INTERNATIONAL MONETARY FUND

The Sequencing and Speed of Reforms in Transition Economies: Implications for the Case of Uzbekistan

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SIP/2025/086

IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on May 30, 2025. This paper is also published separately as IMF Country Report No 25/144.

2025
JUN

SELECTED ISSUES PAPER

 SIP/2025/086

IMF Selected Issues Paper
Middle East and Central Asia Department

The Sequencing and speed of Reforms in Transition Economies: Implications for the Case of Uzbekistan

Prepared by Alejandro Simone

Authorized for distribution by Yasser Abdih
June 2025

ABSTRACT: Uzbekistan has made significant progress in its transition to a market economy since 2017, achieving advancements in macroeconomic stabilization, trade and exchange rate liberalization, price liberalization, and small-scale privatization. Despite these successes, challenges remain in reforming and privatizing large state-owned enterprises and banks and fostering a competitive market environment with easy market entry and exit. Future reforms should focus on entrenching macroeconomic stability, completing trade and price liberalization, hardening budget constraints for state-owned enterprises and banks, enhancing their corporate governance, accelerating privatization, and redefining the state's role to support private sector development.

RECOMMENDED CITATION: Simone, Alejandro (2025) “The Sequencing and speed of Reforms in Transition Economies: Implications for the Case of Uzbekistan”, SIP/2025/086, International Monetary Fund.

JEL Classification Numbers:	P20,O1,O20,O4, E00, F00
Keywords:	Sequencing of Economic Reforms, Pace of Economic Reforms, Transition Economics, Privatization, Uzbekistan
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SELECTED ISSUES PAPERS

The Sequencing and Speed of Reforms in Transition Economies: Implications for the Case of Uzbekistan

Republic of Uzbekistan

Prepared by Alejandro Simone[1]

[1] The author would like to thank Yasser Abdih, Sarvar Ahmedov, Galina Kostina and Uzbekistan's authorities for their helpful comments and Carlos Segura Santana and Svetlana Zolotareva for their research and administrative assistance respectively.

INTERNATIONAL MONETARY FUND

REPUBLIC OF UZBEKISTAN

SELECTED ISSUES

May 30, 2025

Approved By
Middle East and Central Asia Department

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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.

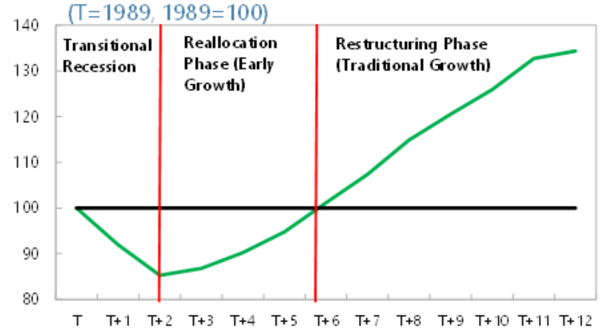
- **Restructuring and privatization of state-owned enterprises.** Restructuring refers to the process of reforming SOEs and SOCBs to create commercially oriented non-financial and financial enterprise sectors that produce goods and services that can be sold in free markets. Privatization refers to the 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):

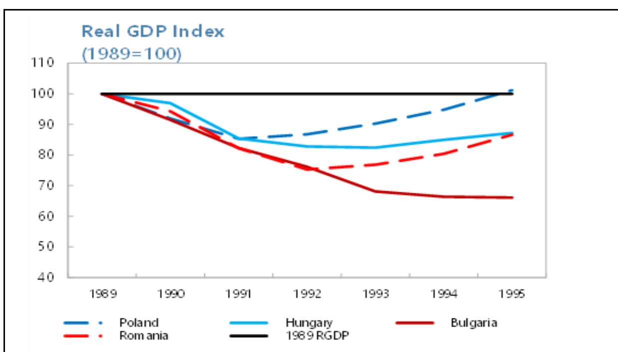
- **With the exception of limited reforms countries, transition countries completed economic reforms first irrespective of the reform approach although with significant differences in speed.** Sustained shock therapy and advanced start countries had already largely completed these reforms (i.e., achieving 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.

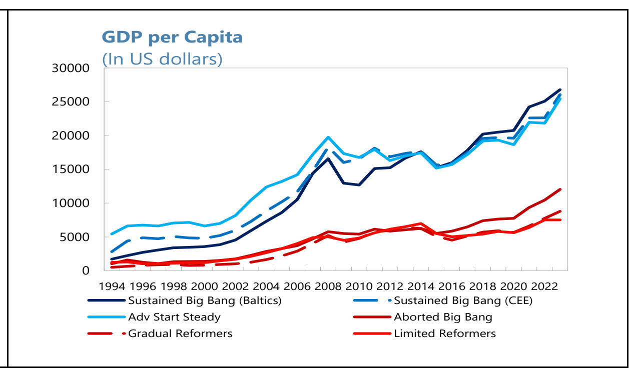
- **Institutional reforms were significantly more difficult for transition countries to complete than economic reforms.** Data show that even the most successful transition economies had not come close to achieving scores in this area as impressive as they achieved in the area of economic reforms in 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

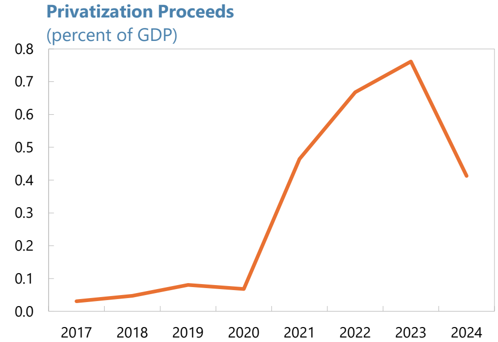
16. The strengths of Uzbekistan transition progress since 2017 are in the area of economic reforms. These reforms are proceeding in a broadly similar pace and sequence as that pursued by successful transition economies:

- **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.

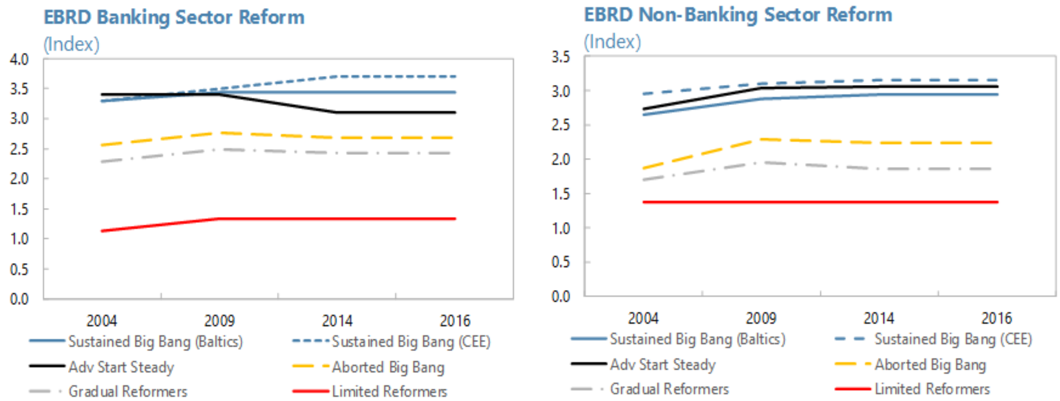
Figure 1. EBRD Core Transition Indicators, 1989-2014

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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