table 1).

- **PPPs can make the consequences of a poor legal framework, project selection, or management worse.** Lack of an adequate legal framework or processes for appraisal, selection, and implementation can result in legal uncertainties and/or inefficient management.

- **PPPs can undermine budget processes.** If PPPs do not require current expenditures from the budget, they can bypass budget controls and seem less expensive than traditional public investment.

- **PPP exacerbate the costs of insufficient competition**: Lack of competition allows the private partner to charge higher than market prices which is more problematic for projects that involve natural or regulatory monopolies.

- **PPPs are not well suited for social infrastructure projects**. Therefore, PPPs work better for projects that have a clear income stream such as infrastructure projects (e.g., toll roads, power generation), compared to projects that do not, such as social infrastructure (e.g., schools). Projects that do not generate a high enough financial return—such as those providing social benefits—may not be attractive to private sector partners or may generate future fiscal liabilities.

- **PPPs can create fiscal illusion.** Governments may be tempted to use PPPs to relax near term budget constraints rather than to improve efficiency. Since PPPs typically involve lower payments in the near term as the private partner brings financing, they may give the impression that costs are lower when they may be more than compensated by considerably higher future costs. Under traditional public investment projects, risks tend to materialize relatively early during the construction phase of a project. Under PPPs, risks tend to materialize later when the PPP is in operation.

[3] This section gives a short overview of PPP risks discussed in the literature. Section C covers specific risks of relevance to Uzbekistan, with examples of the experiences of other countries and possible solutions.

Table 1. Uzbekistan: Common Fiscal Costs and Fiscal Risks from PPPs

	Fiscal Costs	Fiscal Risks
Explicit	• Start up financing • Costs of land, resettlement, need infrastructure before the PPP begins • Payments under Purchase Power Agreements • Operational subsidies	• Explicit guarantees (e.g., financing, revenues, power purchase prices, exchange rate) • Early contract termination clauses • Asset condition at contract termination • Legal disputes
Implicit		• Implicit guarantees: Even without explicit guarantees, the government may need step in to support projects that are not profitable or insolvent.

Source: Adapted from IMF (2021), *Mastering the Risky Business of Public-Private Partnerships in Infrastructure*, Fiscal Affairs Department (FAD) Paper, No. 21/10.

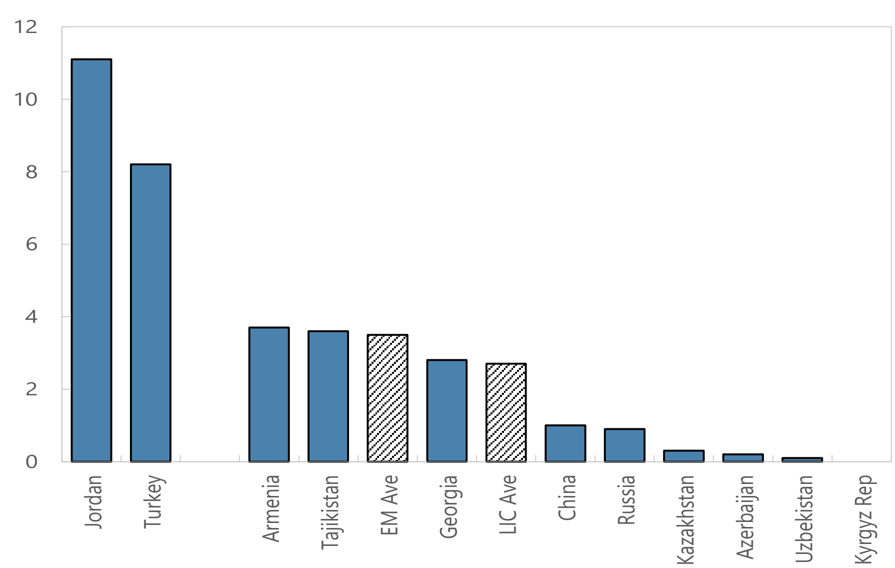
C. Uzbekistan's Experience with PPPs

Size, Sectors, and Pipeline

5. Uzbekistan's stock of PPP projects was initially low relative to other emerging and developing countries but has grown rapidly in recent years (Figures 2 and 3).

- The first PPP projects began in 2018, before the Law on PPPs was enacted.
- By the end of 2019, Uzbekistan had several PPP projects, but they did not comprise a major share of GDP.

Figure 2. Selected Countries: Stock of PPPs in 2019
(Percent of GDP)



Source: World Bank Global Infrastructure Database

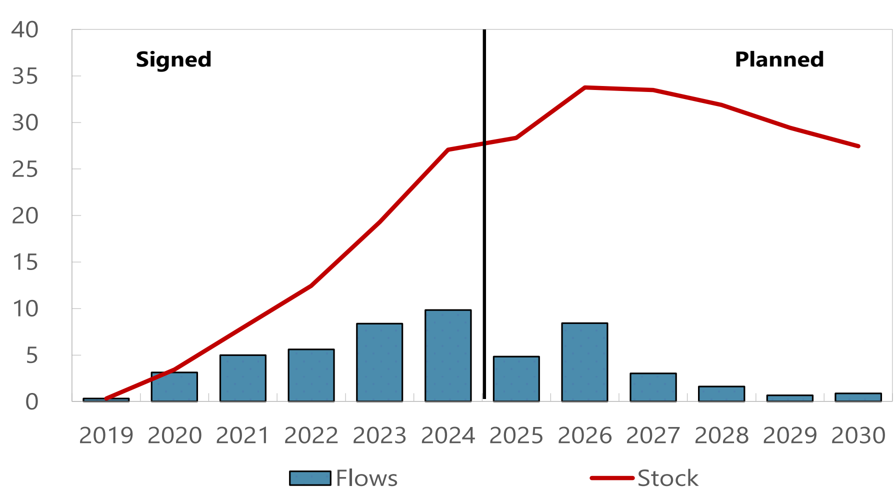
- By end-2021, Uzbekistan had more than 200 PPP projects with a total value of USD 6.2 billion (about 8 percent of GDP). These projects were concentrated almost entirely in the energy sector. The pipeline of projects had also expanded. Nine projects worth USD 1.7 billion were close to signing and 15 projects worth USD 2.2 billion were at the tender stage.
- In 2024, the government signed agreements with a total value of USD 11 billion (10 percent of GDP). And at the end of the year, the value of Uzbekistan's PPPs stood at USD 31 billion (27 percent of GDP). The government estimated that direct and contingent liabilities of PPPs stood at 15 percent of GDP.
- Regarding composition by sector, during 2019-2024 more than 90 percent of the value of these projects was in the energy sector (Table 2 and Figure 4). Information on individual PPP projects can be found on Uzbekistan's Register of PPP Projects website.

Table 2. Uzbekistan: Value and Share of PPP Projects, December 2024
(Percent of GDP)

Sector	USD Mln	Percent of Total
Energy	28,878	93%
Utilities	1,500	5%
Education	144	0.8%
Ecology	116	0.4%
Social	103	0.4%
Other	276	0.9%
Total	**31,118**	**100%**

Source: Ministry of Economy and Finance and IMF staff calculations

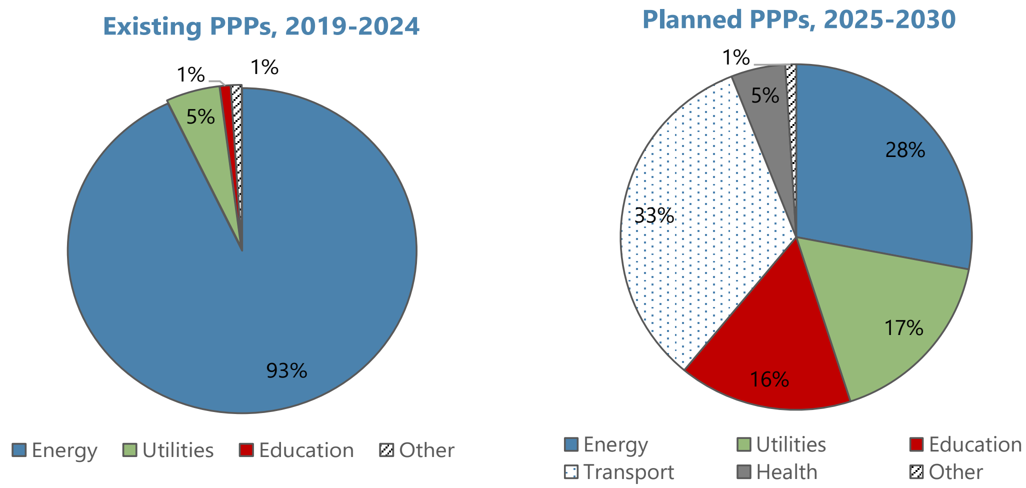
Figure 3. Historical and Planned PPPs, 2019-2030
(Percent of GDP)



Source: Authorities' data and IMF staff calculations, as of April 2025.

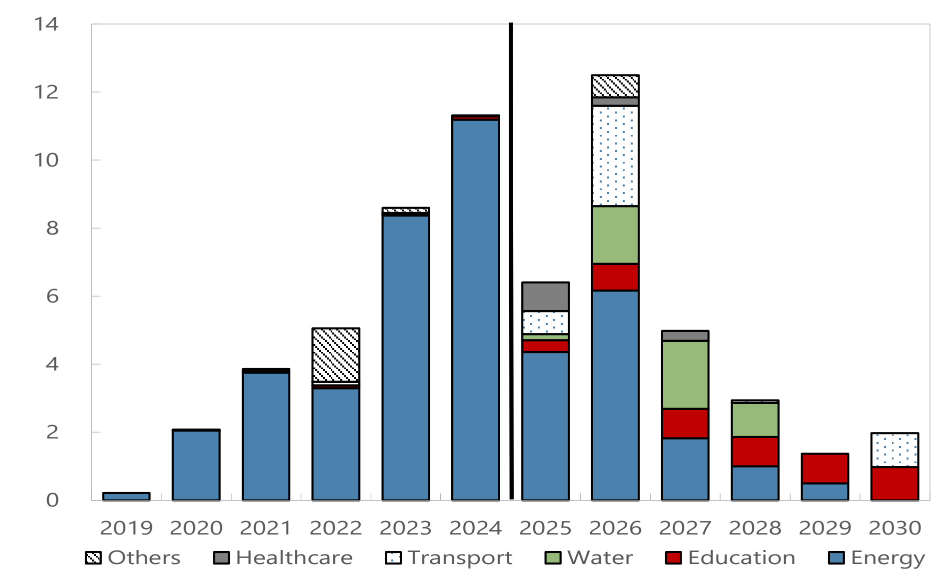
- Looking forward, Presidential Decree 308 presented a list of PPP projects to be completed during 2025-2030 amounting to USD 30.2 billion (Figure 3). If fully executed, the stock of PPPs would rise to 34 percent of GDP at end-2026, before falling to 27.5 percent of GDP in 2030.

Figure 4. Shares of PPPs by Sector
(Percent of Total)



Source: Authorities' data and IMF staff estimates.

Figure 5. Planned Flow of PPPs by Sector and Year of Signing, 2019-2030
(USD billions)



Source: Authorities' data and IMF staff estimates.
Note: Implementation of PPP projects may differ from the plans.

- In the future, it is planned that PPPs will be divided more equally across energy, utilities, education, and transportation, with transportation taking the largest share (Figures 4 and 5). Key projects include the Tashkent-Samarkand and Tashkent-Andijan toll roads. Cabinet resolution 720 broadened the scope of PPP activities. It permits PPPs that produce goods and deliver services traditionally provided by state enterprises and allows PPPs that bring management expertise without private investment.

6. Uzbekistan's scale of PPP development is significantly larger than in other countries. For example, the World Bank reports that in 2023, Uzbekistan signed six PPP projects worth USD 1.6 billion. This comprised almost 40 percent of total commitments to low- and middle-income countries in Europe and Central Asia that year.[4]

Institutional Framework

7. Aside from the line ministries, there are three entities with institutional responsibilities for PPPs. [5]

- The ***Fiscal Risk Assessment Department*** (FRAD) of the Ministry of Economy and Finance collects and monitors data on government fiscal and contingent liabilities from PPPs. It calculates total fiscal liabilities from PPPs on an annual basis and proposes budget limits on PPP guarantees to the Cabinet of Ministers.
- The ***PPP Department*** of the Ministry of Economy and Finance maintains records of payments and guarantees for PPP agreements; assists in calculating fiscal obligations; and assesses the risks, quality, demand, and fiscal commitments of proposed PPPs. It also prepares recommendations and fiscal analysis for the FRAD, ensures projects above USD 10 million are submitted to the Cabinet for approval, and monitors the fiscal obligations in PPP agreements.
- The **Center for PPP Projects** engages with local and international experts, organizes training, and develops PPP initiatives, model agreements, models, and performance standards. It also designs measures to prevent corruption and conflicts of interest in PPP projects.

D. Risks from PPPs

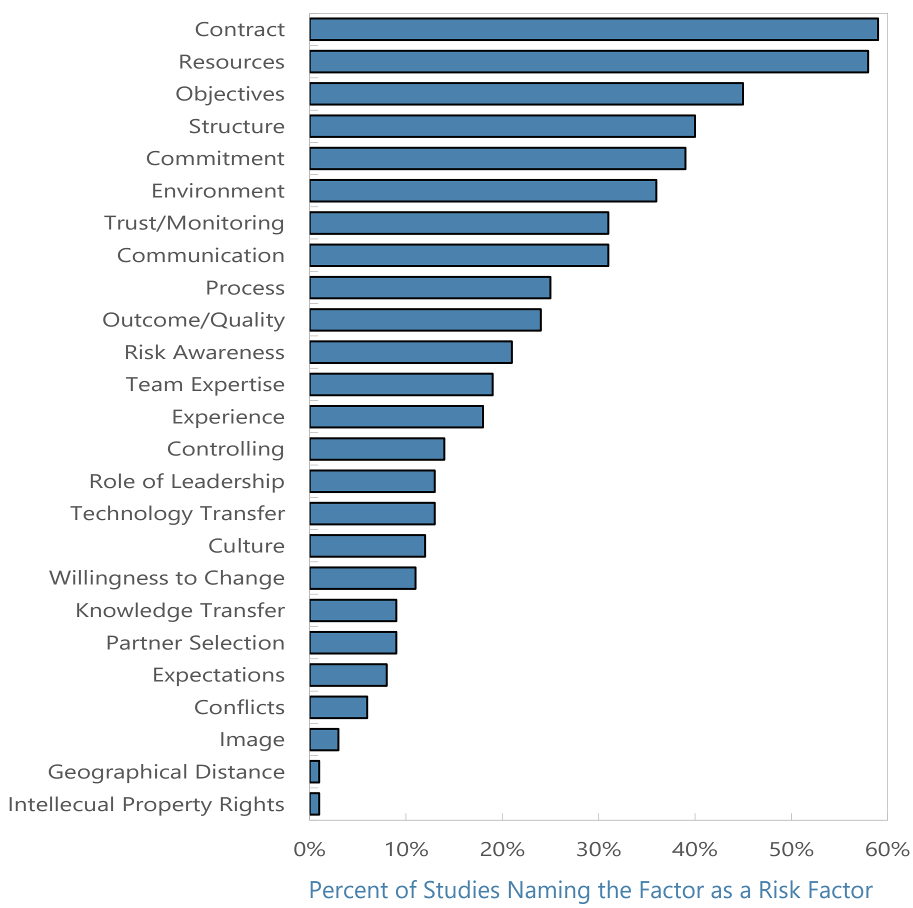
Section A gave a short overview of some risks that can arise from PPPs. This section goes into greater depth on specific risks relevant for Uzbekistan, gives examples of what happened in other countries, and suggests possible solutions. PPP risks include both explicit and implicit risks (Figure 6).

8. Explicit risks include government guarantees, obligations to purchase the output of PPP projects, or supply inputs at fixed prices. Government guarantees are legal arrangements in which the government agrees to pay a debt or perform an obligation in the event of a default by the primary debtor or when other contractual conditions are met. Typical examples include minimum revenue or usage guarantees, subsidies to producers if tariffs fall below an agreed level, and transfers

[4] World Bank (2023). *Private Participation in Infrastructure* (PPI), Annual Report, p. 11.
[5] Annex I lists key laws and resolutions that establish the legal framework for PPPs in Uzbekistan.

to cover operational losses, unexpected exchange rate changes, or higher input costs. In the case of a toll road, for instance, the government may provide a guarantee that the PPP will receive a minimum income. If user fees do not reach the minimum income level, the government pays the difference. While such guarantees, subsidies, or transfers may not involve immediate cash outflows or explicit on-balance sheet liabilities, they facilitate the PPP's access to cheaper credit. They are extended to support projects that are deemed to have large economic or social benefits, which would not be undertaken without the guarantees. The guarantees expose the government to uncertain future cash flows if a borrowing PPP goes bankrupt and the government must make payments under the guarantee. [6]

Figure 6. Potential Risk Factors in PPPs



Source: Rybnicek, R.; Plakolm, J; and Baumgartner, L (2020). "Risks in PPPs: A Systematic Literature Review of Risk Factors, Their Impact, and Risk Mitigation Strategies." *Public Performance & Management Review*. Volume 43, Issue 5.

Based on studies of PPPs in peer reviewed articles in 92 journals.

[6] Fouad, M et al (2021) *Mastering the Risky Business of Public-Private Partnerships*. Fiscal Affairs Departmental Paper No. 21/10, p. 23.

9. **Implicit risks are not legal obligations but entail the expectation that the government will provide financial support if a project experiences difficulties or faces bankruptcy.** From 1990 to 2018, the budgetary impact from the materialization of PPP contingent liabilities averaged about half of one percent of GDP in Middle East and North African Countries.

Project Selection

Risks

10. **Lack of a rigorous selection process can result in less productive PPP projects being chosen.** PPPs are not necessarily more efficient than other forms of investment. Thus, one source of risk is lack of a centralized process for selecting projects. If PPPs are not part of a centralized system of project selection that includes all investment projects, less productive PPPs may be approved. It could be the case that a PPP project replaces a public investment project with better economic or social returns. The selection process should also take account of potential financial costs that could arise. To do this, many countries institute gateway processes, i.e., PPP projects may not proceed without the approval of ministries that check technical feasibility and financial viability. Financial checks are normally the responsibility of the Ministry of Economy and Finance.

11. **Acceptance of unsolicited PPP project proposals can also result in less productive PPPs being chosen.** Unsolicited project proposals are a specific risk since the private partner has an incentive to initiate the project proposal. By contrast, public investment projects are usually initiated by the government. Acceptance of unsolicited proposals can allocate resources to projects supported by the private sector that do not align with the governments sector priorities. For example, the private sector may favor projects with good financial returns while the government may also be interested in projects that have good social returns. Moreover, direct negotiation of PPP projects can result in contract terms that are worse than those of competitive tenders.

Examples

- In **Mongolia**, PPPs were seen as a method to obtain financing for investment projects. As a result, they faced less scrutiny regarding their efficiency and fiscal impact. Due to these weaknesses, many PPP projects failed to deliver promised services, and the public began to lose confidence in them.

- In **South Africa**, the Treasury is required to approve PPPs at four stages of project development: (i) following the feasibility study, (ii) after preparing bid documents, (iii) while evaluating bids, and (iv) before the approval of contracts.

Solutions

12. **The government could further integrate PPP projects into its public investment management system.** Project selection is an issue for all government investment, not just PPPs. All public investments, including PPP projects, should be integrated into a unified public investment

management system that screens and selects public investments. Selection of PPP projects should be based on clear objectives and criteria, including fiscal sustainability, ability to deliver services, capacity of providers, and availability of private sector financing. Having a government unit dedicated to evaluating PPPs helps maintain expertise and provides an institutional mechanism to improve the evaluation of PPP projects. In Uzbekistan, the Ministry of Economy and Finance should act as a gatekeeper, with the power to stop PPP projects at several stages of their preparation if proper steps have not been taken. These stages typically occur when the project feasibility study, tender documents, and final contract have been completed. To discourage unsolicited PPP proposals, the government could also consider forbidding or restricting direct negotiation of PPP projects. This approach has been implemented in several other countries.

Uzbekistan

13. Some PPP projects have gone through the formal selection process provided by the PPP Law while others have been signed under the Law on Investments and Investment Activities. Although the original PPP law was passed in 2019, many PPPs were signed under the Law on Investments and Investment Activities. The use of the Investment Law occurred because the original PPP law did not provide a sufficient framework for private sector borrowing. In addition, approval of PPPs under the Investment Law was easier as it did not require oversight or approval by the Ministry of Economy and Finance. Subsequently, a 2021 amendment to the PPP Law required the Ministry of Economy and Finance (MoEF) to approve projects that incur direct costs to the budget, create contingent liabilities, or create any direct or indirect costs borne by the budget. A 2022 Presidential Decree required that future PPPs be approved under the PPP Law and suspended the practice of direct negotiation of unsolicited proposals by the line ministries.

14. Currently, the level of approval of a PPP project depends upon its size.

- For PPPs whose value is <u>less than USD 1 million</u>, the government partner assesses fiscal risks and approves the project. The MoEF can set guidelines for limits on fiscal liability.
- For PPPs whose value is <u>USD 1-10 million</u>, the government partner submits the project concept and project evaluation document to the MoEF which reviews and either approves, rejects, or requests revisions. The government partner prepares tender documents and the draft PPP agreement for MoEF approval. The MoEF then reviews fiscal commitments and finalizes approval.
- For PPPs whose value is <u>above USD 10 million</u>, the government partner submits the concept and analysis of fiscal obligation of the PPP project to the Cabinet of Ministers for approval. The Cabinet reviews the PPP proposal and approves, rejects, or asks for revisions to the proposal.

Optimism Bias

Risks

15. Optimism bias entails overestimating the benefits or under estimating costs of a project. Optimism bias can occur in several areas including budgeting, asset recognition, and assessment of risks. Sources of optimism bias include overestimating demand and underestimating the cost of inputs or financing. The private partner may have an incentive to overestimate the profits to get financing and approval for the project. Similarly, the government sponsor may have an incentive to underestimate the possibility of needing to provide future financial support if the project is less profitable than expected.

Examples[7]

- In **Colombia** in the 1990s, the government guaranteed toll revenues and utility payments under long-term purchase power agreements (PPAs). Lower than expected demand resulted in the government paying $2 billion to private partners.

- In **Korea**, the government guaranteed 90 percent of revenues for 20 years on a toll road to the airport. When the road opened, traffic was only 50 percent of projected demand. As a result, the government paid several million US dollars per year over the course of the project.

- In **Mexico** in the early 1990s, the government contracted with private partners to build and operate 5,500 km of roads. Lower than expected traffic and higher than expected interest rates led the government to take over many of the private partners participating in the road PPPs. The Mexican government ultimately assumed $7.7 billion in debt.

- **Studies of PPPs around the world** have found consistent optimism bias.[8] One study found that actual costs for 258 transportation projects were on average 28 percent higher than planned. Another study, focusing on rail projects, found that actual demand was on average half as high as projected demand.

Solutions

16. To address optimism bias, demand forecasts should be stress tested via scenario analysis. For PPPs in which the government is the customer, demand forecasts should ensure the projects can produce the expected output. For projects that are supported by users, the government should employ conservative assumptions to assess project viability. Typical stress scenarios would estimate the impact of: (a) demand below projections, (b) a sizeable depreciation of the exchange rate, (c) higher input prices, and (d) the fiscal cost if the private partner goes bankrupt after several years of operation. Such stress tests should be required by the PPP contract. The Ministry of Economy and Finance should ensure that these tests are completed at minimum during two gateway checkpoints, the first after the project feasibility study is finalized, and the second after negotiations are concluded with the private partner but before the contract is signed.

Uzbekistan

17. As most PPPs are at an early stage of development, it is not yet apparent whether PPP selection has been subject to optimism bias. However, there is little reason to think Uzbekistan is

[7] World Bank (2017). *Public-Private Partnerships: Reference Guide* for additional examples.

[8] Ibid, p. 24.

an outlier in this respect. Work by the Ministry of Economy and Finance is underway to conduct scenario analysis regarding the scope of contingent liabilities.

Fiscal Illusion and Off-Budget PPPs

Risks

18. While PPPs may reduce expenditures in the near term, they may entail larger expenditures in the future. For example, if the government is the primary customer of an electricity generation project, it will have to pay for electricity from the project in the future. There is a risk that PPPs can be used to bypass limits on the budget and public borrowing in the near term, not giving sufficient weight to possible future costs. This risk is exacerbated since fiscal risks generally materialize later in a project.

Examples

- In **Jordan,** the share of public investment in total general government expenditures decreased from about 20 percent in 2009 to about 10 percent in 2013–2015. Because less financing was available for investment projects from the budget, government entities relied more on PPP projects. As a result, PPP debt guarantees almost doubled between 2010 and 2017.

- In **Mongolia**, PPPs were widely viewed as a way to finance projects when funding from the budget was lacking. As a result, PPP projects were implemented without attention to long-term implications. This led to higher future costs.

Solutions

19. As with assessing the value of a project, to avoid fiscal illusion the government should ensure that the costs and risks of PPP projects are evaluated during the selection process. PPP projects should not proceed until the Ministry of Economy and Finance has given approval. The possible realization of contingent liabilities should be considered during budget formulation.

Uzbekistan

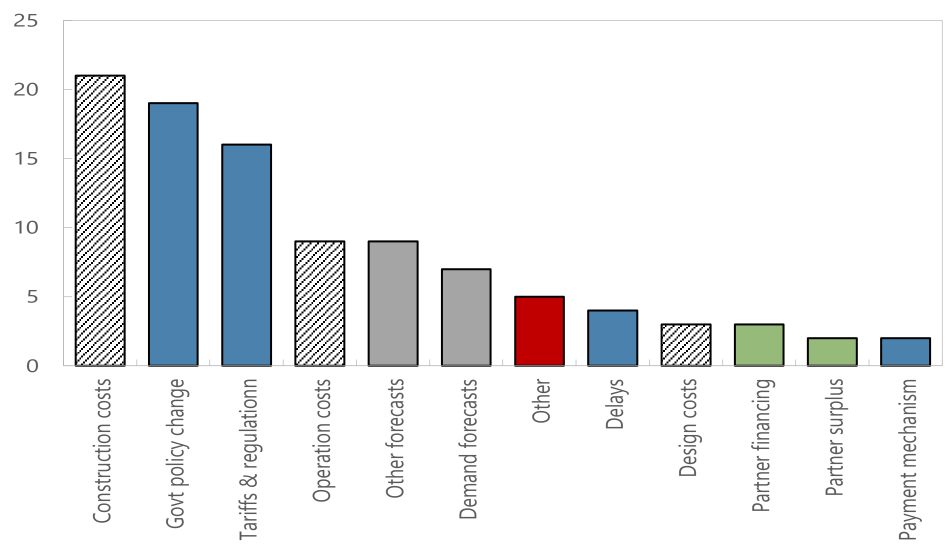
20. The Ministry of Economy and Finance has been developing the expertise to assess potential contingent liabilities, so that risks from PPPs are considered appropriately. Like in other countries, PPPs are not included in the budget and the liabilities of PPPs are not included in public and publicly guaranteed debt. The Ministry of Economy and Finance often struggles to get information from other ministries to assess fiscal risk at the early stages of project planning.

Renegotiation

Risks

21. The sharing of risks—which is a key feature of PPPs—can result in renegotiation of responsibilities. In many cases, renegotiation may be warranted to deal with new developments. However, the private partner may also attempt to renegotiate a project for its own benefit knowing the government incurs a cost when it switches partners or closes a PPP. Events that can trigger renegotiation include higher-than-expected construction costs, changes in government policy, changes in regulated prices, and higher-than-expected operating costs (Figure 7).

Figure 7. Main Causes of PPP Renegotiation



Source: Global Infrastructure Hub, PPP Reference Tool, Renegotiation, Chapter 4, 2018

Examples

- A study of 1000 projects in **Latin America**, found that 10 percent of electricity, 55 percent of transportation, and 75 percent of water projects were renegotiated.[9] Another study found a global renegotiation rate for PPPs of 33 percent, ranging from 12 percent in East Asia to 58 percent in Latin America.[10]

- From 1991 to 2007, **Chile** implemented an extensive program of PPPs. The accumulated value of these projects stood at $11 billion (about 5 percent of GDP) in 2007. Of this amount, a quarter of PPP investments required renegotiation, partly due to unclear institutional arrangements. While

[9] Guasch (2004) as cited in the *PPP Reference Guide*, p. 28

[10] Global Infrastructure Hub (2018). *PPP Reference Tool, Renegotiation*, Chapter 4, p. 20.

the initial contracts were awarded competitively, the renegotiations did not require competitive bidding resulting in higher costs to the government.[11]

Solutions

22. Several methods can be used to minimize renegotiation of PPP contracts. For example, in 2010, **Chile** revised its PPP law to establish a Technical Expert Panel to review disputes between the government and private partners. The Panel's recommendations have been followed in 40 percent of cases. When the private partner disagrees with the recommendations, the law requires mandatory arbitration. The revisions to the Chile's PPP law also exclude the existing partner from participating in tenders for additional work agreed during renegotiation. After the PPP law was revised, the fraction of investment that was renegotiated fell from over a quarter to less than one percent.[12] **Colombia** and **Peru** followed a similar strategy, forbidding renegotiation during the first three years of a PPP project. In **Australia**, renegotiations of a PPP project require Cabinet approval. As noted earlier, it is also important for the Ministry of Economy and Finance to assess any changes to PPP contracts just as they would for new PPP projects.

Uzbekistan

23. As PPPs are relatively new in Uzbekistan, there have not yet been significant renegotiations of PPP contracts. Nonetheless, as in other countries, there is likely to be pressure to renegotiate contracts in the future.

E. Managing Risks

The previous section focused on individual risks and possible solutions. This section focuses on global solutions to mitigate macro risks.

Limiting Exposure with Annual Ceilings and Stock Caps

Risk

24. Even when individual PPP projects have acceptable fiscal risks, the rapid accumulation of PPP projects can result in an overall level of PPPs that represents a macroeconomic risk.

Examples

To control risks from PPPs, many countries impose a limit on annual contracting or on the overall stock of PPPs. For example:

- **Armenia** limits the value of PPP contingent liabilities to GDP.

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[11] Fisher, Ron (2011). *The Promise ad Peril of Public Private Partnerships: Lessons from the Chilean Experience*. International Growth Centre Rwanda, Institute for Policy Analysis and Research.

[12] Eduardo Engel, Ronald D. Fischer, Alexander Galetovic (2020). *When and How to Use Public Private Partnerships in Infrastructure: Lessons from International Experience*. NBER Working Paper 26766, p. 24.

- **Brazil** limits current spending on PPPs to five percent of current revenues.
- **China** limits PPP fiscal liabilities from local government budgets to 10 percent of their expenditure.
- **Georgia** limits PPP aggregate liabilities as a share of GDP.
- **Kazakhstan** limits the ratio of direct PPP liabilities to revenues.
- **Peru** limits the present value of PPPs to 12 percent of GDP.

Solutions

25. A ceiling on the overall stock of PPP investment is appropriate to limit the risk from contingent liabilities to fiscal sustainability. Although a cap would ideally focus on PPP liabilities, without sufficient information, a cap on the value of the stock of PPPs could be easier to implement. Such a cap would require a good database of PPP projects and their liabilities. Caps should have broad coverage and be easy to measure. And even if a cap on the stock of PPP liabilities is implemented, operational targets—for example, an annual limit on the signing of new PPP projects—may be needed. If potential fiscal risks are large and an annual ceiling or cap on the stock of PPPs is not sufficient to address these risks, the government could consider a reduction or a temporary moratorium on new PPP projects.

Uzbekistan

26. To manage the overall value of PPP projects and limit potential contingent liabilities, Uzbekistan's 2025 Budget includes an annual ceiling on the value of new PPP projects of USD 6.5 billion (about 6 percent of GDP). If a PPP project fails, the government may need to provide financing. While the government does not provide explicit guarantees to PPP projects, it may step in regardless. For example, if a toll road does not cover its expenses, the project could become insolvent. In this case, rather than closing the road, the government would likely take over its operation. To limit the size of such contingent liabilities, the annual budget law places a ceiling on the value of new PPP projects that may be signed during the year. The 2025 ceiling is relatively high and future ceilings should be lower to mitigate the risks. To further strengthen its management of PPP risks, the government is analyzing an upper limit on government commitments for PPP projects. An upper limit would provide another mechanism to prevent the buildup of possible liabilities from PPP projects and would complement the 60 percent of GDP cap on public and publicly guaranteed debt, which does not cover PPP liabilities. IMF staff are providing technical assistance to the government to identify an appropriate cap on the stock of PPPs.

Managing PPPs

Risks

27. After PPP projects have been selected and financed and implementation has begun, performance may be less than expected or unforeseen shocks may arise. Risks include lack of adequate monitoring, insufficient planning for dealing with unforeseen problems, lack of a designated monitor, and inadequate maintenance of PPP infrastructure.

Examples

- Both **Brazil** and **Hungary** use several performance measures to monitor PPP projects. These include measures of efficiency, service quality, and activity.[13]

- **Korea** has employed surveys to evaluate user satisfaction with PPP projects.

- **South Africa** determined that delaying road maintenance for three years results in repairs that cost six times more than the cost of preventative maintenance.

- In the **Philippines**, the government monitored monthly traffic volume on the Daang Hari-SLEX road PPP. This allowed the government to learn if the project was deviating from projections and to make changes or intervene to address them. KPIs included ensuring that tolls handled at least one vehicle every two minutes and that the toll could process a minimum of 400 vehicles an hour. To ensure proper maintenance, 15 KPIs were set on road maintenance, including indicators on road smoothness and maximum times for repairs to the road.[14]

Solutions

28. Governments should have in place an adequate system to monitor the private partner's implementation of a PPP.

- The **frequency of monitoring** should depend on the size of the project and stage of implementation. Large projects that pose the most risks may need quarterly or monthly monitoring.
- Monitoring also requires **a clear baseline and key performance indicators (KPIs)**. The baseline can often be obtained from the fiscal sustainability report (FSR). Key performance indicators should focus on measurable indicators of outputs, service quality, and financial performance. Users of the PPP services can often be a useful source of information on the quality of services provided. Where the government is the customer, payments can be reduced if the PPP does not meet KPIs.
- Proper risk management requires **reliable information** based on appropriate, ongoing reporting and oversight of PPP projects. Thus, PPP contracts should require PPPs to send annual financial statements to the government.
- If monitoring shows that risks are materializing, the government should have an **intervention plan** to address these risks and put the PPP project back on track.
- To promote **proper maintenance**, the PPP contract can include KPIs on maintenance issues.

[13] Organization for Economic Cooperation and Development (2017). *Public-Private Partnerships: In Pursuit of Risk Sharing and Value for Money*, p. 81.

[14] World Bank. *Public-Private Infrastructure Advisory Facility* (PPIAF) website. Downloaded January 7, 2025.

Uzbekistan

29. A series of laws and resolutions have been implemented in the last two years to improve the monitoring of PPP projects.

- In 2023, *Cabinet Resolution 558* established the Fiscal Risk Assessment Department (FRAD) in the Ministry of Economy and Finance and dictated a procedure to review and approve fiscal liabilities and ensure there are sufficient funds in the budget to cover direct and indirect liabilities of the state. Fiscal liabilities must be evaluated when the project concept and project evaluation documents are approved and immediately before signing the PPP agreement. Projects that are valued at USD 10 million or more and payment of contingent liabilities that exceed previous projections require approval by the Cabinet of Ministers. Each year, the Ministry of Economy and Finance, together with the Cabinet of Ministers, must propose to the Parliament budget limits on guarantees and fiscal obligations of PPPs.

- Issued in August 2024, *Presidential Decree 308* on "Measures on the Development of Public-Private Partnerships for 2024-2030" requires the government to amend the Public Debt Law to include an upper limit on take-or-pay agreements and letters of comfort for PPP projects. It replaced the PPP Development Agency with a new Center for Public-Private Partnership Projects, established to coordinate the implementation of PPP projects. The Decree also requires that the text of all PPP agreements be sent to the MoEF, the establishment of a PPP registry, and an annual presentation to Parliament on the status of PPPs.

- Issued in October 2024, *Cabinet Resolution 720* on the "Procedures for Implementation and Financing of PPP Projects" replaces Resolution 259 adopted in 2020. Resolution 720 clarifies the procedures for approving and implementing PPPs. These include addressing property rights issues and amending the requirements for private partner technical expertise, and the qualification criteria of third parties. The Resolution also requires PPP projects to have measurable Key Performance Indicators (KPIs).

Annex I. The Legal and Institutional Framework for Public-Private Partnerships

Uzbekistan's Legal and Institutional Framework for PPPs has Developed Rapidly.

- In June 2018, the government passed a **Law on Public Private Partnerships** (LRU-537). The Law specifies the principles and scope of PPPs. It also lists the rights and obligations of parties to a PPP agreement and creates procedures for preparation, approval, amendment, or termination.
- In December 2018, a **Cabinet Decree on the Organization of the Agency for the Development of PPPs** (No. 1009) established a PPP Development Agency in the Ministry of Finance (MoF) with staff of 30. Its role was to help line ministries identify potential PPP projects. It was not designed to ensure budget affordability or assess fiscal risks.
- In December 2019, Uzbekistan adopted a **Law on Investments and Investment Activity**. The Law established a regime to protect and promote foreign and domestic investment, bringing together previous Laws, including the Law on Foreign Investments, the Law on guarantees and measures to protect the rights of foreign investors, and the Law on Investment Activities. The Law allows for free transfer of funds in and out of Uzbekistan and protection from nationalization.
- In 2020, **Cabinet Resolution 259** was passed, providing procedures for execution of PPP projects. It determined procedures for initiation, development, consideration of PPPs, selection of private partners, and for maintaining a register of PPP projects.
- In January 2021, the **PPP Law was amended**. The amendment requires the Ministry of Economy and Finance to approve projects that incur direct costs to the budget, create contingent liabilities, or create any other direct or indirect costs that would be borne by the budget.
- In August 2021, **Regulation 509** was adopted specifying the procedure for approving PPPs.
- In April 2023, the government introduced a **Public Debt Law**. The law did not define debt incurred by PPPs as part of public and publicly guaranteed debt but did allow the government to introduce a limit on guarantees to PPPs.
- In October 2023, **Cabinet Resolution 558** was adopted, implementing a procedure for the government to review and approve fiscal liabilities from PPPs.
- In August 2024, **Presidential Decree 308: Measures on the Development of Public-Private Partnerships for 2024-2030** requires the government to amend the Public Debt Law to include an upper limit on certain guarantees for PPP projects. This decree also approved a program of PPP projects from 2025 to 2030 totaling USD 30 billion. It replaced the PPP Development Agency with a new Center for Public-Private Partnership Projects, established to oversee the execution of the PPP Program.
- In October 2024, **Cabinet Resolution 720** on the **Procedures for Implementation and Financing of PPP Projects** replaced resolutions 259 and 509. The resolution provides for PPP projects in a broader range of areas, addresses property rights issues, and introduces a requirement for measurable Key Performance Indicators (KPIs).

- The **2025 Budget limits** the value of new PPP projects, which require the assumption of liabilities and issuance of letters of confirmation by the state, to USD 6.5 billion.

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