

# Acta, Non Verba: Privatization Issues of State-Owned Enterprises (SOEs) in Uzbekistan

*Aziza Umarova, Visiting Fellow at Davis center for Russian and Eurasian Studies,  
Harvard University*

*Institutional, Policy and Governance Reform Expert / CEO of SmartGov Consulting*

## 1. INTRODUCTION

Since Shavkat Mirziyoyev came to power following the death of the former leader Islam Karimov in 2016, Uzbekistan showed a proactive approach towards governance reforms, improved foreign relations in the region of Central Asia, and initiated a raft of economic reforms, designed to strengthen the strategic positioning of the country. The country was on push up for foreign investment, using its favorable macro factors, such as large foreign exchange reserves, low government debt, and youthful demographics. Among the most significant results so far have been the liberalization of the foreign exchange market and currency depreciation, improvements in the quality of economic data, promotion policies to increase private sector competitiveness, partial deregulation related to the functioning of the economy, including the simplification of licensing required for doing business in many fields. In addition, practical steps have been taken to bring about greater openness in several economic sectors, stepping up country promotion efforts.

Karimov's refusal to embrace potentially destabilizing market reforms and his desire to preserve the assets under his control left independent Uzbekistan a Soviet-style autarkic economy with excessive state dominance and state enterprises<sup>1</sup> with vested political and private interests. And this legacy determined the path. Paradoxically, SOEs have long been seen as a vital tool for advancing the nation's industrial policy goals. Uzbekistan has

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<sup>1</sup> Abdullaev (2020) *State-Owned Enterprises in Uzbekistan: Taking Stock and Some Reform Priorities*. Asian Development Bank <https://www.adb.org/publications/state-owned-enterprises-uzbekistan-taking-stock-reform-priorities>

enacted several activist industrial policies during the past 20 years to sustain the nation's current industrial capacities and foster the growth of new ones.

The country certainly made some undeniable progress, however, SOEs, it is alleged, run 55% of Uzbekistan's economy.<sup>2</sup> Data scarcity emerges as one of the main challenges, due to the lack of regulation in the legislation on the issue of ownership of economic entities by the state and the exercise of control by the state. It makes it an *arduous task* to determine the real number of all SOEs, in all varieties of their forms.

Focusing on the ideas of Limited Access Order (LAO), the current paper sought to apply this framework to the context of the political economy in Uzbekistan.

## 2. THEORETICAL APPROACH

Before discussing in greater detail, the situation in Uzbekistan regarding the SOEs, it may be well to point out certain theoretical approaches.

In the first place, Max Weber coined the phrase patrimonialism in 1947<sup>3</sup>, it implies that the state intervenes in the economy and the economy traditionally depends on rents, which are essential to sustaining the rent-seeking elite and at the same time enabling patronage of the society. Term and paradigm have been repetitive in several scholarly works related to the region of the former Soviet Union <sup>456</sup>

In the second place, to understand how this relates to development, one could apply the framework from a seminal study by North et al<sup>7</sup>. North argued that all societies must solve the problem of violence and distinguishes between two ways in which societies solve this

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<sup>2</sup> Rapoza, Kenneth. (2022) Uzbekistan: From Privatizing Everything to Leapfrogging 30 Years. *Forbes* [Uzbekistan: From Privatizing Everything To Leapfrogging 30 Years \(forbes.com\)](https://www.forbes.com/2022/02/15/uzbekistan-privatization-leapfrogging-30-years/)

<sup>3</sup> Weber, Max (1947). The theory of social and economic organization. New York: The Free Press

<sup>4</sup> Ades, Alberto, and Rafael Di Tella. 1997. "The New Economics of Corruption: A Survey and Some New Results." *Political Studies* 45 (3): 496 –515

<sup>5</sup> Becker, Uwe, and Vasileva, Alexandra (2017) [Russia's political economy re-conceptualized: A changing hybrid of liberalism, statism and patrimonialism \(sagepub.com\)](https://www.sagepub.com/journals/rupe)

<sup>6</sup> Hale, H. E. (2007). Correlates of clientelism: political economy, politicized ethnicity, and post-communist transition. In H. Kitschelt, & S. I. Wilkinson (Eds.), *Patrons, clients, and policies. Patterns of democratic accountability and political competition*. Cambridge: Cambridge University Press

<sup>7</sup> North, Douglass C.; Wallis, John Joseph; Webb, Steven B.; Weingast, Barry R.. 2007. *Limited Access Orders in the Developing World : A New Approach to the Problems of Development*. Policy Research Working Paper; No. 4359. World Bank, Washington, DC. World Bank.

<https://openknowledge.worldbank.org/handle/10986/7341> License: CC BY 3.0 IGO.

problem. He asserts that limited access orders (LAO), covering most developing countries today, solve the problem of violence by granting elites privileged control over parts of the economy, each getting some share of the rents. Rents are produced by restrictions on both function and resource access. Access and competition must be restricted to preserve the stability of rents and, by extension, the social order. The typical LAOs of today comprise state-controlled industries, difficult business licensing requirements (for new entries), and "corrupt" patron-client networks in contrast to an open-access society. Open access, rent-making, and selective repression of competition are how LAOs survive. By restricting access, LAOs opt for rent-creation and the selective suppression of competition. This makes the transition more difficult to understand, much less to implement or trigger by deliberate policy interventions, and deserves further discussion<sup>8</sup>. Scholars argue that the reforms will be opposed by those who directly profit from market distortions, such as monopoly profit-making companies or organizations that obtain services at reduced costs.

In the third place, Waterbury emphasized the question of public sector reform as the *heart of the matter* in the adjustment process. He argues that the SoE sector is the lynchpin of a reputedly powerful coalition of beneficiaries with well-established claims to public resources.<sup>9</sup> The pathology is the chronic loss-making SOEs and market distortion.

As will be described in the article, specific signs of LAO culminate in stifling competition by distorting the market. It also may have political ramifications by **eroding competition policy institutions**.<sup>10</sup>

### 3. LEVEL PLAYFIELD FOR THE PRIVATE SECTOR

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<sup>8</sup> Yakovlev, Andrei (2021). Composition of the ruling elite, incentives for productive usage of rents, and prospects for Russia's limited access order, *Post-Soviet Affairs*, DOI: 10.1080/1060586X.2021.1966988  
To link to this article: <https://doi.org/10.1080/1060586X.2021.1966988>

<sup>9</sup> Waterbury, John (2018). In Kaufman, R.R., & Haggard, S. (eds) *The Heart of the Matter? Public Enterprise and the Adjustment Process* John Waterbury. *The Politics of Economic Adjustment: International Constraints, Distributive Conflicts and the State*. Princeton: Princeton University Press.

<sup>10</sup> Rob Robinson, N. (2013). Russia's response to crisis: the paradoxes of success. *Europe-Asia Studies*, 65(3), 450-472

As part of the reform package, the government earlier announced its readiness to move on massive privatization of both SOEs and banks, this would increase competition and minimize conflict of interest or the persistence of vested interest networks<sup>11</sup>.

A wide spectrum of decrees was adopted, culminating in the adoption of the Strategy of privatization of SOEs 2021-2025. The government announced that 75% of all SOEs will be eliminated, and the state's share in 115 will be fully sold. Specifically, in oil and gas, energy, chemical, and banks, as well as oil and fat, alcohol, newspapers, and markets. Among the key reasons was unjustifiable ownership of SOEs, e.g. keeping government ownership in areas where competitive environments exist (shopping malls, food processing and textile industry, services, tourism).

Furthermore, the government decided to introduce the “explain or sell” approach.

- Restrictions on state participation: Prohibition on the creation of enterprises in areas where competition is developed, the introduction of Singapore’s Yellow Pages Rules
- Privatization and PPP: Systematization of the legislation on privatization, the widespread introduction of the IPO practice, and widespread use of PPP in the field of transport, commercial facilities, road construction, energy, etc.
- Corporate governance: Transition of SOEs to market mechanisms, the introduction of performance evaluation of the executive body and the Boards<sup>12</sup>.

The fundamental purpose of state regulation is to nurture growth. According to the figures presented by the Agency for Management of State Assets (key driver at that time, later responsibilities were re-organized between the Ministry of Finance and the Agency) at

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<sup>11</sup> *Uzbekistan - Systematic country diagnostic (English)*. Washington, D.C. : World Bank Group. <http://documents.worldbank.org/curated/en/304791468184434621/Uzbekistan-Systematic-country-diagnostic>

<sup>12</sup> Lex.uz (2021) Decree of the President “Strategy on the managing and transformation of the SOEs” No. PP-166 of 29/03/2021 [166-сон 29.03.2021. 2021-2025 йилларда давлат иштирокидаги корхоналарни бошқариш ва ислоҳ қилиш стратегиясини тасдиқлаш тўғрисида \(lex.uz\)](#)  
Decree of the President of the Republic of Uzbekistan No. PF-6096 dated October 27, 2020;  
Decree of the President of the Republic of Uzbekistan No. PP-3067 dated 16.07.2017;  
Decree of the President of the Republic of Uzbekistan No. PF-5552 of October 11, 2018;  
Decree of the President of the Republic of Uzbekistan No. PP-4112 of 14.01.2019;  
Decree of the President of the Republic of Uzbekistan No. PF-5666 dated February 19, 2019;

the discussion of the draft of the Strategy for privatization for the international community in March 2020, the number of SOEs is more than 3000, more than 1,800 in the form of state unitary enterprises (SUE). SUEs set up by SOEs or state bodies had the right to be contracted directly or work without a license, adversely affecting competition. Around 30% of 900 SOEs enjoyed tax and duty subsidies, distorting the market for the private sector. 1.6% was the level of ROA and only 57% or 1,703 SOEs received a net profit.<sup>13</sup>

Apart from the problem of performance, one should also keep in mind that in the country SOEs generate only 6% (estimates fluctuate between 6 to 20%) of formal employment<sup>14</sup>. These examples are *non sequitur* with sacrosanct statist thinking and illustrate the inability to create jobs and enable inclusive and equitable economic growth. As politics and economic power entwine, a society's political system does not evolve independently of the distribution of social inequality.

The question naturally arises as to why incentives and institutions for corporate governance are not strengthened to manage more effectively responsibilities as company owners, thus helping to make state-owned enterprises more competitive, efficient, and transparent. Instead, command and control orders continue flowing from the government to specific enterprises, in addition to overarching key functions, such as appointments of the CEO and all members of the Boards of Directors, investment programs, grants subsidies, access to loans, waivers for custom clearance, and tax. Inevitably, the overwhelming majority of Boards remain *politicized* and disengaged, dominated by public officials, the minimal role of the independent member of the Board, rare in-person meetings of the Boards, and unpublished protocols of the Boards. These should have been the critical regulatory expectations and may have had an important bearing on the situation with the performance of SOEs.

The preceding assessment of SOEs is in no sense intended as a disparagement of the progress made in the regulatory framework since 2016. Overall, progress is evident and widely acknowledged. Indeed, numerous decrees openly describe the problem and

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<sup>13</sup> Spot.uz (2019), Explain of selling your share, how the government will decrease its share in the economy, available at [Объясняй или продай: как государство сокращает свое участие в экономике – Spot](#)

<sup>14</sup> Data in the official presentation of the Agency for Management of State Assets 2020 March

address the reform challenges, and the respective legislation is in a state of flux. Yet it remains to be seen how and when it will be implemented, the mismatch between regulation and its implementation in practice, whereas policies are aborted or altered when practical implementation remains difficult, raises the question of the bureaucracy's capacity to implement the declared ambitious reform agenda.

Perhaps the pandemic has impacted all areas of the economy, resulting in the delay of privatization plans, as well as the situation with the monopolies. But the slow pace of reforms could also be a litmus test for the lack of incentives.

Another rift between the SOEs and public welfare is most glaring in the *competition policies*. According to the public record, 80 percent of *monopoly* organizations<sup>15</sup> have a state share or are controlled by business entities with a state share. The underdevelopment of the market environment and the excessive participation of the state in the economy lead to the inefficiency of the activities of individual business entities with the participation of the state, which is offset by state support in the form of cross-subsidizing, providing tax and customs benefits, preferences, and preferential loans.

Just as North et al. suggested, in LAO better local institutions (outside the enclave) remain dysfunctional, which creates a barrier to entry that benefits incumbent elites. The latest report on the competition legislation in Uzbekistan concluded that the Antimonopoly Committee of the Republic of Uzbekistan (ACRU) should clarify the goals of its competition policy to ensure focus and prioritization in enforcement as it may negatively impact the competition enforcement and result in contradicting outcomes. OECD authors argue that country should increase the efficiency of ACRU by ensuring its financial security and freedom from political meddling<sup>16</sup>.

Economic structure matters and determines political conditions. Neither the government nor SOEs, supposedly “picked as the winners”, can effectively promote inclusive

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<sup>15</sup> According to data of the Anti-Monopoly Committee, at the end of 2019, 137 natural monopolies existed in Uzbekistan. In comparison to 2018, this number has decreased by a mere three.

National registry of monopolies of Uzbekistan [Государственный реестр субъектов естественных монополий - Антимонопольный комитет Республики Узбекистан \(gov.uz\)](http://gov.uz)

<sup>16</sup> OECD (2022), An Introduction to Competition Law and Policy in Uzbekistan, OECD Publishing, Paris, [www.oecd.org/daf/competition/an-introduction-to-competition-law-and-policy-inuzbekistan.pdf](http://www.oecd.org/daf/competition/an-introduction-to-competition-law-and-policy-inuzbekistan.pdf)

economic growth. It is the opposite. In the absence of competition in the market, monopolistic market structures with a specially privileged relationship with the authorities cause exaggerated costs. Such a form of statism may contain the germs of its own destruction.

Enough has been said to indicate the problematic nature of the economy dominated by the state. But the counterargument for slowing down privatization efforts and keeping dominance in the economy could be empirical data and some mixed records from privatization in various parts of the former USSR (e.g. Russia, Kazakhstan). Privatization of SOEs is a double-edged sword as there is a risk that non-transparent privatization of state assets can pose a potential risk of an oligarchic economic structure being formed. Another possible explanation for delaying reforms is a consideration for labor force. Modern history remembers several waves of reforms in developing economies that involved reductions in public outlays, layoffs of public personnel, and liquidation or consolidation of SOEs. However, as stated earlier, the number of jobs created by SOEs is too insignificant and cannot be used as an argument in Uzbekistan.

We may close this chapter with a few general observations. The issue at stake is much more fundamental than that of the operational efficiency of the public sector. It is SOEs-turned-monopolies and constraining access to the market that impacts prospects for the sound and competitive business sector.

#### **4. CONCLUSIONS AND RECOMMENDATIONS**

Academic literature states that the various elite groups within an LAO may change their preferences for the utilization of available rents depending on the external environment and the overall motives of the elite. Yet we know too little about the mechanisms and institutions by which a mature LAO sustains these institutions and motivates members of the dominant coalition. But I would agree with the Russian scholar Yakovlev, concluding that the experiences of Singapore, South Korea, Malaysia, and other nations show unequivocally that a LAO's successful economic and political transformation occurs when the process is started by a strong charismatic leader who can present a

future vision that unites various social groups<sup>17</sup>. The ability of the strong leader to establish a system of institutions capable of sustaining the transformation process and ensuring the productive use of a significant portion of the rents at the elites' disposal during their term in office, however, is what determines how long the results obtained will last.

Under any system, delicate adjustments are at the time necessary. Implementation of regulatory frameworks to contest the advantages of SOEs should replace predatory policies favoring SOEs and monopolies. The most important lesson is the necessity to distinguish between the interest of one enterprise and broader societal outcomes, such as developing competitive markets. The author believes that privatization and liberalization of public enterprises could free up public money (through subsidies) and yet significantly reduce the scope for rent-seeking broadly.

Presidential elections took place in Uzbekistan in late 2021. Within the ongoing 7-year term, it is feasible to implement transformative reforms that would focus on public-sector efficiency and competitive dynamics for companies. All this leads us to acknowledge that playing a smaller role in the economy, could help the government to prioritize its **core** government functions - better manage and deliver public resources. Equally, implementing future privatization programs through transparent mechanisms could generate cash to reach broader societal goals.

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<sup>17</sup> Yakovlev, Andrei (2021) Composition of the ruling elite, incentives for productive usage of rents, and prospects for Russia's limited access order, *Post-Soviet Affairs*, 37:5, 417-434, DOI: [10.1080/1060586X.2021.1966988](https://doi.org/10.1080/1060586X.2021.1966988)

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