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THE UZBEK MODEL OF ECONOMIC DEVELOPMENT 1991-9

Uzbekistan has been one of the most enigmatic of the thirty-plus economies in transition from central planning during the 1990s. The government explicitly avoided the shock therapy advocated by the international financial institutions and also avoided the economic collapse of non-reformers such as Belarus or Turkmenistan. Its economic performance, measured by change in real GDP between 1989 and 1999, was one of the least bad among transition economics and the best of all former Soviet republics.

In the early 1990s the new government frequently invoked the Chinese model or the South Korean model as its blueprint for gradual reform leading to rapid economic growth. In fact, policies bore little relation to China's strategy of agrarian reform plus opening of the economy followed by a hands-off approach to new enterprises, and even less resemblance to Korea's market economy. One similarity to China, however, has been the commitment to political stability and harsh response to open dissent. Also as in China, the autocratic leader has on critical occasions pushed reforms forward rather than allowing interests resistant to change the opportunity to turn back the clock.[1]

The government now refers to the Uzbek model but, apart from not being rapid reform, its content is unclear. On several key occasions, policies appear to have been reactive, rather than part of a consistent strategy.

[1] In China, Deng Xiaoping used his authority to push through the initial reform package in December 1978. In 1981-2 when conservative leaders were fearful of the growth of unregulated township and village enterprises, Deng's camp gave the seal of approval to this development. Again in 1986, after a brief reversal of the reform process, the leadership pushed ahead with major liberalization of foreign investment legislation and in 1992, after a longer hiatus, Deng's symbolic Tour of the South signalled further reforms. On all of these occasions

1. Initial Conditions, to the End of 1993

The Uzbek Soviet Republic had a troubled history during the second half of the 1980s. When Mikhail Gorbachev soon after coming to power in 1985 launched his anti-corruption campaign, the Uzbek Republic's leadership was his first target. Although First Secretary Sharof Rashidov's timely death in 1986 excluded him from the purge, over 2000 officials were punished. A succession of First Secretaries, however, failed to establish themselves until in 1989 a local technocrat, Islam Karimov, was appointed the Republic's leader.

At the time of the last Soviet census in 1989, the Uzbek Republic with 20 million people was the third most populous Soviet republic. It was, however, one of the poorest republics with one of the highest poverty rates (Table 1). Its role in the Soviet division of labour was as a producer of primary products, especially cotton, which dominated the agricultural sector where 40% of the labour force worked, and minerals such as gold and uranium. Politically the Uzbek Republic, like the other Central Asian republics, was conservative, making no reform experiments during the Gorbachev era. Ethnically, the republic was one of the more homogeneous in Central Asia with a strong historical and cultural tradition to draw upon.[2] Although there were ethnic troubles between Uzbeks and Kyrgyz in Osh in the Kyrgyz Republic in 1990 and Uzbek minorities lived across most of the Uzbek Republic's other borders, there were no serious irredentist claims. Tashkent was the acknowledged metropolitan centre of Soviet Central Asia and fourth largest city in the USSR.

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the decision to move forward was taken in Beijing, despite strong opposition, even though the main beneficiaries were specific reform-oriented regions of China.

[2] Before the Russian conquest in the late nineteenth century, the region's major rulers were the Uzbek emirs of Bukhara, Khiva and Khokand. More important the Uzbeks claimed the heritage of the great historical cities and rulers such as the Emir Timur (Tamerlaine). The existing sense of nationhood, clearly lacking in all Uzbekistan's neighbours, was reflected in the attitude towards Rashidov, castigated by Gorbachev for corruption but lauded at home for directing resources from Moscow to the Uzbek Republic; after independence one of Tashkent's major streets was named after Rashidov.

For most of 1991 the Uzbek Republic continued to slumber. Its citizens overwhelmingly supported continuation of the Soviet Union in the March referendum. Its leader kept silent during the August coup. In September the Uzbek Republic, like several other republics, declared its sovereignty, which at the time meant control over use of its own natural resources but subsequently was celebrated as the national independence day. During the last three months of 1991, President Karimov seemed little concerned about the possible dissolution of the Soviet Union. When the three Slav republics declare independence in early December, Karimov was a follower rather than a leader in negotiations to replace the USSR by the Commonwealth of Independent States (CIS) at the end of 1991.

Newly independent Uzbekistan seemed little prepared for nationhood in 1992. Still using the Soviet ruble as a common currency, Uzbekistan had little choice but to follow the Russian price reform of January 1992. Although prices were generally freed, Uzbekistan retained controls on more items than neighbouring Kazakstan or Kyrgyzstan (Pomfret, 1995, 53-7). Uzbekistan's stance through 1992 and early 1993 was to try to maintain external stability and Uzbekistan was one of the CIS republics which participated in the various unsuccessful conferences to reestablish common monetary or trade institutions. Domestically change was limited, which caused recurring border closures as arbitragers sought to export fixed-price goods from Uzbekistan to higher price destinations within the ruble zone. Uzbekistan shared in the ruble's hyperinflation in 1992 and 1993, but because of the controlled prices the high inflation rates in Table 2 were among the lowest in the CIS.

During the second half of 1993 the ruble zone disintegrated, due partly to Russian policy choices, but mainly to the design fault of having multiple centres of credit creation (Pomfret, 1996, 118-29). Uzbekistan appeared to hang on until the last minute and, apart from war-torn Tajikistan, was least prepared to issue a national currency. When Uzbekistan did leave the ruble zone in November 1993, it issued a temporary currency, the som coupon, in which people had little trust.[3] Issue of the new national currency was delayed until July 1994.

2. Emergence of the Uzbek Puzzle, 1994-6

Following a January 1994 Presidential Decree on deepening economic reforms, a period of accelerated change began. Uzbekistan's output performance had not been bad by former Soviet republic standards, with real GDP declining by only 11 % in 1992 and 2 % in 1993 (Table 2). This reflected a favourable resource endowment with the major export commodities facing buoyant world prices, and Uzbekistan able to reduce its dependence in imported energy and grain.[4] Uzbekistan, however, continued to suffer from high inflation even as price increases started to moderate elsewhere in the former Soviet Union. Unlike in other gradualists of the time (e.g., Belarus, Turkmenistan and Ukraine), Karimov took the decision to seek macroeconomic stability.

The national currency was introduced in July 1994 and supported by reductions in the growth rate of money supply over the next three years. Price controls were reduced and food rationing abolished, so that open inflation reached a peak in 1994 before declining to below 50% per year in 1997.[5] Foreign trade was liberalized and exchange restrictions relaxed. The fiscal deficit was cut from 10.4% of GDP in 1993, to 6.1% in 1994, and 4.1% in 1995 (Table

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[3] Many citizens had lost out in the July 1993 price reform when Russia unilaterally replaced the Soviet rubles with new Russian ruble banknotes. The November temporary currency issue was confiscatory and the issue of a permanent currency was also expected to be confiscatory. The som coupons were unimpressive in appearance and traded at huge spreads in the black market as almost any other currency was preferred as a store of value.

[4] Tarr (1994) predicted a small terms of trade loss to Uzbekistan as a result of switching from Soviet to world prices, but this ignored the possibility of import substitution in oil and wheat. Moreover, unlike Kazakstan or Turkmenistan whose oil and natural gas exports were sold well below world prices but who could not access world markets due to pipeline routes, Uzbekistan's cotton and gold were fairly easy to transport to global markets.

[5] In Uzbekistan's more rapidly reforming neighbours, annual inflation had dropped below 50% in the Kyrgyz Republic in 1995 and in Kazakstan in 1996.

2). The tax system was reformed and collection improved, while expenditure on supporting state enterprises and on consumer subsidies was reduced.

During the middle 1990s Uzbekistan emerged as a paradox among CIS countries. Although cumulative reform was still fare behind the Baltics, Russia or even neighbouring Kyrgyzstan and Kazakstan, Uzbekistan did not experience the deep decline in GDP suffered by all other CIS countries. The cumulative decline in GDP between 1989 and 1996 was the lowest among all former Soviet republics. Moreover, Uzbekistan appeared to do relatively well by other measures such as providing a social safety net, alleviating poverty and limiting spending cuts in education and healthcare (Pomfret and Anderson, 1997).

Zettelmeyer (1998) examined the relative importance of various potential explanations of the "Uzbek Puzzle". Measurement errors and favourable initial conditions played a part, but their impact was dismissed as small in magnitude. Good policy and public investment were left as the major explanatory factors.

The resource endowment was, however, fundamental to the BOP, public budget and investment. Buoyant export earnings from cotton and gold contributed directly to GDP, and were a major source of government revenue. The government kept tight control over both activities and, by a state order system which gave farmers a small fraction of the world price, siphoned resources from agriculture amounting to as much as a twelfth of GDP in1996 (Pomfret, 2000). An important difference to Russia or Kazakstan was that the resource rents were not privatized and the government used the revenue to maintain public spending on education and healthcare better than in other CIS countries. The government also acted innovatively and effectively in targeting social assistance through the decentralized *mahallah* scheme (Coudouel and Marnie, forthcoming).

Public investment also contributed to GDP, although the attempt to pick winners led to several failures and no obvious successes. Chemical and petrochemical projects in the desert were the biggest flops, but heavily subsidized cotton textile mills may also have been socially wasteful, even if they survived on the basis of distorted prices. The import-substituting nature of these projects illustrates the inward-looking development strategy, even though Uzbekistan was an open economy by measures such as the export/GDP ratio.

Direct foreign investment into Uzbekistan was modest in total, but included some high profile projects. Apart from Newmont Mining's involvement in gold production, practically all the foreign investment was in import substitutes such as Mercedes Benz, BAT in tobacco and Daewoo in cars. The Daewoo plant, in language familiar from Beijing Jeep in China or Proton Saga in Malaysia in the 1980s, was claimed to be a base for exporting to the region but its two cars and a minibus were sold only in domestic markets during the 1990s.

Economic success was accompanied by greater confidence in international relations. In the early years of independence President Karimov represented himself as a bulwark against Islamic fundamentalism, and continued to work with Russia in the Tajikistan conflict as well as in trying to maintain economic ties from the Soviet era. After a brief period of economic nationalism tinged with isolationism in late 1993, Karimov started to exert a more positive leadership role in Central Asia during 1994 and then on the world stage. Relations with the USA warmed considerably as Karimov took opportunities to denounce Iran and vote with the USA at the United Nations.[6] In July 1996 Presidents Clinton and Karimov met in Washington.

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[6] The most notable denunciation of Iran was at the May 1996 ECO summit in Ashgabat, which consequently broke up a day earlier than planned. ECO, the Economic Cooperation Organization, which includes Iran, Pakistan, Turkey, Afghanistan, Azerbaijan, Kazakstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, has attempted to bring together all of the non-Arab Islamic countries west of India, but has made little concrete progress (Pomfret, 1999). In the United Nations the USA found itself on occasion with only two supporting votes, Israel and Uzbekistan.

3. Reintroduction of Exchange Controls

Up until the summer of 1996 relations between Uzbekistan and the IMF and World Bank had been thawing. Uzbekistan was still seen as a slow reformer, near the bottom of most liberalization league tables such as that in the World Bank's 1996 *World Development Report*, but there were signs of improvement. In particular, Uzbekistan was committed to liberalizing its foreign exchange regime and establishing convertibility for current account transactions. In Autumn 1996, however, this commitment was reneged upon as draconian exchange controls were reintroduced.

The exchange controls appear to have been a drastic reaction to balance of payments pressures rather than part of a considered strategy. Other elements of Uzbekistan's gradual transition remained essentially unchanged. The exchange controls were strongly criticized by the IMF, and the Uzbekistan government took pride in asserting its independence by defending the policy.

Economic performance continued to be good by CIS standards as growth became positive in 1996 and accelerated in 1997 and 1998 (Table 2). Inflation was brought below 50%, although this figure's meaning is in some doubt as over 1400 prices remained controlled in 1999. A mass privatization program was initiated through Public Investment Funds with World Bank aid, but the outcome was meagre, as was that from a case-by-case approach to privatizing thirty large enterprises (only one had been privatized, through foreign purchase, by late 1999). Creation of new small and medium-sized enterprises was also slow, apart from small-scale restaurants and other service activities.

The most worrying sign was a growing external imbalance, not fully reflected in official statistics, but by 1999 frequently referred to by officials as a crisis. Some negative external developments, such as cotton and gold prices and the 1998 Russian crisis, contributed, but the major problem was the import substitution strategy exacerbated by the foreign exchange policy. Production for export was discouraged by policies directing capital to import-competing projects and skewing relative producer prices in favour of such activities. As the gap between the official exchange rate and the black market rate widened to 100% by autumn 1998 and 300% a year later, voluntary exports through official channels became less and less attractive. The external debt increased in 1998 and 1999, and although debt-service ratios were not yet high (Table 2), the more recent loans had been contracted at 14-15% and earlier IMF loans were coming due for payments in 2000.

In many respects Uzbekistan's experience mimicked that of many newly independent countries of the 1950s and 1960s which enjoyed early economic success, but ran into subsequent problems after pursuing import-substitution policies and ignoring the costs of resource misallocation. An overvalued official exchange rate discouraged production of traded goods, while the large black market premium encouraged rent-seeking activities. Capital was allocated mainly by government directive, and the outcome was declining productivity of capital; by 1999, official estimates of the incremental capital-output ratio were around 6 and the IMF estimate 8.3, compared to ICORs for well-functioning economies of 3-4.

The viability of the government's strategy depended heavily on its continued implicit tax on cotton and gold.[7] Supply of these commodities was believed to be relatively price inelastic, which is likely to be true in the short-run but less plausible for the longer term. Apart from the continued misuse of public resources by directing credit and foreign exchange to specific enterprises, the government continued to spend relatively wisely by maintaining health and education spending and extending the social support delivered via the *mahallas*.

4. Is There an Uzbek Model?

The hallmark of Uzbekistan's economic policies since independence has been cautious recognition that economic change is inevitable, and a commitment to gradual reform in order to minimize negative or disruptive consequences of change. In important respects this has been a wise approach, as Uzbekistan has avoided the pitfalls of rapid reform in Russia and Kazakstan without falling into the trap of non-reform as in Turkmenistan. In particular, Uzbekistan avoided alienation of natural resource rents, which gave the government an important continuing source of revenue.

Uzbekistan has also benefited from good governance in the economic sphere, at least by a narrow definition of economic management and by the generally low standards of the CIS. Although some revenue has been frittered away on wasteful public investment in industrial projects, the government has done fairly well in maintaining health and education expenditure and in providing a social safety net (Pomfret and Anderson, 1997). Public building has improved the cityscape in Tashkent and other towns, without the grandiose aspirations of the Presidential Palace in Turkmenistan or the new capital in Kazakstan. Transportation and other public services have continued to function. Loosening of restrictions on small-scale activities and rising disposable income in the late 1990s, at least in urban areas, saw a revival of eating and drinking out, which recalled a past cultural heritage and raised the quality of life for many. Politically the regime is unattractive to liberal observers, but President Karimov appears to enjoy a degree of popularity for maintaining relative stability with social justice. Corruption is endemic, but is widely accepted, with little perception that it has created a *nouveau riche* class comparable to that of other CIS counties.

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[7] The foreign exchange controls helped to hide the full extent of the difference between world cotton prices and farmgate prices set in domestic currency.

Nevertheless, all is not well. Although reasonably well administered, the general strategy is flawed. Import substitution is not a viable strategy for promoting long-run growth, and the severe exchange controls imposed since 1996 are a major error with ever more dire consequences. The cautious approach to reform means that there is still time to loosen up the controls and reverse the bias against exports, much as South Korea did in 1964 after a decade of relatively mild import substitution. The longer that change is delayed, however, the more severe the shock of reform will be and the more unpredictable and uncontainable the negative consequences.

Table 1: Initial Conditions: Republics of the USSR 1989/90

	Population (million) mid-1990	Per cap GNP[a] (1990)	Gini coeff (1989)	Poverty (% of pop)[b] (1989)	Terms of trade[c]	Real GDP (% of 1989) (1999)
USSR	289.3	2870	0.289	11.1		
Kazak	16.8	2600	0.289	15.5	+19	59
Kyrgyz	4.4	1570	0.287	32.9	+1	62
Tajik	5.3	1130	0.308	51.2	-7	43
Turkmen	3.7	1690	0.307	35.0	+50	53
Uzbek	20.5	1340	0.304	43.6	-3	89
Armenia	3.3	2380	0.259	14.3	-24	42
Azerbaijan	7.2	1640	0.328	33.6	-7	46
Georgia	5.5	2120	0.292	14.3	-21	33
Belarus	10.3	3110	0.238	3.3	-20	75
Moldova	4.4	2390	0.258	11.8	-38	30
Russia	148.3	3430	0.278	5.0	+79	53
Ukraine	51.9	2500	0.235	6.0	-18	35
Estonia	1.6	4170	0.299	1.9	-32	79
Latvia	2.7	3590	0.274	2.4	-24	60
Lithuania	3.7	3110	0.278	2.3	-31	65

Note: (a) GNP per capita in US dollars computed by the World Bank's synthetic *Atlas* method.
(b) poverty = individuals in households with gross per capita income less than 75 rubles.
(c) impact on terms of trade of moving to world prices, calculated at 105-sector level of aggregation using 1990 weights.
(d) annual increase in consumer price index (end of year)

Sources: columns 1-2, World Bank (1992, 3-4); columns 3-4, Atkinson and Micklewright (1992, Table U13) - based on Goskomstat hc
Tarr (1994); columns 6 and 7, European Bank for Reconstruction and Development *Transition Report Update, April 1997* (
1999 (Table 1.1).

Table 2: Uzbekistan: Selected Indicators of Macroeconomic Policies and Performance, 1992-98

	1992	1993	1994	1995	1996	1997	1998
Growth rate of real GDP	-11.1	-2.3	-4.2	-0.9	1.6	5.2(2.4)	4.4(3.4)

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