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The Central Asian States 20 Years After: The “Puzzles” of Systemic Transformation

Bakhtiyor Islamov, Doniyor Islamov

Somewhat more than two decades at the end of the 20th century and the beginning of the new millennium have drastically changed the global and, especially, the Eurasian world, the integrated part of which comprises five Central Asian newly independent states (CA NIS): Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. These years with unprecedented experiences and challenges for all of them need to be examined thoroughly to draw lessons from both positive and negative developments and introduce a new generation of market reforms. Comprehensive study of both the theory and practice of systemic transformation accumulated within this period is important for the further sustainable development of each CA NIS.

The first section of the paper is devoted to alternative theoretical and methodological approaches to evaluating the outcomes of market reforms. It briefly describes the original method, which has been developed by the author of this paper and implemented to research traps of development, transition, and globalization, that has been applied to comparative analysis of transformations in CA NIS.

The second section of the paper is devoted to a political economic analysis of empirical data of more than 20 years with emphasis on the second decade of independent development of Central Asian states. The “puzzle” of economic growth within the systemic transformation of Uzbekistan compared to Kyrgyzstan and the other CA NIS is examined and a new explanation of this phenomenon is given.

The third section deals with the case of Uzbekistan. It argues that its macro-economic (inflation and exchange rate) problems and certain difficulties in doing business could not offset its achievements. Moreover, they could be resolved employing the strategy of evolutionary institutional transformation able to cushion against domestic and external shocks better, without impeding its development and growth.

The final section briefly assesses the novelty of the reform strategy in Uzbekistan and some policy implications for all Central Asian countries. It also draws conclusions regarding the necessity to seek a new paradigm of reforms for these states, which could better promote their sustainable development and further their step-by-step integration into the world economy.
I. Pursuing Alternative Theoretical and Methodological Approaches to Research Systemic Transformation

Systemic transformation, i.e., transition from one system—a centrally planned administrative-command system—to another—a market-based economy system—in fact, appears to be much more complex and controversial than had been initially expected. It is difficult to agree with the as-yet-dominating main explanations of its principal problems proposed by orthodox economists and policy researchers. Their ideas have different variations but mainly serve to prove that development and transformation problems are heavier in those countries that have failed to implement properly recommended policies.

Summarizing the experiences in the developing and post-socialist countries, then chief economist of the World Bank and later Nobel Prize winner in economics J. Stiglitz together with B. Plescovic expressed “doubts over neoliberal model of development.” They also stressed that “some countries that have followed the dictates of the neo-liberal model are still waiting for growth to improve, while others that have ignored these dictates have experienced some of the highest sustained growth rates ever.”1 Moreover, it was also noted that “failures of the reforms in Russia and most of the former Soviet Union were not just due to sound policies that had been poorly implemented. Their roots went deeper, to a misunderstanding of the foundations of a market economy as well as a misunderstanding of the basics of an institutional reform process. The limited success in so many of the countries in transition also meant that they remained many opportunities for applying better policies.”2

These criticisms were taken into certain account and second-generation reforms started to emphasize institutional building as a top priority. Following the World Bank, the EBRD in its Transition Report3 the same year introduced some explanations from an institutional viewpoint. However, the incorporation of elements of institutional analysis (“institutions and behavior,” “social capital”) were used to strengthen the above-mentioned conclusions of “mainstream” economists, rather than to develop further ideas about the roots of “failure” in order to find and apply “better policies.”

Recently, due to the global financial crisis, criticisms against the standard “big bang” approach have increased from different angles, sometimes from opposite extremes. The author of this paper has tried to avoid both extremes. The first is that recommended policies were the only alternative for systemic

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transformation. The second is that they were the only evils bringing all the subsequent political, economic, and social problems to those countries in transition and the developing states that followed them.

The author’s position in this respect is close to the approaches of J. Stiglitz, J. Kornai, Y. Nishimura, and others based on evolutionary institutional analysis. The main idea as it was noted by S. Mizobata was that “measures on liberalization, stabilization, and privatization were not sufficient conditions but necessary ones for creation of the market... The liberal market economy cannot exist without building sufficient number of institutions.”

In order to implement institutional changes and make them efficient for each state, whose role in transition is crucial, it is necessary to find the proper speed and sequence of reforms, and to implement them. Moreover, the search for additional options for the systemic transformation and integration into the world economy required because of “path dependency” needs thorough examination of the initial conditions and the peculiarities of political, economic, social, and human capital. This then has to complement the analysis of urgent needs and long-term development goals so as to formulate tailor-made recommendations for each country.

Methodologically, this position is supported by the alternative approach and original study of transformational “traps.” Their most acute forms emerge with transition based on neither a certain level and character of political, economic, and social institutions nor the readiness of the state and people to make appropriate use of new opportunities. In the case of systemic transformation, the chosen strategy and policies, recommended and implemented, in CIS countries appear to be fraught with completely different implications and consequences due to the lack of such institutions and respective readiness of states and peoples.

In this sense, countries in transition at the initial stage, though to different extents and forms, face major transition traps (high inflation or hyperinflation and a huge fiscal deficit; transformational recession and de-industrialization; and rapidly growing poverty and income disparity). Many of them were hurt, in addition, due to the rapid disruption of the existing state system regulating foreign economic relations, by globalization traps (immensely increased vulnerability to external financial and trade shocks, chronic current account deficit, capital flight, and foreign debt), too.

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At the beginning of transition and opening up to the global economy, the systemic transformation traps were larger in those states in which the dichotomy between the initial conditions and the policies implemented was bigger. However, despite variations in the combination, in different countries, the most disappointing result was that no economy in the CIS or even Central and Eastern European (CEE) countries was able to avoid them. The degree of negative effect of the traps can, first of all, be judged by the depth and length of output and income declines.

The negative effect reached its most full-fledged forms in the countries that introduced the most radical forms of “shock therapy” with much less prior experience of market reforms. As noted by J. Kornai, it was not possible for them to “jump almost directly from classical socialism to post-socialism... In Hungary, the supplanting of bureaucratic co-ordination began much earlier, in 1968, after which gradual progress was made.”6 The results of such a jump could be observed first of all in Russia and in the majority of other NIS7 as well as in less developed CEE states.

Based on a comparative analysis and “re-evaluation of policies for transition to market economy,” Y. Nishimura proved that reforms in Russia were much more radical than not only in Hungary but Poland as well. Even in the latter country, “the transition to a market economy had a longer history, the policies for liberalization and macro-economic stabilization have been implemented more moderately and gradually.”8

In the second decade of transformation, an institutional approach was suggested by different economists to study systemic transformation as well as sustainable human development and economic growth. However, model institutions were assumed by orthodox economists affiliated with international organizations from today’s practice of developed market economies and again had not been properly adjusted to the individual conditions of countries in transition. The issue, as it was noted by Y. Qian therefore, was the political feasibility of the recommended policies.9

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Later, the problem of governance became the focus of some other economists and political scientists. Where should one search for the best practice of governance? J. Ahrens and W. Hoen warned that it should not be just transferred from the most developed countries. It is necessary to consider different initial conditions, economic structures, and stages of development and to adjust policy proposals respectively. Moreover, the experience and strategies of some newly industrialized countries like South Korea, Singapore, and Malaysia with rapid economic growth and progress in human development could suit such countries as CA NIS better.\textsuperscript{10}

Of course, economic performance can be affected not only by policies and their implementation, but also by various other factors, including natural resource endowments, geography, world prices of exported goods, political conditions, and so on. A real new consensus among economists on the key matters of the main factors of systemic transformation has not yet been reached. The following sections attempt to draw readers’ attention to the importance of the suitability of the adopted political and economic reforms to the readiness of the conditions to implement them properly.

**II. Political and Economic “Puzzles” of Central Asian States**

Despite growing criticism of orthodox neoliberal economists, because of the weak results of transformation aggravated by the recent global financial and economic crisis, market reforms based on monetarist approaches have dominated in numerous policy circles and experts of the IMF, World Bank, and EBRD throughout the whole period under consideration.

In the IMF working papers, “the output records of Uzbekistan” achieved within the first decade were considered to be “a challenge to the standard transition paradigm.”\textsuperscript{11} They were also presented as the “Uzbek growth puzzle” in terms of modest output decline and rather fast recovery compared with other countries in transition including even the most advanced CEE states.\textsuperscript{12}

Although afterwards several other books and papers were published on the “Uzbek model,” “Uzbek paradox,” and “Uzbek path” compared with other NIS from slightly different positions,\textsuperscript{13} and according to T. McKinley “its


achievements appeared to remain a frustrating puzzle to many orthodox economists.”

Meanwhile, an alternative explanation of the “Uzbek puzzle” given by one of the authors of this paper is recently supported by new data in V. Popov’s articles on the “economic miracle in Uzbekistan.”

At the same time, the most recent European Bank for Reconstruction and Development (EBRD) Transition Report “Stuck in Transition?” has introduced a new, Kyrgyz, “puzzle.” The question is why “Kyrgyz Republic democracy does not seem to have helped to improve economic institutions.”

Following the publication on November 20, 2013 of the latest Transition Report by the EBRD, University College London (UCL) organized a panel discussion. In the announcement of this event, it was stressed that “the latest report highlights that economic reform continues to stagnate in the transition region, as reforms face significant political, social and human capital constraints. Progress in transition across countries has been closely correlated with their political systems: more democratic countries have come further, in terms of reform, than less democratic countries. But even and especially in the more democratic countries, public opinion turned against market reform after the 2008–2009 financial crisis.”

No one argues that political and economic reforms are intertwined and to a certain extent interdependent. However, the correlation between them is not always as strict and direct as “more democracy—deeper reforms.” Reforms themselves must be assessed not only by their own depth and maturity but, first of all, by their results. The main criteria are their economic and social outcomes. From this point of view, it is possible to explain not only stagnation in economic reforms but also negative public opinion against them, reinforced by the latest global financial crisis, as well.

As for CA NIS, Transition Report 2013 admitted itself that the Kyrgyz Republic “is currently rated 7 on the Polity 2 scale—at the same level as Georgia, and almost as high as the Czech Republic and Latvia. However, neither early reform efforts nor democracy have so far translated into good economic institutions. With respect to governance, in particular, Kyrgyz economic institutions have generally performed significantly worse than its political institutions scores would have predicted.”


17 [http://www.ucl.ac.uk/european-institute/events/201314/transition#sthash.Qy4ktdWo.dpuf].

In this sense, recognition by the EBRD of this fact is very symbolic. The main theoretical conclusion of the report does not work even in respect of Kyrgyzstan. The Kyrgyz “puzzle” introduced in the report looks like a kind of reversed “Uzbek puzzle.” The meaning of the “Uzbek puzzle” is as follows: why did Uzbekistan without properly introducing the recommended policies achieve such impressive economic growth? As for the “Kyrgyz puzzle,” it is a vice-versa. Why is Kyrgyzstan, applying almost all recommendations, stuck in transition in its institution building, economic growth, and social and human development?

Of course, the empirical findings of EBRD’s *Transition Report 2013* will be under further consideration by researchers. Special interest could be drawn to a new interpretation of solid data series included in the *Transition Reports* for more than 20 years. For instance, analysis of political and economic reforms shows another, Central Asian, “puzzle”: why do they have exactly the reverse correlation—less political reform, better economic performance?

These “puzzles” are not mentioned in the *Transition Reports* or in any other sources but it is clearly seen in the case of CA NIS from the EBRD data on Polity 2 scale 2012 indices (political institutions, defined from –10 to +10; the latter denotes the highest score for democratization).

The lower the Polity 2 score in Central Asian states (Turkmenistan: –9, Uzbekistan: –9, Kazakhstan: –6, and Tajikistan: –3), the better the economic growth performance.

The group of other CIS and CEE countries with negative scores also includes Belarus: –7 and Azerbaijan: –7. They also confirm the reverse correlation with economic growth. In other words, it is strictly vice-versa (see Table 1).

### Table 1: Economic Growth Rating and EBRD Polity 2 Indices

<table>
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<tr>
<th>Economic Growth Rating, 2012 *</th>
<th>EBRD Polity 2 scale, 2013</th>
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<tbody>
<tr>
<td>1. Turkmenistan &gt;215%</td>
<td>–9</td>
</tr>
<tr>
<td>2. Uzbekistan &gt; 210%</td>
<td>–9</td>
</tr>
<tr>
<td>3. Azerbaijan &gt; 195%</td>
<td>–7</td>
</tr>
<tr>
<td>4. Belarus &gt; 175%</td>
<td>–7</td>
</tr>
<tr>
<td>5. Kazakhstan &gt; 170%</td>
<td>–6</td>
</tr>
<tr>
<td>6. Tajikistan &lt; 130%</td>
<td>–3</td>
</tr>
<tr>
<td>7. Kyrgyzstan &lt; 100%</td>
<td>+7</td>
</tr>
</tbody>
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*1989 is set to be 100%.


Of course, Uzbekistan and most of the other countries listed above are not good counterfactual countries for Kyrgyzstan from the viewpoint of their differences in resource endowments and other initial domestic and external

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In this respect, one cannot ignore the observation made by J. Ahrens and H. W. Hoen that for most CIS countries, including CA NIS today, “the straightforward trajectory of transition towards market based democratic system... is not feasible... It is not viable policy and strategy choice...”

If there is growing feeling against proposed forms of market reforms even among Central and East European peoples as well as Western economists, then it is necessary to take a closer look at the strategy of reforms and find proper ways for their implementation but not at the expense of economic growth and sustainable human development. It is very important to examine objectively the relationship between market reforms and economic growth. References to “significant political, social, and human capital constraints” mean that they have not been properly and in advance taken into account.

In this respect, an interesting picture can be seen from Chart 1 with GDP data. It gives additional grounds to challenge the EBRD Transition Reports’ conclusion about direct dependence between democracy and reforms again. Such countries as Turkmenistan, Uzbekistan, Azerbaijan, Kazakhstan, and Belarus in the last six to seven years are among those who are better off than the aver-

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20 Ahrens and Hoen, eds., Institutional Reform in Central Asia, p. 11.
age of the most democratically and economically developed Central and Eastern European states. Economic growth in such “democratic” and liberal states as Georgia, Ukraine, and Moldova is much worse than even in Kyrgyzstan.

According to the statistical (correlation) and econometric analyses (“means-adjusted Bayesian vector auto-regression,” BVAR) conducted in Transition Report 2011, Ukraine appeared to be the country most vulnerable to fluctuations in Eurozone output, followed by the three Baltic states. In the case of Ukraine, the analysis shows that its economy is also quite susceptible to external shocks in general from both the West and the East, especially Russia, as well as volatile oil, gas, and some other commodity prices.21 The political events at the end of 2013 and the beginning of 2014, besides some immediate reasons (entrance to EU issue and new legislature) and even consequent civil war, could be linked, in the author’s opinion, with these worsened economic and social situations.

The volatility in the world financial and commodity markets significantly affects through depressed exports and financing inflows nearly all of the countries in the CEE and CIS region. However, the trend is for the more reformed countries to show slower dynamic growth and greater vulnerability to external shocks. In other words, shocks of transformation and globalization have had a stronger negative effect on more politically and economically liberal CEE and CIS states. This phenomenon is confirmed by the experiences of all Central Asian NIS.

As for economic freedom, the picture is almost the same, with the one exception of Kazakhstan. According to the most recent economic freedom indices distributed by the Heritage Foundation together with the Wall Street Journal, Kyrgyzstan ranked 85 with an overall score of 61.1 within the group of moderately free economies. In this sense, it is superior to Tajikistan (ranking 139 with an overall score of 51.9), which has been positioned in the group of mostly unfree economies, as well as to Uzbekistan (ranking 163 with an overall score of 46.5) and Turkmenistan (ranking 171 with an overall score of 42.2), which are included in the group of unfree economies.22

So, the essence of the Central Asian “puzzles” is why less economically and politically liberal states within their systemic transformation have, as a rule, been showing more dynamic growth performance. On the other hand, the converse question is why the politically and economically more liberalized Kyrgyzstan has faced the most acute social problems with several revolutions that have drastically impeded its growth and development.

The answer is that the more rapid the political reforms and the more comprehensive the market reforms along with fast and unprepared-for opening up of the economy, the bigger the dichotomy between the initial conditions and

22 Index of Economic Freedom 2014.
the policies implemented, resulting in worse performance. Lack of political, economic, and social institutions as well as readiness of the state and people to make appropriate use of new opportunities within the recommended and implemented strategy of systemic transformation in CA NIS led to different approaches and results.23

To better understand what is behind the “puzzle” in each case, it is necessary to examine country by country their peculiarities. The mix of factors, which has really led to the main failures and certain successes in various countries in transition, is different.

III. “Uzbek puzzle”? 

This section of the paper attempts to find the answer to one of the main Central Asian “puzzles,” examining the case of the largest populationwise CA NIS—Uzbekistan. It is interesting how Uzbekistan in transforming its economy and integrating into the world market has managed to show one of the highest GDP growth dynamics among the CIS and CEE countries, as well as protecting itself from external shocks better than almost all of them.

Why does the case of Uzbekistan with its economic growth achievements remain a “puzzle” to orthodox researchers?

Firstly, Uzbekistan was the pioneer among all CIS countries that achieved a pre-transition GDP level in the first 10 years of independent development (2001). It was in the group of two leading countries among all countries in transition that, according to EBRD data, more than doubled their GDP in 2012 compared with the pre-reform period (1989). This is one of the best achievements among all post-socialist states. The dynamic economic growth continued and, according to an annual report, the GDP of Uzbekistan increased by another 8% in 2013.24

Secondly, Uzbekistan achieved even more remarkable results in its industrial development. The country suffered the least from fall in industrial output and managed to avoid the sharp de-industrialization of the economy that took place in almost all countries in transition within the first decade of transformation. Uzbekistan was the first country among CIS and CEE states that achieved a pre-transition level of industrial output in the mid-1990s, which doubled in 2007 and in 20 years, almost tripled (Chart 2).

Meanwhile, almost half of the CIS countries have not yet achieved the pre-transition level even in 20 years, including Kyrgyzstan (48%), Moldova (52%), Tajikistan (84%), Russia (84%), and Ukraine (93%). The latter exceeded

24 Here and below, the official data for 2013 are taken from the report of the President of Uzbekistan I. Karimov in the Session of the Cabinet of Ministers on Socio-Economic Development in 2013 and the Most Important Priority Directions of Economic Program for 2014 [“Narodnoe slovo” (January 19, 2014)].
the pre-transition level in 2006, but because of the strong negative effect of the most recent global financial crisis directly, as well as indirectly via the EU and Russia, its main economic partners, it has lost momentum and has not yet recovered (Chart 2).

Chart 2: Dynamics of Industrial Output in the Commonwealth of Independent States (CIS) in % (1991=100%)

In 2013, the volume of industrial output increased in Uzbekistan by another 8.8% and it has now more than tripled compared with 1991, while its share in GDP reached 24.2% compared to 14.2% in 2000. These indices by themselves are remarkable. But the most important thing is that re-industrialization was accompanied by structural and technological changes in this key sector of the economy.

Today, the share of manufacturing in industrial output of high-value-added commodities is more than 78%. In 2013, production in machine-building and mechanical engineering increased by another 21%, followed by 13.6% growth in the production of construction materials, 11.3% growth in light industry, and 9% growth in food processing. Overall, in 22 years of independent development, production of mechanical engineering has increased more than 14 times (Chart 3).
It is worth noting that quantitative changes have been achieved on a new technological basis. Modernization covered almost all branches of the industrial sector, especially the manufacture of telecommunications equipment, computers, mobile phones, and day-to-day consumer electronic goods, as well as the fuel sector. Its output, especially because of dynamically grown production of gas between 2005 and 2010, increased more than two times (Chart 4).

As a result of structural changes and diversification of production, the share of heavy industry is now predominant in total industrial output compared with light industry, which was leading in 1991. Now, the share of the latter is even lower than the share of food processing in industrial output (Chart 5).
Thirdly, the structure of agricultural production has been deliberately changed. This was done to avoid the so-called monoculture of cotton and to diversify this sector to reduce pressure on water use and the environment. Due to decreased designated plots of land, cotton production diminished from about 5 million to today’s 3–3.5 million tons. At the same time, Uzbekistan achieved grain and food self-sufficiency and started to export more of its fruits and vegetables. With optimization of the volumes of cotton production, farmers increased production of grain 2-fold, vegetables 3.2-fold, meat and milk 2.1-fold, and eggs 3.1-fold compared with 2000.

In 2013, the total volume of agricultural production increased by 6.8%. In absolute terms, it was 2.3 times greater compared with 2000. But, in relative terms, its share in GDP decreased within this period about 1.8-fold from 30.1% to 16.8%. This fact proves once more the trend towards further industrialization of the economy. Uzbekistan, which used to be mostly an agrarian country, is now becoming a more industrialized state.

Fourthly, crucial structural changes in the economy are also revealed in the relationship between production and services. Transition to a market economy in all post-socialist countries is connected with dynamic growth of the share of the tertiary sector in the economy in its GDP. The service sector in Uzbekistan contributes today to more than half of its GDP (53%) compared with 37% in 2000. Moreover, it is growing faster than many other sectors. In 2013, the volume of services increased by 13.5%. Special attention over two decades has been paid to the banking, transport, and telecommunications services and respective new infrastructures.

Another sign of systemic transformation is the decentralization of the economy and growth of small businesses and private entrepreneurship. In this
respect, due attention has been paid in Uzbekistan to their development from the beginning of economic reforms. Their role, especially since 2000, has been increasing rather rapidly, which can be seen from the growth in the number of small entities, their share of people employed (Chart 6), and in GDP (Chart 7).

**Chart 6: Growth in the Number of Small Business Entities and in the Share of People Employed by Small Businesses**

![Chart 6: Growth in the Number of Small Business Entities and in the Share of People Employed by Small Businesses](image)


**Chart 7: Share of Small Businesses in GDP (as %)**

![Chart 7: Share of Small Businesses in GDP (as %)](image)

* Small businesses include small enterprises, micro-firms, and individual entrepreneurship. Small enterprises employ up to 100 workers depending on the sector of the economy (light and food industry, metalwork, furniture, and construction materials industries up to 100 workers; machinery, metallurgy, fuel and energy, chemical, agricultural production, and agro-processing industries up to 50 workers; science and technology, transport, communications, trade, catering, and some other services up to 25 workers). Micro-firms employ up to 20 workers in the production sphere; in the services up to 10 workers; in trade and catering up to 5 workers. Individual entrepreneurship includes self-employed entrepreneurs.

In 2013, the contribution of small businesses was as follows: 55.8% of GDP (31% in 2000) and 75% (49.7% in 2000) of employment. They rendered almost their entire volume of services and produced 23% of total industrial output, and their share in exports reached 18%. To further promote their exports, the Special Foundation under the National Bank for Foreign Economic Relations was established with branches in all regions of Uzbekistan.

Fifthly, the modernization and structural changes of the Uzbek economy with comprehensive measures on localization of production together with export promotion and industrial policy have beneficially influenced the development of its external sector, both exports and imports. Foreign economic policy based on a combination of import substitution and export orientation permitted the protection and development of local industries. It also helped to promote modern sectors of the economy able to compete with foreign companies not only domestically under protection of high import tariffs but in regional and global markets as well.

These two strategies were intertwined and supported each other. Export orientation of manufacturing goods, especially in such sectors as automobile production, required development of locally produced spare parts and encouraged different forms of industrial cooperation. In 2013, 455 Uzbek enterprises were engaged in 1,140 localization projects. As a result, their production increased by 20% and, because of import substitution, they saved 5.3 billion USD. Within the recent last three years, the output of localized production increased two-fold.

The global financial crisis affected exports and imports. However, it did not impede the dynamic economic growth of Uzbekistan. Its exports within 22 years due to tax promotion and undervalued exchange rate policies have grown about seven times. In 2013, exports increased by 10.9% and exceeded imports by 1.2 billion USD. It means that in the last 11 years Uzbekistan has been exporting more than it imports, has a positive trade balance, and enjoys a surplus that has mostly been growing.

Another positive trend is connected with the increasing share of non-raw material goods in total exports. In 2013, it exceeded 72% compared with less than 30% in 1990. The share of cotton-fiber in total exports has been decreasing, while the share of fuel and energy has been significantly rising recently (Chart 8).

The share of cotton-fiber, which used to be the main item of Uzbek exports, has decreased. This has happened not only because of the decrease in cotton production but due to the increase in cotton manufacturing domestically as well. While its share has been steadily decreasing, the share of machinery and equipment, energy, metals, and chemicals has become predominant in total exports. Especially starting in 1995, these changes are on a rather firm trend. As for imports over the last 10 years, they have been growing in parallel with exports but to a somewhat lesser extent. There were also changes in the commodity structure of imports with the share of machinery and equipment in total imports playing an important role compared with the beginning of the 1990s (see Charts 9 and 10).
Geographically, exports in 2012 reached 179 countries (compared with 166 in 2011). It is worth mentioning that the share of non-post-Soviet countries in total exports increased from more than 11% in 1989 to more than 55% in 2011, about five-fold. However, such CIS countries as Russia and Kazakhstan continued to play an important role as the main trade partners. However, the most dynamic growth in foreign trade of Uzbekistan has been observed with China. Its share in 12 years in exports increased almost 69 times and in imports, about 90 times (Table 2).
Table 2: Share of Selected Countries in Total Exports and Imports of Uzbekistan (in million USD)

<table>
<thead>
<tr>
<th>Country</th>
<th>Export 2000</th>
<th>Export 2012</th>
<th>Change, %</th>
<th>Import 2000</th>
<th>Import 2012</th>
<th>Change, %</th>
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<td>5 177</td>
<td>850</td>
<td>510</td>
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<tr>
<td>Other non-CIS countries</td>
<td>1 756</td>
<td>3 721</td>
<td>112</td>
<td>1 527</td>
<td>2 695</td>
<td>76</td>
</tr>
<tr>
<td>Non-CIS countries</td>
<td>2 093</td>
<td>6 521</td>
<td>212</td>
<td>1 822</td>
<td>7 363</td>
<td>304</td>
</tr>
</tbody>
</table>


In early 2012, Uzbekistan joined the free trade agreement signed by the majority of CIS countries, including Russia, Ukraine, Kazakhstan, and other neighboring states, except Turkmenistan. Within less than one year, the share of trade with the CIS countries increased by 11.4% in total trade. It was mainly because of the dynamic growth of exports. The share of the CIS countries in total exports increased from 44.7% in 2011 to 54.3% in 2012. The main contrib-
utors to this growth were Russia, whose share in total exports of Uzbekistan increased within one year from 29.3% to 36.3%, Kazakhstan, from 11.1% to 11.8%, and Ukraine from 1.2 to 2.9%.

As for the main import partners, in 2012, they were as follows: Russia (20.4%), Republic of Korea (16.8%), China (14.7%), Kazakhstan (8.9%), Afghanistan (6.3%), and Turkey (3%). Among highly developed countries are Germany (3.8%), USA (1.8%), and Japan (1.7%).

Sixthly, there were no balance-of-payments problems even during the global financial crisis. Gold and currency reserves had increased within the period 2004–2012 from five to 15 months of imports, meaning three times in eight years. In 2013, the reserves increased by 2% despite a decrease in world prices of precious metals. State debt decreased from 59% in 2001 to 0% in 2013. As for foreign debt, it was rather modest—17% of GDP, about 60% of exports.

Savings and investment are considered to be a key priority for economic growth and development in any country. In 2013, about 13 billion USD worth of savings were invested into the economy of Uzbekistan, 11.3% more than in 2012. Almost half (47%) of all investments were made by private entities and physical persons. A total of 70% of all investments were used productively for construction and new production equipment. Foreign investments were about 3 billion USD, 72% of which or 2.2 billion USD were foreign direct investments (FDI).

In 2006, the national fund for reconstruction and development (FRD) was established and 5 billion USD were put into it by the Uzbek government. Now, its assets are about 15 billion USD. It supports the provision of industrial policy with necessary finance and attracts additional foreign investments with new technologies to top-priority sectors and projects. The FRD co-financed 86 investment projects with a total amount of more than 29 billion dollars. In 2013, it implemented 33 projects with a total amount of 780 million USD, 24% more than in 2012. Within the national investment program, 150 projects all in all worth 2.8 billion USD were completed in 2013.

Data on the share of the total amount of investments and foreign investments as a percentage of the GDP of Uzbekistan between 1995 and 2012 is provided in Chart 11.

A total of 66.6% of all investments were directed into production in the chemical, construction material, and food industries as well as fuel and energy sectors. Dynamic growth was also observed in the healthcare (166.5%) and education (142.4%) spheres, as well as housing and water and gas pipelines especially in rural areas. More than two-thirds of all foreign investments went to the transportation and telecommunications sectors (37.9%) and the fuel and energy sectors (30%).

Special industrial zones in Navoi, Angren, and Djizak with a branch in Syr-Dariya with tax holidays designated to promote innovations and high technology have been becoming popular among foreign investors in recent

years. Within a short period of time, the Navoi special industrial economic zone attracted more than 100 million USD and developed 19 projects. Their production of electronics, pharmaceuticals, and different other value-added commodities in 2013 increased by 25.8%.

Seventhly, social orientation of market reforms from the beginning of systemic transformation has been one of the main priorities of the strategy of gradual transition and state-led evolutionary reforms in Uzbekistan. Economic growth and step-by-step integration into the world economy have been combined with sustainable social and human development.

In fact, more than half of the state budget has been spent on social needs, education, science, and culture. In 2013, it consisted of 59.3% of all expenditure in the state budget. Expenditure for education was used not only for construction and reconstruction of schools, colleges, and universities, but for their modern equipment, computers, and new books, as well as for further improvement of the education process.

Last year, English as a foreign language was introduced from the first form in all schools of Uzbekistan. The proportion of classes and courses taught in English has increased in secondary and higher schools, as well as at all universities.

A tangible share of the budget has also been spent on healthcare to create modern well-equipped infrastructures and render up-to-date medical services in all regions of Uzbekistan. In 2013, the volume of expenditure for healthcare was for 3.8 times greater than in 2010.

Income disparity between the top and bottom 10% of the population is eight times in Uzbekistan, which is much less than in many other, including neighboring, countries. Money income over 20 years has increased almost four times and the Gini coefficient has decreased from 0.40 to 0.30.
It is worth noting that between 2000 and 2012 GDP per capita almost doubled while the proportion of the population below the poverty level decreased almost twice (Chart 12).

**Chart 12: Dynamics of GDP per Capita and Proportion of the Population below the Poverty Level (2000–2012), %**


In 2013, the real incomes of the population increased by 16%, while salaries for civil servants, pensions, and stipends distributed from the state budget increased by 20.8%. In Uzbekistan, incomes from entrepreneurship now comprise more than half of all household incomes compared to 20–25% in other CIS countries.

Of course, there are problems, like in any country, in Uzbekistan, too. Creation of new jobs for the rather fast-growing population and provision of proper employment is one of the most serious social problems. It is especially important to give more economic incentives to farmers and small and medium-size enterprises and businesses in rural areas with stronger demographic pressure for jobs. In 2013, 970,000 new jobs were taken by citizens of Uzbekistan, including 480,000 in the private sector and 210,000 in family businesses. More than 60.3% of all new job places were in rural areas. In 2014, it will be necessary to create even more jobs, half of them for graduates of professional colleges.

Meanwhile, migration from the labor-abundant Central Asian states to labor-deficient Russia is too large to ignore. According to the Central Bank of Russia, remittances sent by labor migrants to Uzbekistan were about one-sixth of its GDP in 2012.26 (In the same year, remittances from Russia to Tajikistan and Kyrgyzstan were about half of their GDP.27

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26 [http://www.eurasianet.org/node/66671].
27 RIA Novosti (January 2013) [http://en.ria.ru/world/20130125/179026395.html].
Macroeconomic policy in Uzbekistan, according to the IMF data, still needs to deal with double-digit inflation and multiple exchange rates (2013). The EBRD gave a gloomy outlook: Uzbekistan’s growth prospects will likely be constrained by the slow progress with structural reforms, continued direct-ed lending practices by the state, limited currency convertibility, and continued disengagement with international financial organizations (IFO).28

As it is well known, however, high inflation and hyperinflation is a heritage of all newly independent countries from the late Soviet period. Therefore, macroeconomic stabilization became one of the most urgent tasks in the early post-Soviet period. The recommended monetary policy was introduced in Uzbekistan within the first half of the 1990s in combination with effective use of fiscal instruments and social safety nets. It was not as rigid as in most of the other CIS countries, softening shocks to real sectors of the economy and in the social sphere.

Starting with 1997, inflation in Uzbekistan more or less stabilized with the CPI being around 20%. In 2003, strong efforts were made to reduce inflation to lower than the one-digit level. This was done up to a level of about 3%, but it affected economic growth. Afterwards, according to official statistics starting in 2004, it was somewhat relaxed but is still less than 10%. Meanwhile, deposits of individuals that were in the 1990s at a level between 0 and 1% (of GDP), due to relatively low inflation and reasonably high interest rates in the second decade, have increased four-fold from 1.8 to 7.2%.

In 2000–2013, because of growth of incomes and savings, consumption of the population increased 9.5 times. The structure of the consumption basket has been changing from mainly foodstuffs to a combination of foodstuffs with services and non-food commodities, especially durables (mobile phones, TV sets, refrigerators, computers, and cars). In 2013, 41.4 families out of 100 households had their own private cars, compared to 20 families in 2000. So, inflation in the last decade has not impeded economic growth and has not been too harmful in respect of real incomes and consumption of the population of Uzbekistan.

As for bank deposits and loans in 2012, they were at the level of 23.6% and 21.1% of GDP respectively (Chart 13).

As for the exchange rate policy that represents another important macro-economic instrument, Uzbekistan has also chosen its own, gradual, evolutionary way of liberalization. Considering the impact of the currency crises in Asia (1997), Russia (1998), and neighboring countries, the Central Bank of Uzbekistan in 1996–1999 tangibly devalued the national currency. In 2000 and 2002, the Uzbek som was devalued by 230% each year.29

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In October 2003, it was announced that the national currency would be convertible for current account operations in respect of exports and imports of goods and services. However, due to the negative impact of a rigid monetary policy on GDP growth rates, it has been loosening since the second half of 2004. Annual devaluation of the official exchange rate in the range of 4–11.5% in 2004–2013 together with tax privileges promoted the export orientation of the economy.

In fact, there is no disengagement with IFO. The IMF is currently providing technical assistance and training to Uzbekistan in a number of areas: budget and treasury reforms, banking and financial supervision, tax administration, national income accounts, and balance-of-payments statistics.\(^{30}\)

It is the same with the World Bank, which is now implementing several projects in Uzbekistan. Firm registration and tax reporting procedures were simplified and a large number of licenses and permits were abolished. This was acknowledged in the World Bank’s report *Doing Business 2013*, which upgraded the ranking of Uzbekistan by 24 points in two years.\(^{31}\) It is a good example that shows that Uzbekistan is ready to cooperate with IFO and follow, for instance, the World Bank’s substantiated recommendations, if they serve further economic and social development, in this case via a better business environment.

As a matter of fact, the most fruitful cooperation has been established between Uzbekistan and the Asian Development Bank (ADB). It could serve as a model for the other IFO and development agencies on how to cooperate with Uzbekistan. The contribution of Mr. Chino and Mr. Kuroda who headed the


ADB for most of this period and now Mr. Nakano is highly appreciated in Uzbekistan. Overall, the ADB has more than 40 projects worth 14.5 billion USD.

Most importantly, so far, the EBRD’s criticisms and outlook have not been confirmed. Economic growth continued to be high—not less than 8%—and the same level is forecasted for 2014. According to Moody’s rating agency, the banking sector outlook remains stable in the near future. Government spending on industrial modernization and rather strong domestic demand make prospects for economic growth in the medium to long term less gloomy than predicted. Twenty years, especially the recent decade of faster economic growth experienced due to alternative strategy of reforms with state involvement in economic development via export-led industrial and socially oriented policies, in fact, contrary to EBRD’s predictions, present good grounds for a more optimistic outlook.

**Conclusions**

In theory and in practice, there is a trade-off. On the one hand, is it better to follow orthodox market reforms with fast and simultaneous liberalization of all prices and exchange rates with slower economic growth and greater vulnerability to changes in the world markets? Or, on the other hand, is it better to make step-by-step reforms trying to maximize the domestic and external positive effects of economic growth and sustainable human development while cushioning against negative shocks whenever it is required? Uzbekistan from the beginning has chosen the second option based on a stage-by-stage evolutionary approach. This has become the main reason for certain disputes with the IMF, the EBRD, and the orthodox neoliberal economists affiliated with them.

Theoretically, Uzbekistan’s strategy is closer to “neoliberalism” in its first meaning as a combination of “the price mechanism, free enterprise, system of competition” with “a strong state” and “state policy to temper social inequality” [A. Rüstow, W. Röpke, A. Müller-Armack or the so-called, ordoliberalism of W. Eucken, F. Böhm]. In practice, these ideas were first implemented in the post-World-War-Two FRG under L. Erhard’s reforms and laid the foundations for a social market economy in Germany and for its “economic miracle.”

One of the proponents of the “Uzbek model” wrote a series of articles entitled “An Economic Miracle in the Post-Soviet Space. How Uzbekistan Managed to Achieve What No Other Post-Soviet State Has.” He argued that “the economic success of Uzbekistan resembles the Chinese—gradual economic reforms with the strong state institutions, good macroeconomic policy, and an export oriented industrial policy” based on “an undervalued exchange rate together with strong tax stimuli for the export of manufactures.”

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32 Попов В. Экономическое чудо переходного периода: как Узбекистану удалось то, что не удалось ни одной постсоветской экономике // Экономическое обозрение. Ташкент, 2013. № 7.
Of course, export-oriented industrial policy has been a key element in these kinds of reforms and development in Uzbekistan. In this respect, it learnt lessons from the “East Asian miracle” that first appeared in post-war Japan and tried to properly adjust them to its conditions considering specific domestic and external circumstances.

Another proponent of the reform strategy in Uzbekistan, T. McKinley, writing about “Puzzling Success of Uzbekistan Heterodox Development,” concluded that the non-orthodox “policies have served it fairly well” “over two decades’ transition and development” and it has become “relatively successful.”

After 10 years of systemic transformation, it had become clear that the outcomes of suggested market reforms were not satisfactory and the problems were connected not only with their implementation, but a misunderstanding of the market economy and the institutional reform process. Now, more than 20 years after, non-orthodox strategy has been admitted by more and more economists to be a better option for most countries in transition.

From this viewpoint, the achievements of Uzbekistan is not a “puzzle,” but the logical result of its efforts to gradually introduce, step-by-step, market reforms combined with state-led industrial export-oriented policy. The most important thing in this strategy is to make the following steps of reforms upon the readiness of state, institutions, and people motivated to support them wholeheartedly and not to resist, but implement them properly. Some steps can be taken more rapidly, but some steps require more time. Unpopular steps, whenever necessary, can also be taken but they should lead to positive economic and, especially, social outcomes.

It is not revolution with overall liberalization and de-regulation through radical transformation but political and economic evolution within gradual systemic transformation that has been more appropriate for all Central Asian, as well as many other CIS, countries. Their transition was combined with building independent states and economies as well as civil societies able to face the challenges of transformation and integration into the world economy and community. CA NIS, besides, had from the beginning additional tasks to meet the challenges of development as well. The generation and proper evolution of a developmental state with market institutions and people with a new way of thinking ready to make a step-by-step transformation are the main factors in the success of Uzbekistan since its independence.

Thus, from the analysis of 20 and more years of systemic transformation in CA NIS with special focus on Uzbekistan, the following main conclusions can be drawn:

33 McKinley, “The Puzzling Success.”
34 Stiglitz, “Whither Reform? Ten Years of the Transition.”
35 Ahrens and Hoen, eds., Institutional Reform in Central Asia.
1) It is high time to reconsider approaches according to which assessment and ranking of achievements of countries in transition are made not by real economic results but solely by the level of implementation of orthodox reforms. Market reforms have not been undertaken for the sake of reforms. They are not the goal, but the tools to achieve a higher level of economic efficiency and social and human development. The goal is the formation of a developed state—advanced knowledge based on a mixed economy with modern production and equitable distribution. Experience of post-World-War-Two Japan, which within a short period of time became one of the most developed countries in the world, could serve as an inspiring model not only for East Asian states, but Central Asian states as well.

2) Countries in transformation that are unable to achieve a pre-transition level of GDP and industrial output within 20 years should not be considered as good reformers. And, vice-versa, countries whose production has doubled or even tripled and whose human development indices have drastically improved should not be criticized as slow reformers.

3) If a certain speed and sequence of reforms promote systemic transformation without worsening but improving social and economic indicators, then this is the better way for reforms in the respective country. However, if full-fledged political and economic reforms bring negative economic and social outcomes with minimum or no support of the people, then it is necessary to adjust the policy recommendations and implement a more appropriate strategy.

4) It is now clear that all Central Asian states had to adjust their general prescriptions of market reforms to their political, economic, social, demographic, ecological, and other circumstances. Those countries that have managed to do this show better results in economic and social development.

5) The experiences of transition to a market economy and integration into the global economy bear witness to the gradual step-by-step systemic transformation better suiting most of them. This can be observed in all stages: cushioning against shocks of systemic transformation and disintegration of the FSU at the beginning of the 1990s, as well as negative impacts of regional (Asian in 1997, Russian in 1998), global financial (2008–2009), and Eurozone (2011–2012) crises, and recovering from them, providing sustainable economic growth and development.

6) Of course, further reforms will be needed in all Central Asian states. In this respect, the expertise of IFO, highly developed states, first of all Japan and Germany, as well as East Asian newly industrialized countries could be very helpful. The only point is that these reforms should be tailor-made and properly adjusted to the specific conditions of the respective country. In this case, they will bring the benefits of positive economic growth and human development. Then, they will not “face significant political, social and human capital constraints.”
7) As for the case of Uzbekistan, it has transformed from a centrally planned administrative-command system to a developmental state promoting gradual socially-oriented market reforms with export-led industrial policy. It is included in the group of fast-growing states. Despite the global financial and regional crises, its annual economic growth has been 8–8.5% in all the last nine years. It is important to sustain it in the near future when the prices of its exportable goods show signs of decrease. For this, high speed of economic growth needs to be backed up by further private-sector development and macroeconomic, structural, and especially institutional reforms. It is also necessary to:

- choose proper steps related to foreign exchange and trade regimes;
- form a full-fledged competitive environment;
- further improve the business and investment climate;
- provide new jobs for 1 million people, half of whom are graduates of professional colleges.