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FINAL REPORT

PROJECT FORMULATION ON
BUSINESS PROMOTION PROGRAMS
(UZBEKISTAN)

SERVAER
CONSULTING

QUALITY-TIME-RESULTS

List of Abbreviations

ABA/CEELI	American Bar Association - Central European and Eurasian Law Initiative
ADB	Asian Development Bank
BAS	Business Advisory Service
CabMin	Cabinet of Ministers
CBU	Central Bank of Uzbekistan
CEIE	Committee for Economic Insolvency of Enterprises
CEM	Country Economic Memorandum (World Bank)
CIS	Commonwealth of Independent States
DIF	Direct Investment Facility
EBRD	European Bank for Reconstruction and Development
EU	European Union
FDI	Foreign Direct Investment
FI	Financial Institutions
GDP	Gross Domestic Product
GOU	Government of Uzbekistan
GTZ	German Technical Cooperation Agency
IAS	International Accounting Standard
ICG	International Crisis Group
IFC	International Finance Corporation
IFI	International Financial Institution
ILO	International Labor Organization
IMF	International Monetary Fund
MOF	Ministry of Finance
MOJ	Ministry of Justice
MSE	Micro and Small Enterprises
NBU	National Bank of Uzbekistan for Foreign Economic Activity
NGO	Non-Governmental Organization
OECD	Organization for Economic Cooperation and Development
OTC	Over the Counter
PCA	Partnership and Cooperation Agreement
SME	Small and Medium Enterprise
TACIS	Technical Assistance for Commonwealth of Independent States
UNDP	United Nations Development Program
USAID	United States Agency for International Development
VAT	Value-added Tax

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I. INTRODUCTION

A. Uzbekistan: Background

Of the fifteen states of the former Soviet Union that became independent in 1991, Uzbekistan is the third largest in population, with approximately twenty-five million people, and the fourth largest in land area (447,000 square kilometers, World Bank, 2003). The country is the cultural and historical heartland of the Central Asian region, with its legacies from the golden era of medieval Islam and its glittering Silk Road cities. Currently, an estimated twenty-eight percent of the population lives below the national poverty line; two-thirds of those people live in rural areas (World Bank, 2003). Approximately half of the population is considered 'working age' (16-60 years old for men, 16-55 for women), and approximately forty-three percent are below and seven percent are above working age (UNDP 2001). From 1997 to 2001, the labor force increased by more than 9.7%, especially in rural areas. Forty percent of total employment is in agriculture (UNDP 2001).

Uzbekistan has a GDP of \$12.8 billion, with an average growth rate of about 4% annually since 1997, and an estimated GDP per capita of U.S. \$500. A significant portion of Uzbekistan's budget is made up of foreign aid, with the World Bank alone disbursing about \$268 million from 1994-2003. Uzbekistan's overall public sector deficit (including state enterprises) was at least 7% of GDP in 2000. Government procurement made up approximately 30% of public expenditures (9% of GDP) during 1999-2001. In 2001, total expenditures were approximately \$513 million, or 352.658 million sown. The government's revenue was 32.6% of GDP in 2000; expenditure and net lending were 33.2% of GDP in 1999. There was a steady decline in the monetization of the economy during the time period 1996-2002 as a result of high inflation, together with Lars exchange rate devaluations, low trust in the banking system, and restrictions on access to cash. Foreign direct investment has been steadily declining in recent years, and net FDI inflow per capita is now lower in Uzbekistan than in any other CIS country (Heritage Foundation 2004 World Bank, 2003).

Uzbekistan is rich in natural resources (such as coal, copper, gold, natural gas, oil, silver and uranium) and was at one point a leader in cotton production. However, mineral resources are underexploited, and cotton yields have actually been declining in recent years. The country is also experiencing severe environmental degradation due to the use of agro-chemicals, the diversion of water for agricultural irrigation, and poor drainage systems; such environmental problems will further adversely impact the agricultural sector, as well as the wider economy and the health of the population (World Bank 2003).

Uzbekistan embarked on a gradual process of economic restructuring and privatized some enterprises in various state-run industries, including fuel and energy, chemical, metallurgical, and machine building industries, and agriculture. Yet, the country's annual revenues from privatization were only about 0.1% of GDP during 1998-2000. Privatization was not only limited in scope but often nominal, leaving the government in de facto in control of firms irrespective of their ownership structure. The government also controls many prices and allocation of key products and commodities. In short, despite progress on restructuring and privatization since 1991, Uzbekistan's productive sectors are still largely under state control and remain highly inefficient.

B. Economic Environment

Uzbekistan remains a laggard in economic reform. State intervention and control of the economy is pervasive, in particular in the financial system and external trade. A further tightening of import substitution policies and the attempt to eliminate informal economic transactions has led to a further deterioration in the investment climate.

Growth over previous years has been well behind the regional average. A revival in growth in 2004, to an estimated 7.4 percent, has been driven by some productivity gains in the agricultural sector, and by the exports of state-owned industries, which have benefited from preferential access to credit, and reduced tax and tariff rates. While this represents a substantial acceleration over previous years, it is unlikely that such growth rates can be sustained in the absence of reforms. International organizations have expressed serious concerns regarding the transparency and consistency of Uzbek national accounts data, which impedes an accurate assessment of the macroeconomic situation.

The unification of exchange rates represents a major achievement. In the period leading up to the introduction of current account convertibility in October 2003, several restrictive exchange regulations were lifted. Foreign investors now report a much improved availability of foreign exchange in the OTC market. However, access to foreign currency is still regularly disrupted. The private sector reports delays in obtaining foreign exchange for certain consumer goods. At times when the government or state-owned enterprises have large foreign payment needs, private applications for foreign exchange appear to be delayed, suggesting that administrative controls are still in place. Nevertheless, the authorities now hold very substantial foreign exchange reserves, according to official numbers at a level equivalent to over six months of imports of goods and services, which should ameliorate concerns regarding the stability of the exchange rate.

The introduction of current account convertibility has gone hand in hand with a tightening of a pervasive system of rationing domestic currency in circulation. Foreign and domestic investors now cite this as the primary impediment to doing business in the country. Retail outlets are required to deposit their cash receipts with their local commercial bank daily and commercial banks in turn are required to surrender most cash to the Central Bank system. Cash withdrawals from commercial banks are approved according to a list of prioritized uses mandated by the Central Bank. However, even for payments which are deemed a priority, such as wages, requests by account holders are rarely met in full. Restrictions on commercial banks' access to their correspondent accounts have further contributed to cash shortages. This system of cash rationing represents a particularly severe operational obstacle for small and micro enterprises with limited working capital, and has contributed to the re-emergence of wage arrears, in both private and state-owned enterprises. Claims that are settled in cash therefore regularly benefit from a discount, and there are strong incentives to conduct payments informally, rather than through the banking system. The fact that the largest banknote has a value equal to less than 1 (one) USD creates additional problems and costs for consumers and companies.

The financial system remains largely dysfunctional. Depositors' confidence in the banking system is low, given the restrictions on cash withdrawals outlined above, and the tax authorities' right to debit individual accounts without the account holder's prior permission.

Moreover, at the end of 2004, a number of decrees on the introduction of cash-less payments systems were passed. While the authorities have since scaled back their ambition on this project in response to public comments, uncertainty with regard to the use of domestic currency has increased, and public confidence in the banking system was further undermined.

Credit to entities other than the consolidated government remains low, at an estimated 24 percent of GDP. The access of many SMEs and micro enterprises is further impeded by the multiple regulatory and licensing requirements that potential borrowers have to document to banks. These credit constraints come against the background of a rapid accumulation in the central bank's foreign assets and an expansion in broad money by over forty percent in 2004.

The banking sector remains highly concentrated. The top two state-owned banks account for 60-70 percent of total bank assets and remain essentially unreformed. Official data suggest that asset quality is good, with less than two percent of assets classified as doubtful or in loss at end-2003. However, the private sector and assessments of other institutions suggest that following the major devaluation and a period of low economic growth, a much larger part of the portfolio is doubtful, in particular the assets that had previously been guaranteed, or directed by government intervention. Nevertheless, over the past two years the government has imposed tight restrictions on the extension of further sovereign guarantees.

The government has pursued a fairly disciplined fiscal policy. The 2005 budget introduced a number of changes in tax policy, most notably a further reduction in the corporate income tax from 18 to 15 percent, and a reduction in the sales tax levied on small enterprises. Under the so-called localization program, the government has also considerably widened the exemptions from customs duties and profit taxes for selected enterprises. Together with a number of tax increases this is expected to result in a modest consolidated budget deficit of about 3 percent of GDP. A key uncertainty in projecting the government balance is the contributions into the newly created funded pension accounts. Over the medium term, the government intends to further reduce individual rates while broadening the tax base and strengthening tax enforcement. Following a zero net borrowing policy, the authorities have successfully reduced gross public debt to about 38 percent of GDP. After a peak in debt service in 2004, and given the projected further decline in the external debt to GDP ratio, this will substantially reduce external vulnerability.

Despite the stated objective of simplifying the tax structure for the corporate sector, both domestic and foreign investors view unpredictable tax rules, and arbitrary tax enforcement as a key factor in explaining the very poor investment environment. Lack of transparency and the discretion granted to tax and other law enforcement agencies have facilitated rent extraction from the private sector. A recent survey of SMEs by the IFC revealed a number of obstacles to doing business in Uzbekistan. Apart from restrictions on cash withdrawal from bank accounts, respondents cited difficulties in using land as collateral, the limited enforceability of contracts, and the restrictions imposed on individual traders. Together, these factors explain a low and declining propensity to reinvest profits in the country. European embassies in Tashkent report a near absence of interest from their investors, and point to several notable efforts to withdraw or scale back existing assets. One exception is the textile processing sector, in which investors benefit from subsidized access to raw cotton, and, as all joint ventures, from a five-year tax holiday. The Government sees great promise in the interest from Russian and Chinese investors in the hydrocarbon and telecom sectors. However, for 2004, FDI inflows were estimated at a still disappointing EUR 146 million.

Progress with privatization, in particular of large enterprises, has been slow. In 2004, privatization revenues were estimated at EUR 57 million, including a number of large scale enterprises such as Akhangaran Cement and Uzcable. 2004 also witnessed a significant increase in the number of small enterprises opened up to private investment, a process technically called privatization by the Uzbek authorities. However, it is difficult to assess the true extent of private participation in the corporate sector.

Uzbekistan's trade regime is among the most restrictive within the group of transition countries, and further contributes to the adverse investment environment. The tariff regime features a relatively moderate average of most favored nation tariffs, which is subject to a number of exemptions on imports from regional trading partners or of certain goods. Yet, Uzbekistan discriminates against other countries and against imports by Uzbek individuals. Tariff peaks and discriminatory excise taxes have led to relatively high rates of effective protection, in particular for consumer goods. From late 2002 onwards, the authorities have also introduced a number of discriminatory administrative restrictions on imports. In parallel, the government imposed restrictions on domestic retail and wholesale trade, such as requirements for certain infrastructure to be in place, minimum capital requirements, and controls on domestic currency collected by individual traders, all of which have further strengthened the position of large, typically state-owned retailers.

Some restrictions in bilateral trade with Kazakhstan have recently been lifted, however progress in regional cooperation – importantly within the Ministerial Conference on Central Asia Economic Cooperation supported by the ADB – remains limited. Uzbekistan has further pursued its accession to the World Trade Organization (WTO), though this process is still at a very early stage. Recent measures, such as substantial excise duties on imported products run counter to WTO principles.

While on the whole structural reforms have been limited, two areas stand out for some modest progress. First, following substantial investment to expand access to gas and electricity in the 1990s, payments discipline in the energy sector has been strengthened through a metering program, and pre-payment requirements. Against the background of substantial deficits in the state-owned electricity provider, tariffs have been increased over the last three years, and are now close to cost recovery levels. Second, a number of reforms have been implemented in the agricultural sector. Mandatory sales to the state of raw cotton are now in principle limited to 50 percent of output. However, as farmers depend on state entities for key inputs and financing, they are typically obliged to supply a larger share to the state cotton processors at official procurement prices. These prices are now close to world market prices, net of transport and processing costs, and smuggling of raw cotton to neighboring countries has subsided. This convergence is in part due to the sharp and unexpected drop in world cotton prices in the middle of 2004. There has also been further progress on the privatization of collective farms ("shirkats"), which has accelerated further in 2004. This appears to have increased agricultural productivity, though the system of mandatory allocations of arable land to certain uses and production targets remains in place.

C. Legal Environment

Uzbekistan's commercial laws remain generally limited in scope and their provisions open to conflicting interpretations. This is particularly true of the Law on Pledge and the Law on

Bankruptcy. The registration and enforcement of pledges is still uncertain, costly and complex. There are inconsistencies and ambiguities concerning, inter alia, the scope of reorganization proceedings and the priority of secured creditors in bankruptcy.

The main legal impediments to investments by the Bank and other private sector investors in Uzbekistan remain:

- the absence of an efficient pledge registration and enforcement system;
- complex and sometimes contradictory legal rules coupled with insufficient or weak implementation;
- practical difficulties regarding conversion of local currency into foreign currency; and
- a high level of discretion granted to government officials to interpret the legislative framework.

In addition, there continue to be concerns about the readiness of courts to enforce foreign arbitral awards in Uzbekistan in accordance with the country's treaty obligations under the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

Legal and judicial reform and institution building (pledge registries, independent regulatory agencies, training of court judges, etc.) need to remain firmly on the institutional agenda if Uzbekistan's investment climate is to improve sustainably.

D. Social & Labour Issues

Despite the recent economic growth in Uzbekistan, income poverty still remains a problem with an estimated 27.5 percent of the population characterized as poor and a third of these as extremely poor. Income poverty is mostly found in rural areas, with an estimated 70 percent of all poor people residing in rural areas. The highest incidences of poverty are found in the regions of Kashkadarya, Namangan and Karakalpakstan. Poverty incidence amongst households where the head is employed and where s/he is unemployed are similar; partly due to the fact that remuneration in state industries in urban areas and in agriculture in rural areas is often low and irregular. In addition, wage inequality is high. The unemployed, however, have the highest rate of poverty amongst the working-age population and are a particularly vulnerable group. As in other CIS countries, a higher education and not just a secondary education protects against poverty. Indeed, the poor have lower enrolment rates and higher levels of education, which exacerbates the intergenerational nature of poverty within families.

Nonetheless, there has been a recovery and/or improvement in some of the country's well-being indicators such as life expectancy, enrolment rates in basic education and infant and child mortality rates. Some gains which had started before the transition have continued: illiteracy has now been eliminated, and gender gaps in education have been closing, now remaining mostly at the higher levels.

Women are not formally impeded from seeking a role in the workplace, and women who start businesses or seek careers are not hindered legally. Although the law prohibits discrimination against women, economic activity amongst women is low compared to that found in other CIS countries. Women are severely under-represented in high level positions. This can mostly be explained by the lack of a higher education, higher numbers of young children and cultural

factors. During the past ten years, the government has attempted to institute some safeguards for women's rights, mainly in the area of social welfare support. Domestic violence remains a serious problem faced by women. State policies intended to keep families together and to provide assistance to families 'in conflict' often compound the problem, as women facing abuse in the home are often prevented by these policies from seeking redress and/or relief.

Key Issues: Legal regulation of licensing procedures and system are often based on jurisdiction level in the form of various inter-departmental or inter-organizational instructions and resolutions. In such cases, information availability is a rare case and the legal compliance evaluation of such procedures is not questioned. As a result of the lack in clear and transparent mechanisms of legal regulation in licensing system, many entrepreneurs find themselves to be in information vacuum.

- **Financing System (Banks' operations)**

The main problems of Uzbekistan's financing system were analyzed with focus on banking sector. Also, main problems that face entrepreneurs were identified and due concern was given to the issue.

Key Issues: The main problems in the banking sector of Uzbekistan, as entrepreneurs see it, are: (1) episodically lack of cash in the bank; (2) complexity of getting cash from the enterprise's foreign currency account and (3) complexity of getting cash from the enterprise's local currency account.

Also, one of the problems is related with an issue that, today, many state bodies (such as Central Bank, Cabinet of Ministers, Ministry of Finance, Prosecutor's Office, etc.) can address a commercial bank and obtain any information on the bank's clients creating a mistrust among entrepreneurs.

- **Competition Development and Demonopolization**

Review of legal base was conducted in the sphere of competition development and demonopolization. State bodies' activities were analyzed and presented for further review of the system.

Key Issues: The main problem that the entrepreneurs see in the competition development and demonopolization system is that many state-owned enterprises have an access to so-called "administrative resources", which they often use and create a situation where private businesses are less advantaged.

- **State Interference into Entrepreneurship**

Unjustified state interference into the private entrepreneurship were studied and due respect to this problem was given, as well as analysis of "wrong" interpretation of legal acts by various state bodies.

Key Issues: Planned inspection activities are carried out in accordance with plans, set up by the Republican Council on coordination of controlling bodies' activities. The Law limits only the number of planned inspections carried out during the year. However, there are a variety of other inspections, the number of which are not limited. These include non-planned inspections, cross inspections, short-term inspections, and inspections in order to perform control functions, etc.

Among entrepreneurs that, in cases of unjustified interference by state bodies, addressed Courts or Higher standing authorities, only 25 percent received positive results and solved unjustified interference for the benefit of entrepreneurs. 41 percent of entrepreneurs said that the long timing process of

II. REVIEW OF THE SME SECTOR

- **Entrepreneurship**

Internal and external problems of the business environment were taken into consideration and close study was made. Entrepreneurs' opinions regarding faced problems and their way of finding solutions are also evaluated.

Key Issues: The main sources of information for the entrepreneurs on the business legislation environment update and review are the newspapers, colleagues, friends and television. Unfortunately, on 17 of 120 entrepreneurs named Chamber of Commerce and Industry as their source of legal update information. This is an indication of weak support from the side of CCI towards entrepreneurs. Also, state bodies and affiliated training and consulting centers have low rate of information support. There is an obvious disappointment and mistrust from the entrepreneurs' side to participate in public meetings, which are directed to improve current entrepreneurship environment in Uzbekistan and identification of unjustified state interference into their activities.

- **Taxation System**

Review of Uzbekistan's taxation system, including the results of entrepreneurs' survey and research team's comments on current practice of taxation. Also, considered cases of unjustified state interference into private business from the side of tax committee.

Key Issues: Nowadays, the main negative factor in the entrepreneurship development is taxation system currently in use. The three main problems that arise are: (1) high tax rates, (2) many types of various taxes and (3) unstable tax legislation. High tax burdens, instability and complexity of tax law are pushing entrepreneurs to enter a so-called "shadow economy" and hide their income (or part of it) from taxes.

- **Certification and Standardization System**

Review of current certification and standardization system, methods and practice used by the employees of relevant controlling organizations and problems faced by entrepreneurs.

Key Issues: There is no unified database and information resource available on certification and standardization, which might have been used by entrepreneurs and other related parties to be aware of current system and the adjustments that are made to it. The main problems of certification and standardization system are: (1) long timing of gathering all relevant documentation, (2) long timing of applications review, (3) lack of information and (4) financial burdens.

- **Licensing System**

Legal background of licensing process and current problems that arise in this sector, unjustified actions taken by officials during licenses issuance and agreements conclusion and the results of entrepreneur's survey.

judicial trial (legal investigation) brought to "fading of case", and 33 percent of entrepreneurs said that their attempt to solve unjustified interference through legal channels made a negative effect on them.

A. Entrepreneurship

The current legislation of Uzbekistan includes more than 300 Legal Acts, 15 Codes, 80 Laws and 120 bylaws, regulating entrepreneurs' activity. Most of them contradict each other, which together with the excessive control creates high barriers for entrepreneurs and leads to flourishing of bureaucracy, corruption and pushes entrepreneurs in to, so-called, "shadow" economy.

Nowadays, the right of the legislative initiative is given to 8 bodies in Uzbekistan. Only they, in the correspondence with the main law, can introduce the draft laws to parliament. But the work with the projects of the laws requires careful preparation, as it is complicated polyhedral and long process. If the law does not absorb innovations - it is dead and impractical. In this connection there is a problem - what should be the practice of elimination of these discordances; is it possible to participate in process of creating laws. May entrepreneurs make offers and then observe consideration concerning their offer?

Lately in Uzbekistan the various organizations conducted many similar researches. But all this has not brought an appreciable outcome.

Government is in good intentions to reduce the interference in private entrepreneurship activity and enters a number of measures on magnification of entrepreneurship activity, however all is combined to that the economic growth collides with serious problem - excessive state monitoring above economy as a whole, the measures on additional monitoring the bank sector and trade are entered. The given measures promote growth of shadow economy, and restrain the property rights of the entrepreneurs. With the purposes of further effective development of economy as a whole, is suggested to consider interests of small business in the process of development of future economic solutions.

In 2001, the Government has proclaimed the intention to implement the program of economic reforms directed on acceleration of transition to market economy, so that it is better to correspond to the international standards. A main purpose of Government was a diminution of a sector of economy, acting within illegal system of licensing, taxation, certification, and also reduction of other administrative barriers for business.

However, at the end of 2003, the state program has become ineffective and has not given an expected push for development of a private sector of the country. The good intentions to increase the number of the legal enterprises of small and medium business have been replaced by sad consequences of the incomplete legislation and excessive regulation.

In the last months, the promising pitches are undertaken, as the Government revises some solutions. Nevertheless, many barriers for development of business and economic growth strongly remain on the place.

On July 7, 2004 the Decree of the President of Republic of Uzbekistan #3453 "on creation of chamber of commerce and industry of Uzbekistan" was approved.

In line with its articles, the Chamber of commodity producers and entrepreneurs of Uzbekistan is reorganized with formation on its basis of Chamber of Commerce and Industry of Uzbekistan. The main objectives and directions of the activity of CCI are identified. In particular:

- Assistance for development of business in the republic;
- Assistance to the entrepreneurs of the republic in the extension of business contacts with the foreign partners and investors;
- Adjustment and development of cooperation with chambers of commerce and industry and public associations of the entrepreneurs of other states;
- Delivering a broad spectrum of services to entrepreneurial activity, including information supply and advisory help;
- Defense of the rights and interests of the entrepreneurs, including the relationships with state organs and economic board on issues of their registration, certification of products and licensing; concern about court proceeds, etc.

The practice of application of administrative norms concerning the subjects of entrepreneurship activity testifies that the work of inspecting organs is directed not on preventing illegal acts from part of the businesses, but on ascertaining of the facts of violations, and as a corollary - collection of the very high fines, literally destroying the business, which is not able to stand for such pressing.

The Administrative Code grants broad authorities to the officials of inspecting organs in the field of identifying of administrative offences practically in any sphere of business and superposition of collections on the natural and legal entities. Moreover, the presence of a necessary level of special preparation, qualification of the officials is not stipulated, and in the absence of experts the compulsion of engaging of the specialists of an appropriate structure is not stipulated. An outcome can become the unreasonable superposition of collections.

In the articles establishing fines for various offences, for the legal entity in most cases the "gap" of fines is given varying in the range (from 5 to 1000 minimum wages). In a number of the articles only the upper bounds - up to 1000 MW is established, that generates indeterminacy of the sanctions. The choice of a concrete amount of the fine in each separate case depends on the official, imposing it. Increase of the rates of fines pushes the businessman to make a choice - whether to pay according to the law, or to pay off much with smaller bribe. Establishment of the unique approach to fines sanctions related to small and major enterprises certainly puts in unequal conditions small and large business. Such approach contradicts conventional legislative practice.

As a whole, number of the articles especially concerning tax offences, the application of the fine sanctions with aggravating consequences in the case of repeated violation during the year is established. The application of the overstated fines leads to significant withdrawal of money resources from a turnover and puts the businessman, especially in the sphere of small business, under threat of ruin.

One of the important factors influencing development of entrepreneurship activity is the sources of information, by means of which the entrepreneurs learn about innovations in the legislation.

Problem	Proposal
<p>The current legislation of Uzbekistan includes more than 300 Legal Acts, 15 Codes, 80 Laws and 120 bylaws, regulating entrepreneurs' activity. Most of them contradict each other, which together with the excessive control creates high barriers for entrepreneurs and leads to flourishing of bureaucracy, corruption and pushes entrepreneurs in to, so-called, "shadow" economy.</p> <p>As it is seen from the research results, nowadays, the main sources of information regarding changes in the field of the legislation of the Republic of Uzbekistan, for the entrepreneurs, are the newspaper materials, colleagues, friends and television. The CCI is very weak in filling the information gap. Also, the low margin is seen with the state bodies and information-consulting centers, the aim of which is to assist entrepreneurship and provide consultancy with relevant information.</p>	<p>One of the important factors influencing development of entrepreneurship activity is the sources of information, by means of which the entrepreneurs learn about innovations in the legislation.</p> <p>The CCI shall spend more time to solve the problem of information gap within the entrepreneurship and give more light to changes in legislation to help entrepreneurs in the changing legal environment.</p> <p>It is proposed to make the following amendments:</p> <ul style="list-style-type: none"> • Limit the number of legal acts issued annually • Consider every focal point in legislation • To protect entrepreneurs' interests in courts, publish the decision-making of these courts to a wider population to be aware <p>Also, necessary to create a single information center that would assist entrepreneurs through removal of information gap.</p>
<p>According to the article 83 of the Constitution of the Republic of Uzbekistan, 8 bodies have a right to legal initiative. Only these organizations, based on Constitution, can put forward draft laws to the Parliament (Oliy Majlis). However, process of drafting laws requires thorough preparation work, since it is a complicated and long process.</p> <p>The current practice shows that the public generally participates in discussion of the draft of law only after its approval at first hearing by parliament and publishing its text in the mass media.</p>	<p>The mechanism shall be developed, where the public will have a force to influence and negotiate the draft laws, as well as proposing their own adjustments to such laws. Here we have to note that even the attraction of general public without granting it some rights would not bring to positive results.</p> <p>The negotiations on draft laws after their approval in first hearing and publishing in mass media are a non-effective technique. It is necessary to attract public on a much earlier stage.</p>
The Administrative Code grants broad	The development of a necessary degree of

authorities to the officials of inspecting organs in the field of identifying of administrative offences practically in any sphere of business and superposition of collections on the natural and legal entities.	special training and education is vital. The qualifications of staff shall be on a proper level. In cases where there is no available qualified staff, the experts shall be attracted from relevant fields.
Most of the entrepreneurs negatively react on participating in seminars, round tables, other arrangements devoted to a regulating system of entrepreneurship activity, the interferences of state structures in activity of the entrepreneurs, and consider it simply as a waste of time, as the outcomes of these measures do not bring any favor.	This is due to a negative experience in the past and absence of trust from entrepreneurs to such activities nowadays. Even more events like this shall be carried out devoted to the regulating system of entrepreneurship and involvement of NGOs is also crucial. The levels of such events implementation shall also be increased and let entrepreneurs feel that their suggestions are taken into concern.

B. Taxation

In the correspondence with the acting tax laws of The Republic of Uzbekistan, the generalized system of taxation includes 12 kinds of the taxes (republican and local), the mechanism of which operation is fixed in the Tax code, and for the small enterprises behind the generalized system of taxation there is a simplified mode also. And which choice is the best is selected by the small enterprise. Within frameworks of the generalized system the subjects of the small businesses are taxed on the general basis, with some privileges acting in the generalized system of taxation. The most significant privilege is the tax vacation for the re-created enterprises and that the profit directed on the investment and on settlement of the credits, is excluded from the taxable basis at a rate of up to 50%. For separate branches the privilege is reducing the rate of taxation. In particular, for the enterprises specializing on the production goods of a child's range, toys and subjects of an art craft, the rate of the profit tax is established at a rate of 10 % (the generalized rate - 26 %). For joint ventures, the rates are reduced depending on a share of foreign capital in the authorized capital.

The subjects of small business can use all these privileges only in frameworks of the generalized system of taxation. Therefore for those categories of the taxpayers, for whom the indicated privileges are distributed, the generalized system of taxation can be more preferable. It depends on a size of a privilege, accordingly, reduction of an incidence of taxation.

One of reasons that bothering entrepreneurship activity is the large custom duties, in addition the lists of the interest rates on raw material are constantly changing, so that sometimes even the experts can not understand them, also not all norms of the acting Tax Code are actual and are applied on business.

The absence in the Tax code of a meaning of "Presumption of Innocence", also delays the development of entrepreneurship activity, afterwards modification of the tax laws does not

create soil for independent development of business activity. Finally, the courts have also ability to bear solutions to the benefit of state organizations.

The problem on impossibility of increasing wages of the workers is a problem, because of the high tax rates. (For example, the payments in various social funds take a large amount of worker's wages). Also, there is a big concern of customs clearance with high excise and other duties.

Another issue relates to the problem of insecurity and inability of entrepreneurs to defend themselves from Tax Authorities' "check-ups". Today, there is a very small percent of won cases by entrepreneurs, related to unjustified interference by Tax Authorities.

The small enterprises, which continue to work in the field of import and export, collide with requests of certification, while the customs remains one of main problems of the entrepreneurs in Uzbekistan. In January 2003, custom authority began to enter severe rules concerning intersection of boundary of country. The private load, which does not fit correspond requests, is subject to confiscation and sale on a place to the consumers or other trade companies on a nominal price, and the proceeds goes to the budget. The government seldom sentences the custom authority breaking the norms.

Many entrepreneurs state that now one the constraining factors of development of business in Uzbekistan is the acting system of taxation. Although the entrepreneurs understand that the taxes are necessity, they underline existing numerous problems, which make a procedure of taxation as one of the largest problems facing them.

Today the tax laws in Uzbekistan consists of the Tax Code, Laws, Decrees of the President, Decrees of a Chamber of the Ministers and various normative acts of State tax committee. Thus, the tax laws represent not simple normative - legal basis, which, in addition, frequently varies (minimum one time per year, when the Government revises the tax rates within the framework of annual budgeting). It considerably disturbs entrepreneurs' activity. 61 percent of respondents have named the instability of tax laws in Uzbekistan as the factor that has negative effect on development of their businesses.

On average, annually a number of normative - legal acts are accepted, which introduce more than 20 adjustments to tax laws, including revision of the rates, entering of the new taxes and privileges.

Problem	Proposal
The absence of the concept "presumption of innocence" in the current Tax Code hinders the development of private entrepreneurship	It is necessary to include on the legislative basis a meaning of "presumption of innocence" and implement a policy of non-guiltiness unless (or until) the guilt is proven. In connection to this, the entrepreneur shall feel that the state organ officials do not have authority to claim for any financial "reimbursements" (or put on financial restrictions) prior to official recognition of one's guilt in court.

<p>In addition, very noticeable is the fact that entrepreneur cannot defend themselves from the state organs, such as Tax Committee.</p>	<p>Today, there is a very small percent of won cases by entrepreneurs, related to unjustified interference by Tax Authorities. In order to have prudent regulation and monitoring of the court decisions, the transparency of decision making shall be taken into consideration and be implemented (maybe with mass media). Such actions would not allow state organs and courts to make decisions in favor of the state rather than being fair.</p>
<p>Rapid changes in the taxation system creates an unstable situation for entrepreneurs.</p>	<p>The creation of a unique and single database, which would be available to all entrepreneurs, would solve the problem significantly. Also, the number of adjustments that are made to Tax legislation shall be limited and decreased and backed-up by necessary legal act.</p>
<p>It is impossible to increase the salaries of employees, due to the high tax rates. (For example, payments in various social funds take away the most part of wages of the employee).</p> <p>In order to pay the employee 30,000 Uzbek Soums in cash, employer has to allocate approximately 100,000 Soums.</p>	<p>The tax legislation shall be revised in connection to the wages payable. A new system of salary payments shall be considered and a "flexible" system be introduced, whereas the employee would have an option of:</p> <ul style="list-style-type: none"> • Receiving less cash on hands today and increase the pension fund in order to get more in the future; or • Receiving more cash on hands today and decrease the pension fund in order to get less in the future. <p>In order to solve this issue, the pension system shall be revised in general and the new adjustments shall be introduced in close coordination between all components in order to harm any.</p>
<p>The tax rates and the number of taxes in Uzbekistan are very high.</p>	<p>The tax rate shall be revised and, in most cases, reduced. These measures will reduce the payments to the state budget in the short term. However, in the long-term, the entrepreneurs will be generating more profits and, as a result,</p>

	generating more cash payable to the state fund. In addition, lower tax rates (as in Russia, for example) would help many entrepreneurs to exit the shadow economy and would strengthen the economy of Uzbekistan, in general.
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C. Certification, standardization, licensing

In Uzbekistan, the Law of the Republic of Uzbekistan "on certification of products and services" and other normative acts govern the certification processes. Objects of certification are products (including program and other scientific and technical production), services and quality systems.

Today, there is no systematized information basis, directories on standardization and certification, which would be accessible for an inspection and study by all interested parties, and first of all by entrepreneurs, which immediately can require similar information. For deriving similar information it is necessary for the subject of business to address, in written form, the Uzbek Agency of standardization, certification and metrology (UzStandard), so that it will provide relevant information, necessary for the business.

Main agency for certification is UzStandard. Apart from UzStandard, there are independent centers of certification, research laboratories, organizations of certified supervision, and experts - auditors to check quality, performing various certified functions with appropriate accreditation from UzStandard. One of the largest agencies is "UzbekExpertiza" under the Agency of foreign economic relations of the Republic of Uzbekistan. In Uzbekistan some international companies with similar kinds of services are accredited: joint venture "Uzintertek testing services" (jointly with Intertek Testing Services Company), joint venture "Techexpertiza" (jointly with Control Union International Company) and Uzbek-British joint venture "Wakefield Inspection Services".

On November 11, 2004, the Ministry of Justice of the Republic of Uzbekistan registered the Order of Director General of Uzbek agency on standardization, metrology and certification (registration number 1422), in line with the Decree on preparation and registration at UzStandard Agency categories of normative documents on standardization was authorized.

The Decree sets main requests to organizations and development works, coordination, assertion, examination and registration of normative documents on standardization. It is determined that the categories of normative documents on standardization, which are being subject to examination and state registration at the agency, to be presented to registration and exposition of the contents of the normative documents on standardization, order of development, assertion, examination and state registration of the indicated normative documents, and other problems.

In analyzing of existing normative - legal basis on problems of certification of products and services in Uzbekistan, study of problems and difficulties, in which the entrepreneurs have problems of deriving the certificates in the authorized organs of certification, and proceeding from experience of a number of foreign countries, the members of a consortium revealed a

number of "gorges" and problems in certification, becoming a serious barrier on a path of accelerated development for the commodity producers in Uzbekistan.

The acting system of certification of products and services is bulky, multistage, and requires preparation and submission of a number of documents, spending a lot of time (on average, from 2 to 4 months) and excessive financial costs, which frequently appear burdensome for the subjects of small businesses.

The legal regulation of process of licensing in Uzbekistan includes the Law of Republic of Uzbekistan, dated May 25, 2000 No. 71-11 "on licensing various kinds of activities", Decree of the Cabinet of Ministers and more than other 50 additional normative and regular acts issued by state bodies, authorized to issue the licenses for some kinds of activities. According to the Decree of the Cabinet of Ministers of Republic of Uzbekistan, dated June 28, 2002 No. 236 "on measures on implementation of the Law of the Republic of Uzbekistan 'on licensing various kinds of activities'", 71 types of economic activity were subject to licensing.

Licensing of 71 types entrepreneurship activities stipulated by the above mentioned Decree is carried out by 14 state bodies. More often, the licensing is carried out by the Cabinet of Ministers on behalf of various governmental commissions, which issue the licenses for implementation of various kinds of economic activities.

Despite of the stated Decree № 236, a number of existing sub-laws and normative acts regulating process of licensing, in particular inter-departmental acts and instructions which are not undergoing legal examination at the Ministry of Justice, have inconsistencies in normative - legal basis of licensing. With low level of knowledge and information insufficiency of entrepreneurs, it becomes a significant administratively-regularly barrier for the entrepreneurs.

Although the Decree of the Cabinet of Ministers, dated June 28 2002, No. 236, clearly stated 14 state bodies that have a right to issue licenses, bodies such as State inspection on supervision of safety of railway transportations, the State inspection on supervision of flights safety, Uzbek agency of automobile and river transport, Goskomarkhitektstroy and a number of other bodies, based on the internal decrees passed by them, continue to issue licensing, though they are not included in the list.

One more example: the activity on manufacturing, sale and rental of measurement equipment is subject to mandatory licensing. Nevertheless, the order and conditions of licensing on occupation of this kind of activity, necessary documents and even a licensing body are not indicated not only in the Law "on metrology", but also anywhere in the legislation. There is only a blank feedback form on certain "order, stipulated by the legislation".

The legal regulation about licensing in these and in many other cases has place only at a departmental level in the form of various kinds of the circulars and positions, the information about which practically is absent, and the legal examination for the correspondence to the legislation is not carried out.

Owing to absence of the precise and transparent mechanism of legal regulation in licensing of some kinds of activities, the entrepreneurs practically are not able to have any information. The only source of information on licensing becomes the licensing body itself, with its own order

and terms of licensing, which is a good base for growth of bureaucracy of arbitrariness in licensing bodies.

Problems	Solutions
<p>1. The main normative document regulating the order of deriving of certificates on production and services "on the Order of preparation and realization of certification" is authorized only by UzStandard Agency (No. 51-062-PI Uz, dated 15.04.2002), but until now it is not registered by Ministry of Justice, and actually has no legal force, as, in line with current legislation, the normative documents of an interdepartmental character come only after their registration, consequently, at the Ministry of Justice.</p> <p>2. The commodity producers producing children's goods, frequently collide with a problem, when it is required to receive the certificate on a model of production (for example, children's jacket), and further for minor modification of a model (for example, adding a pocket to a jacket) To the entrepreneurs it is clear, when it is required to receive the certificate on a fabric, but it is absolutely not clear, when on each modification of a model (the model is formed in connection to the market demand of consumers) it is necessary to spend a lot of time for deriving the new certificate.</p> <p>3. In practice of the authorized members of certification, especially in regions, numerous cases take place, when consumer goods are imported by the entrepreneurs into republic, the certificates are given for the term of 3-6 months, whereas working life of these goods (for example, footwear) is 1 to 3 years. Actually on the same production it is necessary to receive many times the same certificate. Such "departmental" approach of certification results that the entrepreneurs through 3-6 months should once again pass on all circles and to receive the new certificate, by expending large means. As a result, businessmen again suffer.</p>	<p>1. Recommend the Ministry of Justice to conduct examination "on preparation and realization of certification", for the correspondence to the current legislation, and to register it into its application.</p> <p>2. As the modification of a model of a children's wear does not render direct influence to health and safety, it is expedient to cancel the order, which requires to receive the certificate on a model of production (children's wear). The quality fabrics have the important significance and, therefore, should be subject to mandatory certification.</p> <p>3. With the purposes of creation of favorable conditions for development of small and private business in Uzbekistan, prevention of the entrepreneurs on deriving of the repeated certificates on the same production, it is expedient to exclude such practice. The certificate should be issued for the term not less than for the term of the validity of the goods, or, if necessary to renew certificate without superfluous red tape and extra charge from the entrepreneurs.</p>

<p>4. Under the acting process of passing certification procedures, the businessman for deriving the certificate should sequentially pass up to 7 organizations, which takes from 2 to 4 months, and requires the financial costs from 150 to 500 thousand sums and even more. Such process is excessively bulky, burdensome on time and financial costs, and frequently becomes an insuperable barrier for the subjects of small business.</p>	<p>4. To consider possibilities of modification in acting "on the Order of preparation and realization of certification", by providing essential simplification of certification processes, so that the businessman could hand over the application with a minimum package of the necessary documents in the authorized member of certification and it is acceptable that entrepreneurs in the short term (for example, from 2 to 4 weeks) could receive the certificate, or reasonable failure request denial (the principle of "one window", same as stat registry of enterprises).</p>
<p>5. After the approval of the additional list of consumer goods, for which commercial objectives need submission of the certificate of the correspondence (Decree of the CM of RU № 427, dated December 5, 2002) to import into Uzbekistan, a number of problems appeared: 1) on similar goods (for example, female dress) the certificate is required, if it is imported and if the good is of local production - certificate is not required; 2) Using such fixed requirements and insufficient knowledge of the entrepreneurs, tax inspectors, customs, Ministry of internal affairs, etc. require from the entrepreneurs that the certificates for all goods, not only imported, but also on local production, even if they are not included into the list of the goods that are being a subject to mandatory certification. All this overburdens also barrier on a path of the entrepreneurs. 3) The inclusion to the above list practically all consumer goods, has reduced actually, in an abstraction of resources and possibilities of realization of certification, which negatively effected the quality and efficiency of work on certification and became the reason of various abusing in this case. In business, it has come to the monitoring system for the document (which frequently is purchased without actual tests), instead of actual monitoring for quality of the goods.</p>	<p>5. To increase the efficiency and quality of work on certification of products and services, and with experience of other countries (for example, Russia) in this sphere, it is expedient to reconsider the list of the goods and services which are being subject to mandatory certification, in the part of reduction, by keeping in the list the goods and services, which can immediately influence health and safety of the person. It is expedient to unify requests on certification of the goods and services made in countries and delivered in Uzbekistan.</p>
<p>6. The excessively large costs for deriving the certificates in Uzbekistan (example: the</p>	<p>6. On the purposes of creation of favorable conditions for cost reduction and increase of</p>

businessman imports a fabric on 300 thousands sums. So for deriving of the certificate it is necessary to pay 100 thousands sums.) Essentially increase costs of the commodity producers. In the correspondence with the Law « About certification of products and services » there are license deductions to members «Узстандарта» for application of entrepreneurs. The size of these deductions is regulated by the Order authorized by Узстандартом and registered by Минюстом РУ for № 722 from May 11, 1999, and creates for goods of batch production from 0,1 % up to 0,5 %, and for goods of single production - up to 1,0 % from volume of marketed products. Actually, a barrier on a path of development of small business is one more implicit tax to the commodity producer, which reduces it to circulate assets, limit possibilities of purchase of the modern equipment, extension of production, increase the cost price and reduce competition of production of the commodity producers.

7. Serious problem for the entrepreneurs, colliding with procedures of certification is the insufficiency of information maintenance of the subjects of small business on problems of certification. For unclear reasons, the members of certification do not undertake sufficient conductions on informing all entrepreneurs with the contents and requests of the normative documents and positions of the certification process. In many authorized members of certification the free access of the entrepreneurs to normative - instructive information on problems is not supplied. Probably for this reason, even the representatives of separate state inspecting structures require from the entrepreneurs to present the quality certificates instead of the correspondence certificate (for example, letter from the Head of Chief Control Department of the Ministry of Internal Affairs, No. 24/5-394, dated February 11, 2004).

competition of production of the domestic commodity producers, it is necessary including of representatives of the Ministry of finance, Госкомдемонополизации РУ, Chamber CI of Uzbekistan and agency «Узстандарт» to reconsider principles of shaping of the prices and tariffs for services of members in certification of products and services, to take measures on their decrease, and also abolition of the unreasonable costs of the entrepreneurs. A cardinal solution of the given problem can become shaping and inducing of a competitive environment in the market of services on certification of products.

7. On the purposes of radical improving information maintenance of the entrepreneurs on problems of certification of products and services to recommend UzStandard to: a) To generate a package of necessary information materials on certification and to bind all accredited members of certification to have information stands with these materials in accessible for the entrepreneurs place, and also regularly to update information materials on certification; b) with CCI of Uzbekistan: to use possibilities of "Marokand" Center to generate a web site «Certification problems» for regular information to the entrepreneurs about all modifications and additions to the normative basis on problems of certification through modern information-communication technologies; regularly conduct seminars, round tables with entrepreneurs, including regional level, with the purpose of explanatory works, problems and requests of the normative documents on problems of certification goods and services.

<p>8. The entrepreneurs should collide with functional duplications on separate procedures of certification. So, in line with the decree of the CM RU No. 438, dated September 21, 1999, the marking of the goods is carried out with bar codes «EAN» in the correspondence with the standards and normative documents of UzStandard Agency, International association of documentary numbering - "EAN International". The entrepreneurs receive bar codes in Center «EAN Uzbekistan», which is the member of international organization "EAN International" and conduct a necessary database without additional payment from the entrepreneurs. But, in line with the fact above, subjects of business - manufacturers of products, which are being a subject to dashed coding, should represent to UzStandard Agency information about it for inclusion in the State register of production, made in Republic of Uzbekistan, and deriving a first copy of breadboard models of the bar codes.</p>	<p>8. To save time and resources of entrepreneurs, it is necessary to adopt measures for elimination of functional duplications by different organizations. Taking into account, that the center «EAN Uzbekistan» can perform the job on management of a database in production receiving dashed coding, without additional payment and with observance of requests of the international standards, the management of the State register in UzStandard Agency is inexpedient.</p>
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D. Finance and Crediting

The basis of a financial system of Uzbekistan comprise of two-level banking system. Two basic acts regulating a banking system of Republic of Uzbekistan, are the Law « About Central Bank of Republic of Uzbekistan » dated 12.21.1995 and Law « About banks and banking » dated 04.25.1996. The Central Bank of the country, leaning on existing normative- legal base, implements supervision of activity of commercial banks. In the above-stated acts the control functions of the activity of commercial banks and their accountability, assigned to Central Bank, are also stipulated. In particular, article 7 of the Law « About Central Bank of Republic of Uzbekistan » states: « The Central Bank within the limits of the competence issues the normative acts, mandatory for implementation by all faces on the territory of Republic of Uzbekistan ».

The largest bank of the country is the National Bank for foreign economic activities, and serves over 70 % market share and foreign trade turnover of Uzbekistan. «Asaka», Uzpromstroybank», «Paxta-bank» and «Uzjilsberbank» are also traditionally considered as large-scale banks. The amount of their authorized capitals considerably exceed the minimum, established by the Central Bank (2,5 million US dollars)

Group of medium banks, completely or partially controlled by the state is widely represented in the Uzbek banking system. Some of them are «G'allabank» and «Narodniy bank » (former Sberegatelniy), gravitating to large, «Turon », «Uztadbirkorbank» and a number of others - their amount exceeds 15.

The separate group is represented by private banks (about 10), for which the size of the minimum authorized capital is established at 1.25 millions US dollars. The largest of them is «Business Bank» - has passed to the category of medium banks.

The banks with the foreign capital are represented by the Uzbek-Dutch bank «ABN Amro», Uzbek-Korean «UzDaewoo», Uzbek-Turkish «UT-bank», affiliated bank «Saderat» of Iran and Uzbek international bank on privatization and investments «Uzprivatbank».

The commercial banks possess about 800 territorial branches and also about 680 mini-banks. Total volume of assets of banks of Uzbekistan has grown to the present time up to 4 billion sums, cumulative capital of commercial banks - up to 763 billion sums.

Recently banks had to develop and execute, agreed with Central Bank, parameters of cash turnover of the customers. This rule was known as "the cash plan". Each bank made the quarterly assumptions of cash turnover, and the Central Bank on a monthly basis inspected the correspondence of actual outcomes with the scheduled parameters. For this purpose it was necessary for banks to receive the assumptions of streams of money resources from the customers. Before a new month of the enterprise begins, it submitted to bank the application with the indication of how much money in the cash form they assume to hand over in bank and how many money they assume to take (on wages, travelers etc.). By receiving these data, the bank represented the quarterly assumptions of cash turnover to Central Bank not later than 45 days prior to the beginning of the next quarter.

Since September 1, 2002 the managing subjects have received the right on the first request to withdraw from the accounts the cash within the limits of the handed over cash proceeds, and since February 1, 2003 concept of "the cash plan" was completely cancelled. This decision certifies that the Government is going to conduct further policy on liberalization of economy and is a positive pitch. However, simultaneously Central Bank toughened a monetary policy - banks were required to withdraw surplus of cash money from the circulation in order to control the rate of inflation effectively. If earlier commercial banks, in order to execute parameters of "the cash plan", simply closed all account operations on cash after the 20-th day of each month, after toughening of the policy of the CB a problem of deriving of cash by the enterprises from banks has become more acute.

The given policy has a negative impact on the work of the separate enterprises and economy as a whole. At first, the confidence of the entrepreneurs to a banking system is again undermined. The significant part of circulations of the entrepreneurs does not pass through standard bank channels. Secondly, operations the state has generated the special kind of business - some firms specialize on a various kind operations on providing money in cash for 20 % commission from a total amount. The usage of such schemes transfers the entrepreneurs to an illegal position and makes them dependent on inspecting organs.

Commercial banks try to solve a problem of cash money by engaging money resources from the population on a various kind of time deposits. With the purpose of increase of attractiveness of data of deposits for the population and overcoming of usual mistrust to a banking system, they are compelled to offer for deposits very high interest rates.

In total, in spite of the fact that there was a positive modification in the legislative level, they appeared not successful in conditions of toughened monetary policy. Taking into account this usual situation, it is possible to make the supposition, that the government of republic and commercial banks should apply considerable contributions to reestablish the confidence of the entrepreneurs in the banking system, together with that the entrepreneurs hereinafter will conduct a part of operations in cash, not reflecting them in the official financial reports.

Problem	Proposal
<p>One of the main problems is related to high bureaucracy and corruption in the banking system. Many cases where people argue that they are pushed to bribe an official for 10% of the credit value, otherwise they can't get the credit.</p> <p>In 60-70% of all cases, the banks simply refuse in financing / crediting because of "absence" of money resources at the bank. Because the overwhelming amount of banks in Uzbekistan belongs to the state, the "special financing" is in practice, when the banks finance those enterprises, which are "necessary" to be financed.</p>	<p>It is recommended to implement a monitoring system for the banks' employees responsible for credits issuance and trace evidence of corruption among bank employees.</p> <p>The main reason for corruption of the banking system's employees is due to the fact that most of these banks (about 85% of the banking sector) are in state property. This fact restricts and eliminates bank personnel to act for bank's growth and fight against corruption. The process of banking privatization shall be continued and even increased in its speed to make it completely private.</p>
<p>Interest rates for credit are too high for majority of the entrepreneurs and they can not return on expiry of the term.</p>	<p>Interest rates are set in accordance with the Central Bank rates. Taking into account often changes in the interest rates (due to inflation, budget deficits, etc.), one might consider an option of crediting under LIBOR system (for example, LIBOR + 2%).</p> <p>As an alternative source of finance, the capital market shall be considered – corporate bonds. As practice shows, interest rates on corporate bonds are smaller and require less bureaucracy to issue and get funding.</p>
<p>in order to get financing / crediting, it is necessary to fill in a number of applications and other documents. Collection, submission and consideration of these documents takes a lot of time and majority of the entrepreneurs can not get</p>	<p>Review the procedures and requirements on obtaining credits and develop an easier procedure to fill out "similar" applications (standard forms) and speed up the process of application review.</p>

the financing.	
There is a lack of insurance for bad debts.	A draft law shall be prepared "on banking history" to create a single and unified database on non-trustworthy clients that failed to cover previous debts in time. This database shall be available to all banks and related parties and shall be one of the factors to approve or deny new credits.
"Bank Secret" problem – nowadays, various organizations (such as Central Bank, Cabinet of Ministers, Treasury, State tax committee, State customs committee, Office of public Prosecutor, Hakimyat, etc.) may address commercial banks and request information on their clients.	Make adjustments to the Article 38 of the "Bank secrets" of the Law "on Banks and Banking" dated 25.04.1996, removing "... from a request of Tax Authorities, the banks represent necessary information about operations of the enterprises being their customers, for monitoring on completeness and regularity of payment by them of all taxes due". Instead of this clause, add another point that would state that entrepreneurs shall submit a copy of the bank transactions list together with the tax declarations on annual basis.
The order of realization of verifications by commercial banks of the managing subjects is regulated by a lot of the legislative and normative acts. In the correspondence with these acts the commercial banks are obliged to check up a regularity of accrual of the taxes, their payment in budget and non-budget funds, cash discipline, availability of overdue debt and accounts payable.	Remove responsibility of "inspection" from commercial banks and provide a room for them to act as solely commercial enterprises, i.e. credit issuance, deposits, as well as client's bank transactions. The remaining "control" functions shall go to the relevant state organs.

E. Competition Development and Demonopolization

Nowadays, many import-export restrictions have reduced competition in the market and, as they are not distributed to the large companies, became discriminatory for small business. According to the law, the large trade enterprises should have assets (including cash), appropriate to the volume of trade operations. It means that they should comprise 6000 minimum salaries. Moreover, cash should comprise 2000 minimum salaries. For large enterprises that have monopoly to resources, production and materials, these measures have affected insignificantly, while the small and private businesses has suffered very much.

These problems are only brief illustration of those barriers, with which entrepreneurs of Uzbekistan today collide, and which are corollaries of a legislative system depriving the entrepreneurs of the right optimum to use the resources. The legislation has reduced competition, artificially increased prices and created the unhealthy market, which has negative impact to the situation in country. Because of a low level of long-term state planning and weak regional economic cooperation the investment climate hardly has suffered in country.

The entrepreneurs state that unless equal conditions and reinforced norms of the right is not created, the economy of Uzbekistan will decline even more. In this situation many local entrepreneurs have transferred their business in adjacent countries. In Kazakhstan and Kyrgyzstan the private sector comprises considerably large proportion of GDP.

Monitoring of creating the legislation process is important. The laws "on registration of legal entities" and "on competition" are necessary.

Problem	Proposal
Entrepreneurs often compete with enterprises, owned by the state. In these cases, the state enterprises have obvious advantage and use "administrative resources" for suppression of a competition on the part of private enterprises.	Continue (and increase speed) the privatization process of SOE (state-owned-enterprises). Implement flexible system of SOE sale to private sector, i.e. sell them at a market price rather than holding to a "wanted" price. Improve legislation related to FDIs and increase the level of foreign investments through these measures. Carry out a series of pilot studies on cases of "administrative resources" usage for suppression of a competition on the part of private enterprises. If proven to be true, launch court cases.
Many import-export restrictions have reduced competition in the market and, as they are not distributed to the large companies, became discriminatory for small business.	Review import-export issues (as well as monetary value) and identify how these affect small and medium enterprises against large enterprises. Study possibility of introducing different measures on larger enterprise so that SME would be able to keep in the market and compete accordingly.
Current regulatory framework relies primarily on the imposition of price controls on enterprises based on the size of their market share or sector engaged in (natural monopolies). Once these "monopoly enterprises" are identified,	Instead of using "market share" approach to identification of a monopoly, and followed by "price control", shift the accent to anticompetitive cases on the market and regulation of such cases. Also, case-by-case actions shall be taken. The

they are placed in a Register of Monopoly Enterprises, and price controls are imposed by the Ministry of Finance.	laws "on registration of legal entities" and "on competition" are necessary.
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III. PUBLIC ADMINISTRATION

One important cluster of factors affecting the governance challenges in Uzbekistan is, of course, the country's origins in the Soviet Union. Upon independence, this legacy placed special burdens on Uzbekistan and similarly-situated countries. The litany of challenges is well-known, and we say more about it elsewhere in this report. A central part of the Soviet legacy was an extremely large and powerful central government. All the transition countries have grappled with this in different ways, with a range of results.

A. Government System

In this section, we look briefly at the structure of government and then focus on policymaking, coordination, legislation, and ongoing public sector reform efforts. Core concerns here include the quality, cohesion, and democratic accountability of policy processes.

A.1. Constitutional Structure

The Constitution of the Republic of Uzbekistan was adopted in 1992, and was published in Uzbek (some 600,000 copies), as well as Russian, English, and other Western languages.

The Constitution, Article 11, states: "The principle of the separation of power between the legislative, executive and judicial authorities shall underlie the system of state authority in the Republic of Uzbekistan."

The functions of the President of Uzbekistan and the Prime Minister are given in Articles 93-95 and 98 of the Constitution and in the Law "On the Cabinet of Ministers." The ministers' functions are given in the Law "On Cabinet of Ministers" and in the Regulations of the Cabinet. These provisions on functions and responsibilities have little practical effect. This results from the inability of the Parliament to monitor the work of the President, Prime-Minister, and ministers, and the absence of an effective law on interpellation (or judicial review of executive acts, for that matter). Thus, the means do not exist to enforce government's compliance with its duties and obligations. In practice, the Prime Minister and ministers are accountable only to the President, although *de jure* they are also accountable to Parliament.

Under the Uzbek constitution, the legislature (or Oliy Majlis) in principle has powers of legislative initiative as well as financial and bureaucratic oversight. However, the body virtually never initiates policies. Further, Parliament's theoretical power of financial oversight has little practical effect. Parliament participates in adopting and amending the annual budget. In addition, once a year it discusses and gives its assessment of the report of the government on execution of the budget. However, Parliament cannot carry out financial control. Moreover, Parliament does not have effective power of bureaucratic oversight — only administrative monitoring within government is practiced.

A.2. Machinery of Government Policymaking

Here we address the quality of the policymaking framework, notably whether it is coherent, well-documented and understood, technically sound, and participatory. We are concerned here

with the formulation, enactment, implementation, and monitoring of policies. Everywhere in the former Soviet Union, the legacy of concentrated power and party supremacy pose difficult challenges in the modernization of the executive. Reform means re-locating real power to an executive structure that is efficient and accountable.

As suggested above, Uzbekistan has a "presidentialist" system in which policy initiative, control, and approval rest with the President. Advisory bodies such as the Academy on State and Society Building and the Law Institute, the chairmen of parliamentary committees, and ministries, as well as some government-affiliated think tanks, are also involved in policy development. However, this policymaking group consists essentially of state officials, with only minor input from the parliamentary committees and from civil society. The final body that examines the policy program is the Presidential Office. On matters of broad social concern, policy development may involve some input from NGOs and other social organizations.

Policy Development and Coordination

The most effective government administrations across the world are consistently found to be coherent, open to internal debate, provided with sufficient capacities and resources, and disciplined in reaching closure and adhering to decisions once they are made. At the pinnacle of the administration, there needs to be central, cabinet-level body charged with managing the process of policy formulation and implementation. This means ensuring that the Cabinet of Ministers has sufficient information to consider the relevant alternatives (and their implications, budgetary and otherwise), and can make decisions in a way that fits with government's overall agenda and leads to smooth implementation. Where this function is not performed properly, confusion results - with serious implications for policy implementation and its costs. This danger always exists because the ministries engaged with Cabinet in policy development operate in a political environment, and are sensitive to the perceived special needs of their sectors. The post-Soviet transition context poses a special challenge here. The central executive apparatus inherited from communism, although it was "the government" in formal terms, in actuality only provided administrative support to the real decision-makers in the party, and implemented their decisions. Thus, the various policy development functions such as discussing alternatives, arbitrating among different interests, and making authoritative decisions, were the preserve of the party structure. Moreover, the central executive structures inherited from communism fragmented administrative authority across a plethora of ministries and special bodies. Agencies such as the Cabinet of Ministers and the Finance Ministry - which play strategic policy direction roles in the industrial countries - essentially implemented decisions made elsewhere. This situation left to the post-communist governments the challenge of relocating authority to the government itself and creating an executive structure that could handle both the policy formulation and administrative tasks. Uzbekistan has slowly been transforming its central executive, and has recently enacted reforms that may accelerate this process. However, many pre-transition features remain.

The process of elaborating policy in Uzbekistan is set forth in relevant laws and CabMin (Cabinet of Ministers) resolutions, although it is not widely understood. Policymaking at the CabMin level has been described as follows. The Cabinet of Ministers considers proposals on policy and strategy from a range of sources in government. The latter include ministries, state committees and departments, corporations, associations, the Government of the Republic Karakalpakstan, and regional hokimiyats. These proposals are filtered through the Deputy Prime Ministers/Heads of Complexes, the Information and Analytical Department of the

Cabinet of Ministers, and the Presidium of the CabMin. Revised draft resolutions and orders are formally presented, along with brief summary notes on each issue raised by the Cabinet of Ministers. Where the drafts would entail additional expense, financial and economic substantiation is required.

Draft resolutions which emerge from sessions of the Cabinet of Ministers (or its Presidium) are finalized by the relevant Deputy Prime Minister, departments, or commissions that were established during these sessions. Amendments should be agreed with the relevant Deputy Prime Minister and the Head of the Information and Analytical Department. The modified draft is then reported to the Chairman of the Cabinet of Ministers or the Prime Minister of the Republic Uzbekistan. Draft resolutions on urgent issues (or issues where discussion at the Presidium of the Cabinet is not deemed necessary) are made out and agreed (by means of polling) with members of Presidium of the Cabinet.

An effective central management capability is needed to ensure coordination (including communicating decisions to all agencies), appropriate logistical support to decision making, and the recording and monitoring of implementation. In Uzbekistan, the Analytical and Information Department of the Cabinet of Ministers carries out these functions with respect to executive decrees and legislative initiatives. Medium and long-range plans are also created, in principle to ensure policy coherence, and consultations are also carried out to some extent. For example, the agricultural, industrial, commercial and social spheres are covered in a one-year agenda, and the National Program for Personnel Training is in place for the period up to 2010. Behind this is the longer-term vision statement From Strong State to Strong Society, elaborated by the President in 2000. While these documents may be cited in policy formulations, it is not at all clear that they guide policy in practice, nor that anyone is charged with ensuring they are followed. Even in budget planning, where a medium-term framework (covering several years) is essential for good public finance governance, such an approach is just being introduced in Uzbekistan.

Inter-ministerial consultations are in principle carried out with respect to policy-initiatives. Departments of all the ministries discuss the proposals, make amendments or additions, correct them and submit them for signature by the minister. After the minister signs the document it goes to the Cabinet of Ministers or the Office of the President, where the last corrections are made. During consideration by the Parliament, changes are rarely made. Draft documents are sent to affected ministries. For example, draft resolutions of a normative character (acts of a general and legally binding nature) are agreed with the Ministry of Justice. Draft resolutions, orders or proposals related to implementation of programs on the socio-economic development of Uzbekistan and the republican budget are subject to coordination with the Ministry of Macroeconomics and Statistics as well as the Ministry of Finance and the Ministry of Labor.

However, there does not appear to be a mechanism to ensure review by all ministries that would see the policy change as relevant. Nor is it clear that consultations take full account of the financial, legal, economic, and environmental implications of proposed policies. To the extent there are disagreements among ministries and departments on policy initiatives, they are usually based on financial reasons. Differences between the Ministry of Finance and other ministries are the most common. It should be noted, however, that disagreement is frequently suppressed, especially on matters viewed as politically important by the Presidential Apparatus. For example, when government staff cuts of 30% were demanded earlier in 2004, the ministries were said to be unable to express disagreement despite the impact of this measure on them.

Indeed, the budget process is generally said to be highly centralized, with the Ministry of Finance developing the budget with the support of the relevant Deputy PM.

Only in recent years have certain ministries been given the authority to adopt resolutions that affect the state budget. Many ministers have, in effect, no ability to make policy decisions themselves. They are mainly involved in execution of the budget, preparation of proposals for corrections to the budget, execution of state plans and orders, and control and coordination of lower-level bodies. Sometimes, they make proposals on the main directions of state policy and on budgetary matters, but these proposals are rarely taken into consideration. Certain ministries, such as the Ministry of Economy, have a broad mandate to initiate and coordinate policies across sectors. Ministerial posts, by themselves, do not appear to carry sufficient political weight to exercise strong influence on state policy. The decisive powers in policymaking are said to reside in the inner circle of the Presidential Apparatus.

Policy Implementation and Monitoring

There are a few core requirements in order for policy implementation to run smoothly. In addition to appropriate input and coordination in the policy-making process itself, decisions need to be disseminated effectively so that implementing organizations have a consistent understanding of their responsibilities and relationships. The line organization also needs sufficient autonomy, incentives, and resources to handle its responsibilities well. For example, in the context of regulation, the experience internationally has been that independent regulatory agencies with legislative statutes provide an effective framework for this function. Within line ministries, departments, and agencies, there are a number of conditions for successful policy implementation, including clear goals and analysis, targeted plans and indicators, and organizational structures and processes that maintain efficiency (ADB 2003).

Policy implementation also has an important legal dimension. Practice in the Western industrial countries suggests that the authorities and responsibilities of line organizations should be defined in laws that draw clear lines and provide avenues of enforcement and sanction. This enables government agencies themselves, and affected citizens and organizations, to police the boundaries of authority. Where this is not done, conflicts and abuses must be handled via personal and political influence. In Uzbekistan, resolutions and orders of the Cabinet of Ministers are sent for implementation to relevant secretariats of the Deputy Prime Minister, ministries, departments, and sectors. In case public outreach is needed, the texts of resolutions and orders are published in the press and broadcast by television and radio.

The Cabinet of Ministers carries out regular monitoring of the activity of ministries, state committees and departments, other public agencies, the Council of Ministers of the Republic of Karakalpakstan, and regional (and Tashkent city) hokimiyats - concerning the implementation of resolutions, orders, protocol decisions and assignments by CabMin. The monitoring process is comprised of the following steps:

- Development of a monitoring plan for the highest priority issues of social and economic development;
- Policy implementation by relevant structural divisions;
- Targeted study of the course of policy implementation in the ministries,

- departments, regional sectoral authorities and local authorities, enterprises, and organizations;
- Review of the implementation of own resolutions putting into effect the above-mentioned measures, by ministries, departments, Government of the Republic Karakalpakstan, and regional-level hokimiyats. The Cabinet of Ministers regularly receives reports from these sources on the status of implementation of socio-economic development policies, state budget execution, and the fulfillment of decisions by constitutional bodies of the government;
- Examination of the state of affairs across government agencies and regions, and consideration of policy results, at sessions of Complexes of the Cabinet of Ministers;
- Adoption by CabMin of measures to ensure personal responsibility of officials who do not ensure timely and complete implementation of targets set in decrees, orders and assignments of the President, and in decisions and orders of the Cabinet of Ministers. Primary responsibility here rests with the relevant Deputy Prime Ministers, who are also the Heads of Complexes.

On paper, the system for making and implementing policy in Uzbekistan seems coherent. In practice, however, a great number of conflicting policies are put in place, resulting in confusion and failures of implementation. One of the key problems here, noted by the TACIS program (N. WITSEN FOUNDATION 2002) but also evident in government practice in Uzbekistan, is the lack of a legal framework to reinforce policy cohesion and discipline in the system - hence the prominent role of political and relational factors in policy processes. There are two potential sources of legal discipline available in well-governed systems. One is the authority of government agencies to seek enforcement at law to ensure respect for their own statutes by other actors in the system. The other is the right of citizens and private organizations affected by policies and implementation measures to seek redress under the same agency statutes and under a general administrative procedure law. Even if enforcement mechanisms could be improved, ambiguities in the definitions of agency powers and responsibilities would still make it extremely difficult to impose accountability (N. WITSEN FOUNDATION 2002). These legal provisions are missing in Uzbekistan - a glaring lacuna with serious governance implications.

A.3. The Legislative Process

Good governance has usually been associated with the existence of a legislature independent of the executive and endowed with the necessary capabilities and resources to be fully active as a branch of government - on equal terms with the executive. In order to fulfill this role, the legislature needs a predominant role as lawmaker, with any powers by the executive to issue decrees and orders clearly (and narrowly) delimited. In working with the executive, the legislature needs the capability to set up statutory authorities such as independent agencies, to monitor the administration of policies, and to call high officials to account. This implies the need for a robust system of legislative committees able to study and pronounce on all matters of governance, and to call upon expert specialists, whether in-house or external. The idea of a parliament as a fully-empowered and separate branch of government is either new or newly-revived many of the post-Soviet nations.

In Uzbekistan, the Oliy Majlis is constitutionally established as a separate branch. However, the primary characteristic of this body to date has been its domination by the executive, together with its lack of initiative. There is no bar in principle to the parliament taking action on its own initiative. According to Article 83 of the Constitution, there can be the following sources of legislative initiative: 1) the President, 2) the Parliament of the Republic of Karakalpakstan, 3) Deputies of the Oliy Majlis, 4) the Cabinet of Ministers, 5) the Constitutional Court, 6) the High Court, 7) the High Economic Court, and 8) the Procurator General. Also, party factions have a right to express their requirements and preferences that may take the form of legislative proposals.

The government of Uzbekistan is primarily responsible for drafting legislation, and in practice does essentially all of it. Draft legislation on financial issues is prepared by the ministry of finance; legislation on taxation issues by the Tax committee; and laws on social protection, pension, and benefits for the disabled by the Ministry of Labor and Social Protection. All of these drafts are sent to CabMin. The Cabinet, after its final corrections and amendments, sends them to parliament. In some cases, draft laws are developed in committees of the Oliy Majlis. For instance, such draft laws as "On financing political parties" and "On social funds," which concern non-governmental organizations, are developed with direct involvement of these organizations in the committees. However these cases are in fact rare.

Indeed, the adoption of policy by legislative means, at least in the first instance, is not at all the norm. Presidential decrees and CabMin resolutions are more common, as policies are usually considered too urgent to wait for one of Parliament's thrice-yearly sessions. Worse, the mechanisms for harmonizing these acts with the constitution and laws are underdeveloped.

The planned legislative program is not published or gazetted. Rather, it is primarily set out in speeches by the President to the Oliy Majlis. Also, legislative reforms are envisioned in general form in the political document *From Strong State to Strong Society*, and in the state's program of liberalization and economic restructuring. There is no requirement that the legislative agenda be published. Nor are papers on policy issues are not made available to the public with any regularity.

The process of developing secondary legislation is even more opaque. In theory, Presidential decrees, CabMin resolutions, ministerial decisions, and agency regulations are all subordinate to laws enacted by the Oliy Majlis. However, only acts adopted below the level of CabMin are treated as such. In no case is there a regular process of public notice and comment, and indeed often only well-connected individuals and firms can actually obtain the text of such rules after they are adopted. The current parliament is a part-time body with little expertise and even less authority in practice. The Oliy Majlis has 250 members and meets three or four times a year, for two or three days. Only thirty members - those who are members of standing committees (i.e. three of the total of 13 committees) - work full time.

Uzbekistan has adopted constitutional amendments aimed at strengthening the Oliy Majlis vis-a-vis the executive. One amendment calls for the creation of a second parliamentary chamber, and a second purports to reduce the president's role to that of chief of state (rather than head of government). The new bicameral legislature, which was established at the end of 2004, has a full-time lower house, directly elected and charged with developing draft legislation. The upper chamber elected by the regional governments (along with the Republic of Karakalpakstan and Tashkent City) from among members of the regional assemblies. This upper chamber (Senate)

will have authority to approve or reject legislation passed in the lower house. It will meet for up to five sessions per year, with each of these lasting two to three days. Some powers residing in the President transferred to the Senate.

Opportunities for citizen participation

Openness and accountability to the citizens are hallmarks of effective parliaments around the world. In Uzbekistan, by contrast, there are in general limited opportunities for citizens to participate meaningfully in the activities of public bodies. Citizens can act as jury members and lay assessors in certain court cases. Public participation in the legislative process is similarly limited.

Draft laws before the Oliy Majlis are sometimes set out in the state newspapers. The public can, in principle, make proposals in response to these drafts. In practice, only a few such proposals are made, and they are not usually taken into account. This exchange of views in the newspapers is the main access most citizens have to the legislative process. Parliamentary debates themselves are not published. Only heads of large governmental and public organizations can participate in legislative debates in the Oliy Majlis. The Constitution lists eight official sources of legislative initiative — but does not include individuals.

There are certain cases where participation from the public is sought in the development of legislation. For example, the Center on Coordination of the Securities Market (responsible for implementing state policy on the securities market, protecting investors' rights, and regulating securities market activity) is required by law to send draft regulations to market participants and hold meetings for discussion of the drafts. The Oliy Majlis also has a practice (but not a requirement) to consult with affected members of the private sector on proposed legislation. They often hold seminars or conferences concerning new legislation where experts and civil society associations are invited to present comments (Schiffmann 2003). However, interviews with the business community in Uzbekistan suggest that the government in fact rarely consults with businesses, and then on only very minor matters.

Nor do citizens have a regular means of communicating policy preferences to the parliament. The Oliy Majlis does draw on outside expertise. Academicians, doctors, representatives of small business and other specialists are involved in providing necessary input and analysis. But they have only minor involvement in the legislative groups and commissions that carry out investigations and analysis. A law reform committee was established in 2002, composed of representatives from the MOJ, Supreme Court, Procurator General, academia, and NGOs. This committee considers proposed laws and invites expert opinion. It also asks various government agencies about what legislative initiatives are being considered, and make recommendations about them (Schiffmann 2003).

A.4. Public Administration Reform

The public administration and the legal-regulatory framework for economic governance are both in the process of reform. The Government of Uzbekistan is planning to adopt some 80 new regulations in these areas. Many of these legal-regulatory changes focus on government's relationships with the private sector and NGOs, involving privatization, restructuring, and delegation of public sector functions to organizations such as the Chamber. The move towards a bicameral parliament, with complementary changes in the executive apparatus, is a part of this

overall package - and the first one to surface publicly. Apparently, these reforms have been on the agenda for several years, and donor agencies provided extensive technical assistance with background analysis and design.

These reforms were initiated by the President, based on comparative experience — especially, according to the government, recent experience in Russia. The President issued two decrees in late 2003 mandating reforms of public administration and economic governance. Presidential Decree 3358 of 22 December 2003 "On improving the system of republican bodies of public governance" institutes a restructuring of public sector functions. Many experts say that this new structure is an improvement on the previous one, which was more complex. At the same time, some complain that the respective powers, protections, and constraints of the different bodies are not defined with sufficient clarity to permit effective policing of their duties and limits.

The Cabinet of Ministers Office of Information and Analysis is playing a lead role in these reforms, along with the Ministries of Finance and Justice. Two expert groups are said to be working with CabMin on the reforms, as well as on implementation plans and the design of a monitoring mechanism. The Information and Analysis Office of CabMin asserts the need for getting the reforms in place quickly, and as a result the intention is to adopt the package via executive decrees and resolutions - without the involvement of Parliament. A separate reform concerning the independence of the judiciary is said to be in the process of elaboration by the Ministry of Justice.

Many observers fear that the reforms will remain only on paper. This concern is strengthened by the continuing pattern of protecting the prerogatives and private interests of powerful figures in government. For example, government has accepted the view that administrative reform requires clear-cut functions, and that this in turn depends on a thorough functional analysis of ministries and agencies. Studies of this kind were apparently done in 2001 and again this year. Powerful government figures had little interest in reforms to clarify and limit the powers of executive bodies, and so the research and institutional re-design was resisted. This and other examples reinforce a growing sentiment that government attends to the distribution of benefits to its powerful members and backers first, and that it has neither the interest nor the means to gather information and policy input from external constituencies.

Such structural reforms as have been approved usually do not create autonomous centers of policy analysis and administration, but rather bodies directly subordinate to political offices. This strengthens the perception that the reforms are based on the political interests of particular officials and departments. As suggested above, credible and impartial policy implementation requires a line organization at arm's-length from political decision-makers, with its processes and personnel insulated from direct political intrusion.

IV. LEGAL TRANSITION

A. Concessions

Concessions are governed mainly by the 1995 Law of the Republic of Uzbekistan "On Concessions", (the "Concession Law"). In addition, several foreign investors have undertaken natural resources projects under the rules of the 2001 Law "On Production Sharing Agreements".

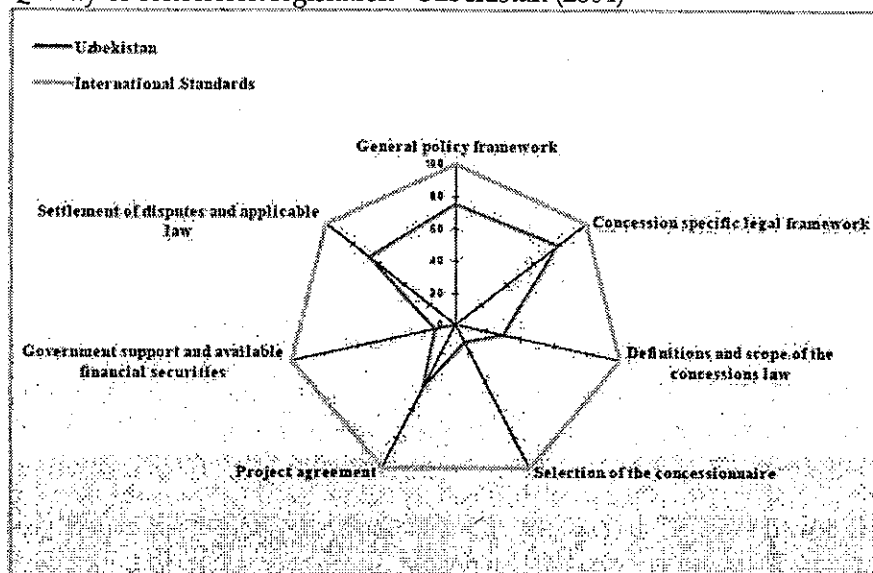
There exists a written policy framework for improving the legal environment and promoting Private Sector Participation ("PSP") in Uzbekistan in the form of a Resolution On approval of the concept of strengthening economic reforms in the public utility services system, issued in 1998 by the Commission on Perfection of the Public Utility Services in the Market Economy. Accordingly, some general provisions on this account could be found, in particular, in the 1998 Law on Guarantees and Measures for the Protection of Foreign Investors' Rights.

Overall, the Concession Law's provisions are fairly vague (as far as all the major modern concession legislation core areas are concerned) and discriminate against domestic investors.

A positive feature of the Concession Law is that a concession agreement may not be terminated unilaterally, except where the concession authority discovers that the concessionaire provided false information at the time at which the agreement was entered into. Another welcome rule of the concession regime is that it allows a concessionaire to dispose freely of its profit after payment of fees, taxes and payments required by Uzbek law.

The Government of Uzbekistan has the preemptive right to purchase the products from the concessionaire. This results in foreign investors being concerned that they may be forced to sell products at a price specified by the State and lower than the market price. Moreover, according to the Concession Law, foreign investors are to keep accounts and financials in accordance with Uzbek law, which does not correspond with the international accounting standards. Another major drawback of the Concession Law is the standard provision that disputes between a concessionaire and the concession grantor fall under the exclusive jurisdiction of economic courts of Uzbekistan. Unfortunately therefore, parties to a concession agreement are not entitled to refer a dispute to international arbitration.

Quality of concession legislation –Uzbekistan (2004)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2004

The recent EBRD Concession Laws Assessment project undertaken to evaluate applicable regime throughout the 27 countries of EBRD operations, revealed that Uzbek laws presented "low compliance" with internationally accepted standards in this sector. As can be seen from the above graph, while rules covering the settlement of disputes in concession-related arrangements, for instance, are regulated fairly extensively, even though not providing for an international arbitration option, most other areas, and, in particular, selection of a concessionaire and availability of financial instruments and state support, need to be dramatically improved in order to meet requirements of modern legal framework facilitating private sector participation.

As far as the selection procedure is concerned, the rules are very general without, for instance, any reference to the pre-selection procedure or to the publication of concession awards. Moreover, there are no sufficiently clear grounds provided for the possibility of direct negotiations and no reference is made to review procedures. Even though the Concession Law contains provisions regulating project agreements, these are not flexible enough to encourage true negotiation of an agreement. Finally, the Concession Law is silent as far as government support, financial securities and lenders' rights are concerned.

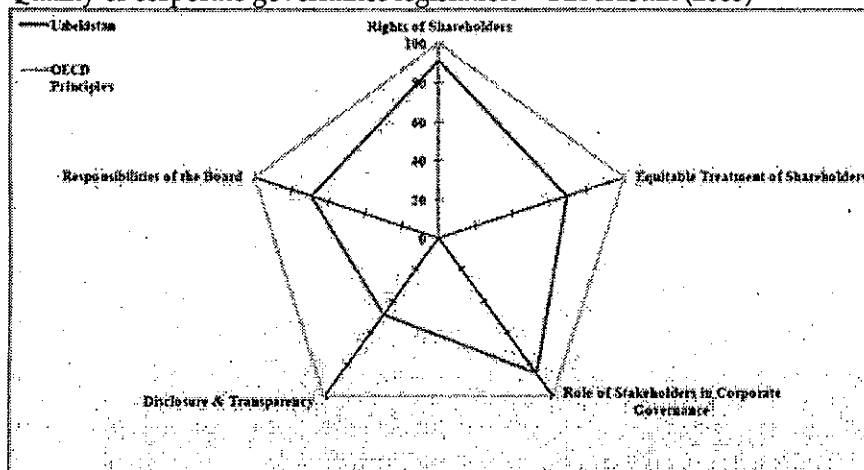
Overall, the Concession Law does not constitute a sufficiently solid legal basis for the development of private sector participation in the infrastructure and utility services in Uzbekistan. Thus, a major reform of concession enabling legislation is desirable in order to create a clearer, more flexible and investor-friendly legal environment for private sector participation in Uzbekistan.

B. Corporate Governance

The Law on Joint-Stock Companies and Protection of the Rights of Stockholders, based on the Russian model, entered into force on 26 April 1996 and was amended in 1997, 1998, 2002 and 2003. The Law on Companies with Limited and Additional Liability, dated 6 December 2001, extended the application of the standards of the Law on Joint-Stock Companies to limited liability companies. These laws, along with the decree of Cabinet of Ministers "On improvement of state registration system and record keeping of subjects of entrepreneurship", dated 22 August 2001 and the Decree of Cabinet of Ministers "On substantial improvement of registration procedure system for organization of entrepreneurial activity", dated 20 August 2003, constitutes the legal framework on corporate governance in Uzbekistan.

In 2003, the EBRD conducted an assessment on the extensiveness (i.e. the quality of the "law in the books") of Uzbek corporate governance legislation, which scored "medium compliance" when measured against the OECD principles. When compared to similar legislation in other Early Transition Countries, the laws of Uzbekistan seem to constitute a good basis to develop sound corporate governance practices in the country. In assisting Uzbekistan in this respect, the Asian Development Bank undertook two initiatives aimed at enhancing transparency and disclosure and at safeguarding investors' rights, helped Uzbekistan define appropriate efforts in the state and private sector, which, among other things, would improve corporate governance practices.

Quality of corporate governance legislation – Uzbekistan (2003)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles.

Source: EBRD Corporate Governance Sector Assessment, 2003

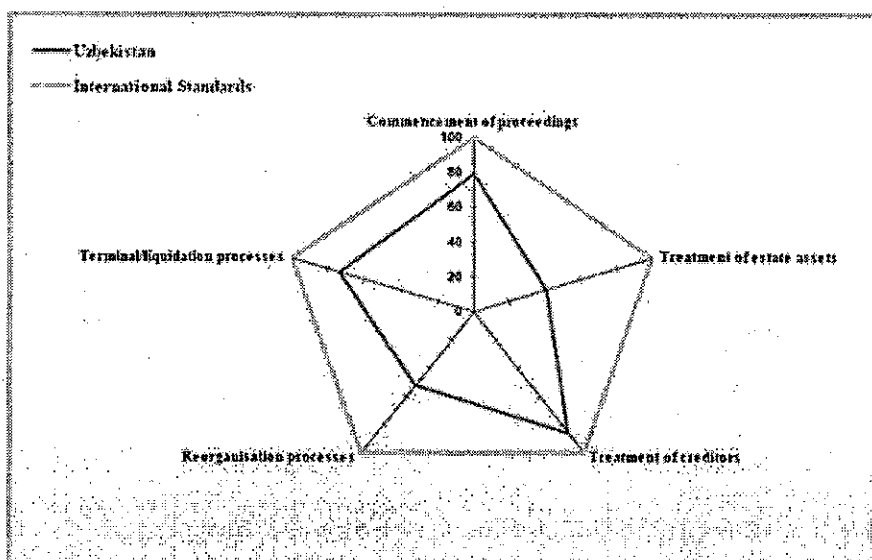
On the other hand, areas for improvement still remain. In particular, provisions requiring that shares be fully paid before a transfer should be introduced as a specific quorum in cases of restrictions of specific shareholders rights.

Information on the compensation of board members and key executives should be determined by the shareholders and the board's responsibilities should include monitoring the effectiveness of the governance practices in place. Boards should include a certain number of non-executive and independent directors and separate committees for dealing with financial reporting.

Executive and board remuneration and board nominations should be created. Finally, as highlighted in the chart above, corporate information disclosure should be generally improved, as should legislation on insider trading.

C. Insolvency

Bankruptcy and insolvency in Uzbekistan are governed by the 2003 Law on Bankruptcy of the Republic of Uzbekistan (as amended) (the "Insolvency Law"). This law scored "low compliance" when compared with international standards in the EBRD's 2004 Sector Assessment.



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank's Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on "Legislative Guidelines for Insolvency Law", and others. The fuller the 'web', the more closely insolvency laws of the country approximate these standards.

Source: EBRD Insolvency Sector Assessment Project, 2003/2004

As the above graph reveals, this law is deficient in many key areas of insolvency. Specifically, the Insolvency Law does not provide for a 'balance sheet' test for insolvency and does not provide expedited time limits within which an insolvency case must be heard by the court. In addition, the law's provisions on the avoidance of suspicious pre-bankruptcy transactions are extremely vague and do not provide the necessary detail to create a predictable avoidance regime.

As is common in insolvency legislation in the ETC, the Insolvency Law is particularly deficient in addressing the issue of reorganization. At present, the reorganization provisions provide for virtually no supervision of the debtor company and prescribe woefully inadequate requirements for the qualification on insolvency administrators, who are vital to the reorganization process. In addition, under the current scheme there is virtually no opportunity to obtain ongoing financing during restructuring. All of these issues must be addressed. Finally,

it would also be worthwhile for the law to address the issue of cross-border insolvency proceedings (although, admittedly, this is not as pressing an issue as the other deficiencies discussed herein).

Although the Insolvency Law does contain some positive elements, such as the adequate notice given to creditors when proceedings are commenced, there is some doubt as to whether any positive attributes in this law can be properly implemented. The results of the EBRD 2004 Legal Indicator Survey on Insolvency, which examined the 'effectiveness' (or how the law works in practice) of insolvency regimes in both creditor-initiated insolvencies and debtor-initiated insolvencies showed that the practical application of the insolvency law by creditors is likely to be unduly expensive and overly complex. In addition, the results of the survey show that the quality of insolvency administrators, in both creditor and debtor initiated cases, is extremely unreliable.

All of these factors, together with the law's deficiencies, militate against the insolvency regime functioning properly as a 'stick' to induce debtors to act in good faith and as a 'carrot' to induce insolvency debtors, with businesses that are fundamentally viable, to try to promote the rescue of such businesses. It appears that a comprehensive package of reforms (of both the legislative and institution-building variety) is required to remedy this situation.

D. Secured Transactions

The legal regime of security rights over movable and immovable assets is defined in the Civil Code of 1 March 1997 and the Pledge Law of 1 May 1998.

Security over movable tangible assets can be structured in several different ways:

- transferring possession of the collateral to the creditor or a third party;
- marking or locking and sealing the assets which would then remain in the possession of the borrower;
- agreeing between the parties that the security will be created without such formalities (in particular for commodities in circulation).

Notarization of the agreement is not compulsory but recommended as it would constitute a "receiving order" allowing the lender to start enforcement upon default without having to obtain a court judgment. There exists no general system of registration of charges over movable property and the question of priority and enforcement remains highly hazardous. Registration is required only when the charged assets themselves are subject to registration, such as (intellectual property rights, and vehicles).

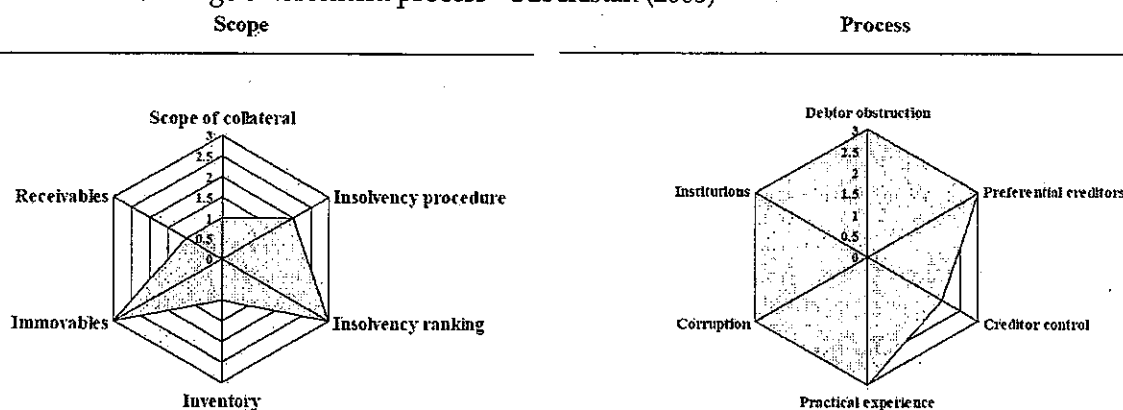
In the case of security over immovable assets (which would include the enterprise), perfection of the mortgage requires notarization of the mortgage agreement and registration in the Land Registry.

Uzbek law is quite rigid in terms of what the parties can agree to: a general description of the collateral is only allowed for security over commodities in circulation and processing. Otherwise, specific identification of charged property is required. Although the charging of future property is explicitly envisaged, it seems that notaries would not accept to notarize

agreements for security over future assets. Also, specific identification of the secured debt is generally required: the agreement must include details of the essence and maturity date of the secured debt. Another serious impediment consists in the creditor's priority: tax arrears and certain debt for which creditors have previously obtained a court order may have priority over the secured creditor, including outside bankruptcy. In bankruptcy, secured claims would be preceded by unpaid wages, taxes and social security claims.

As in many other transition countries, enforcement remains unsatisfactory - being slow and uncertain. In a survey conducted by EBRD in 2003 on enforcement of charges in its countries of operations, the results for Uzbekistan showed that the process is very slow and complex, and the proceeds that the lender can expect upon realization of the assets, limited. This is due to the many opportunities that the debtor would have to obstruct and delay the process (e.g. the sale of charged property could be postponed by up to one year upon the debtor's request) and the clear inability of courts to support the process (see graphs below).

Obstacles to charge enforcement process –Uzbekistan (2003)



Note: The fuller the colored area, the more serious the problems are in each of the respective categories. "Process" factors measure the impact of specific incidences on the enforcement proceedings. "Scope" factors relate to the ability of the system to deal with specific situations or items.

Source: EBRD Legal Indicator Survey 2003

E. Securities Markets

The Law on Exchanges and Exchange Activities of 2001, the Law on Securities and Stock Exchange of 1993, as amended in 1999 and 2002, the Law on Mechanism of Operation of Securities Markets of 1996, as amended in 2002, the Law on Depository Activities at Securities Markets of 1998 as amended in 2002, the Law on Protection of Investors' Rights at Securities Markets of 2001, and the Law on Joint Stock Companies and Protection of Shareholders of 1996, as amended in 1997, 1998, 2002 and 2003, constitute the main legal framework on securities markets in Uzbekistan.

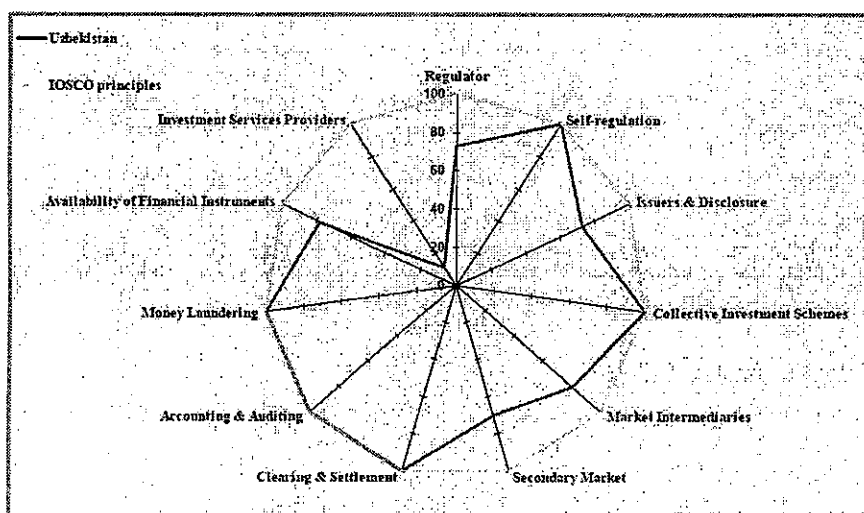
The Centre for Coordination and Control of the Securities Markets, established in March 1996 on the basis of a Decree of the President of Uzbekistan, is the regulator of the Uzbek Securities Market.

The Tashkent Republican Stock Exchange was created in 1994, following the first stage of privatization. Access to the system is limited to licensed brokers, who can make transactions from 12 branches of the exchange located in different regions of the country. In 2003, the turnover of equities in the securities market amounted to approximately USD 33 million, while that of government bonds amounted to approximately USD 56.4 million and that of corporate bonds to around USD 19.1 million. In 2000, an electronic OTC system came into being. Trading on the OTC is limited and in 2002 the total volume of transactions amounted to just USD 575,000.

Notwithstanding the major improvements to the system in recent years, the Uzbek Securities Market is characterized by low liquidity, the absence of an effective system of information disclosure and a low number of investment intermediaries and other investment institutions.

In 2004, EBRD measured the Uzbek Securities Markets legislation against the "Objectives and Principles of Securities Regulation" published by IOSCO and the results demonstrated that such legislation is in "medium compliance" with the IOSCO principles.

Quality of securities market legislation –Uzbekistan (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO's Objectives and Principles for Securities Regulations. The fuller the 'web', the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Market Legislation Assessment 2004

Among the major shortcomings evidenced in the EBRD Securities Market Legislation Assessment, both the regulator's powers on enforcement of disclosure requirements and the disclosure requirements in cases of change in corporate control should be strengthened. Disclosure and transparency are also issues to be tackled in collective investment schemes. Front-running practices are not prohibited and there is no legislation in place specifically

defining investment service providers and preventing financial difficulties of market intermediaries.

V. LEGAL AND REGULATORY FRAMEWORK

It is now widely agreed that stability and prosperity depend on the quality of the institutional framework for governance. This understanding encompasses not only the legal structure directly applicable to investment and commercial activity, but also the basic constraints on government action, the protection of property rights, and the framework for administrative decisions.

A. Legal Framework

In this section, we address two broad questions concerning the quality of Uzbekistan's legal framework. First, we examine to what extent legal enactments emanating from various authorities are mutually consistent, and assess the quality of mechanisms for maintaining clarity and consistency. Second, we look at the application of law to government action, in terms of both substantive coverage and the availability of mechanisms to enforce government compliance. These are two core aspects of the rule of law.

We should first clarify what is meant by "the rule of law." Essentially, it refers to situation where law can effectively guide human behavior - including that of private individuals, organizations, and governments. A number of definitions of the rule of law exist, but the following core elements appear in most of them:

- **Generality:** legal prescriptions must be issued at some level of generality. No legal system can function by addressing its prescriptions to individuals, one by one, or by addressing each particular act separately.
- **Promulgation:** for law to be able to guide human conduct, it must be promulgated to its subjects. People can only follow rules or prescriptions if they are aware that the rules exist.
- **No Retroactive Rules:** for the law to guide human conduct, it must prescribe modes of behavior prospectively. Retroactive rules, i.e. rules purporting to affect behavior that occurred prior to the rules' existence, by definition cannot serve as a guide.
- **Clarity:** Rules or prescriptions can only guide conduct if the subjects understand what the rule requires.
- **No contradictory or impossible prescriptions:** To guide human conduct, rules must be mutually consistent and require conduct that is possible for the subjects to perform.
- **Stability:** Stability over time is essential for the law to achieve its purposes. The law can change, of course, and changes in the law are not infrequent in any modern legal system, but if changes are too frequent, people cannot follow the law. Many actions that the law purports to regulate require advance planning, preparation, and reasonably secure expectations about the future legal environment.
- **Consistent application:** for the law to guide human conduct, there must be congruence between the rules promulgated and their actual application to specific cases. In other

words, the law cannot guide human conduct if deviations from it in practice are treated as normal and have no cost. This requires that agencies applying and enforcing the law in specific cases actually apply those rules promulgated by the law. In practice, this necessitates an independent and professional judiciary, access to courts, reliable enforcement agencies, and mechanisms for legal accountability of government.

A.1. Quality and Consistency of Substantive Law

A cornerstone of the rule of law, and of a legal order that promotes good governance and economic growth, is a functional set of norms governing the relationship among different legal instruments. Inevitably, successive laws, decrees, and regulations will overlap and even conflict. Rules are needed to determine which enactments prevail, and how to interpret them in ways that clarify which provisions apply. Where these overarching rules are effective, they supply the legal stability, certainty, and legitimacy necessary for a prosperous and democratic social order. These rules are sometimes set out formally as a normative hierarchy or order of precedence, and in other cases they arise from judicial and administrative precedent.

The formal hierarchy of official enactments in Uzbekistan is set out in the Law on Normative Acts, 2000. The rank of enactments in terms of their authoritativeness is as follows: 1) the Constitution; 2) legislation enacted by the Oliy Majlis; 3) Presidential decrees; 4) CabMin resolutions; 5) decisions by Ministries and agencies of the central government; 6) decisions by the regional hokimiyats. Within each category, the decision last in time prevails over prior decisions. Article 94 of the Constitution and Article 10 of the Law on Normative Acts give the president the authority to issue decrees that are based on the Laws as well as the Constitution. The same is true of resolutions of the Cabinet of Ministers, which in addition must conform with decisions of the President and the Oliy Majlis.

Proliferation of normative acts

The above formal ranking is at odds with actual practice in Uzbekistan's policymaking processes. There are many instances where the hierarchy is ignored, and/or where a governmental body issues a resolution on a topic that is supposed to be within the purview of a different agency. The President and Cabinet of Ministers frequently overstep the bounds of their authority by issuing decrees and resolutions; although decrees are supposed to be subordinate to laws, in practice, presidential decrees can contradict and even supersede laws; and legislation is sometimes amended to conform to a decree or regulation (Schiffman 2003). The Cabinet of Ministers—"the executive branch of power of the Republic of Uzbekistan," according to the government website—oversees the administrative bodies of the government and "ensures their coordinated activity." The Cabinet has power under Article 98 of the Constitution to issue directives or resolutions, also "in accordance with the current legislation." Interviews with entrepreneurs and experts in Uzbekistan revealed that the Cabinet of Ministers issues frequent resolutions, which are often anti-business and reflect lobbying by private interests. Also, as with presidential decrees, the Cabinet's resolutions sometimes supersede legislation or extend into an area that is formally the realm of the legislature. For example, there have been presidential decrees and resolutions of the Cabinet of Ministers which have granted exemptions and privileges for taxes and duties, or have defined tax rates, whereas the authority to pass such legislation is supposed to rest with the Oliy Majlis (Campbell et al. 2003).

Some of this confusion can be attributed to the lack of any clear rule on the subject-matter competence of the various branches of government and forms of normative acts. Perhaps as important is the want of an effective disciplining mechanism to ensure the separation of powers and the need for consistency among normative acts. For example, whereas in many countries executive decrees are permissible within defined subject areas, emergency situations, or time limits, there are no such limitations in evidence in Uzbekistan. Some decrees are stated to be subject to parliamentary monitoring, but the practical effect of this is marginal.

A recent report on Uzbekistan's legal and regulatory framework attempted to count the number of laws, decrees, resolutions and regulations issued between 2000 and 2003. Although the numbers differed depending on the sources, the report tallied as many as 670 laws, 1,579 presidential decrees, 69 resolutions of the Cabinet of Ministers, and 381 normative acts or regulations issued by ministries, departments and committees (Schiffman 2003). The numbers themselves suggest the difficulties in harmonizing the new with the old or eliminating obsolete legislation. While some government laws and regulations may be made available to the general public, through various official publications as well as in the newspapers and at legal information centers or via the internet, physical availability of the laws alone does not equal accessibility. The laws that are published may also differ from what the Oliy Majlis had actually agreed to. There are "secret resolutions" which are not made public, but which can then be enforced against unwitting violators. Terminology is not uniform: identical words and phrases may be used in different laws, but with different meanings (Campbell et al. 2003).

Mechanisms for review and harmonization

Uzbekistan does have in place limited capabilities for harmonizing policy instruments emanating from different sources in government. Two institutions handle this, the Institute of Legislative Monitoring, attached to the Oliy Majlis, and the Ministry of Justice Bureau for Registration of Normative Acts. These two offices attempt to bring some coherence and legal discipline to the various policy enactments. In some cases, they seem to respond to complaints about the inconsistency or illegality of certain instruments, and so they occasionally perform the function of administrative or constitutional review -but without the necessary formal powers.

The Institute of Monitoring is a governmental body attached to Parliament, and exercising limited autonomy within its mandate of research, analysis, and review. It was created in 1996 to (i) comment on draft laws prior to their submission to Parliamentary commissions, and (ii) analyze enacted legislation and make proposals to Parliament or CabMin to resolve conflicts. The first function is also carried out by the Legal Department of the Oliy Majlis, but with a focus on legal conformity. The Institute poses such questions as: Is the proposed law necessary for meeting the objective? What impacts can be anticipated? How likely is it to be implemented properly? Is it consistent with other laws? Since MPs are largely passive (and part-time), most substantive comments at this stage come from the Institute.

The Institute's second function poses more of a challenge, since it involves harmonizing prior enactments after the fact. Worse, the Institute is only empowered to deal with enactments below the CabMin level. However, it has sometimes found ways to extend its influence. For example, there have been CabMin resolutions that contradict existing law. The Institute's recommendations on correcting these problems were ignored. The Institute then approached the Constitutional Court to provide them information on the conflict of norms, which the Court can consider on the initiative of three of its members. The Institute, which does not have a

formal right of appeal to the Court, says that it has managed to have several CabMin resolutions invalidated in this way (this despite the general impression that the Court is passive). The Institute has also attempted to deal with Presidential decrees that run afoul of prior law, but with no result. The Institute has no formal authority to deal with the enactments of ministries or local governments.

The Institute strives to bring a modicum of consistency and transparency to the policy process with the few tools at hand. It has a staff of 22, including 15 researchers. It holds stakeholder workshops on selected policy issues and legislative drafts. Its studies are internal documents, consistent with the practice of the state-sponsored think-tanks advising government. Only a few draft laws are published - the ones considered "important" to the public - and only a minority of these prompt any public commentary. Nor do NGOs as a rule carry out policy analysis and watchdog functions in the open. Cost-benefit analysis and periodic regulatory review are essentially unknown. In the formulation of one observer: "too many acts, too little control."

The Ministry of Justice Office for Registration of Normative Acts plays a complementary role. Under the Law on Normative Acts, the Office registers the acts of ministries, departments, and agencies of the central government. The goals of the registration process are to ensure compliance with other laws, check that the issuing bodies have appropriate authority, regulate relations among bodies on a legal basis, set criteria for reviewing documents (e.g. time limits), and prevent (or strike down) unnecessary administrative barriers and conflicts. The Office's review process consists essentially of checking an act's compliance with superior norms. It has been given special duties to protect the interests of enterprise development, foreign investment, and human rights against inconsistent rules. The Office has 16 staff, each focusing on designated areas of expertise. It records all normative acts, classifies them, and issues periodic codifications. It is also working on a national legislative database. The Ministry of Justice reports that it rejects many nonconforming directives, in 2002 rejecting as many proposed new directives as it approved, and declaring several earlier-promulgated regulations to be invalid (Schiffman 2003).

The Ministry of Justice Registration Office, like the Institute of Legislative Monitoring, experiences difficulties in obtaining timely information and resolving contradictions. The Office reports that some 15 acts were implemented last year without prior registration. In these cases, the Office speaks directly with the issuing body, requesting it to either register or cancel the act. Failure to cooperate would require the Office to file a complaint in court and to ask government to discipline the responsible official (to date, these steps have not been necessary). The Office monitors the state gazette and newspapers, receives reports from affected persons, and inspects state agencies and their regional offices, for purposes of checking on the issuance of any unregistered normative acts. The Office also, in principle, is tasked with harmonizing prior enactments with new Presidential decrees and CabMin resolutions - neither this Office nor the Monitoring Institute has authority to challenge these executive acts. In addition, the Office is restricted to consideration of decisions that fit the criteria of normative acts. So, for example, decisions by the hokimiyats by definition do not fit these criteria and so are not registered. Yet, the office solicits summaries of local policies from the regional branches of national ministries, and does some monitoring of the conformity of local decisions with national-level norms.

A.2. Application of Law to Government Actions

Is government action subject to legal accountability? To ensure that official acts are held to a legal standard requires a system of administrative law and the application of civil and criminal liability in appropriate cases.

An effective administrative law is important in improving governance because it establishes required procedures, disclosures, and standards of legal validity according to which executive officials and agencies must act. Its implementation requires a hierarchy of appeal and review, and parallel structures of oversight and transparency to ensure compliance. As discussed throughout this report, improving transparency and predictability, by establishing publicly available procedures that dictate how and by whom decisions are made, will contribute to the overall governance environment and foster the rule of law in Uzbekistan.

The Government of Uzbekistan operates within an environment characterized by a large volume of acts, decrees and regulations. Many of these enactments are mutually inconsistent or unclear in their application. When it is unclear what the law is, let alone who is responsible for enacting and implementing particular laws or resolutions, this makes it difficult for an aggrieved party to seek redress through a formal assertion of rights.

At the same time, there are numerous laws purporting to give citizens means to seek redress for wrongs committed by public officials. For example, citizens in principle have the right of "self-defense," under Article 13 of Civil Code. Article 44 of the Constitution allows for "appeal of any unlawful action of state bodies, officials and public associations," although it is not clear from the article what the intended forum is for such an appeal. Other laws (e.g., Article 5 of the Law of the Republic of Uzbekistan "About references of citizens") supposedly provide for administrative and judicial processes for such appeals. An administrative process for appealing actions to a higher state authority is laid out in Article 269 of the Civil Procedure Code. Citizens are supposed to be able to submit complaints about wrongful actions of officials to the courts under Article 44 of the Constitution and sub-item 3 of the Civil Procedure Code. The Law on Appeals of Citizens provides that "complaints against acts or decisions of governmental bodies, public organizations, agencies or officials shall be appealed to a higher body or to the court." Article 18 of the Law on State Control of the Activity of Economic Subjects of 1998 also provides that "losses caused to an economic subject as a result of illegal decisions or other actions of officials . . . shall be subject to compensation in the procedure established by the legislation." Resolution 370 of the Cabinet of Ministers (2003) "On Measures for Further Improvement of the Activity of the Ministry of Justice" notes that the MOJ is responsible for protecting the rights and freedoms of human beings, and provides, among other things, that registration of persons and NGOs must be conducted with "legality," and that the MOJ should form a department concerned with the protection of human rights.

However, there are serious problems with the enforcement of these provisions. A study by ABA/CEELI "did not identify a single high profile decision by the courts that directed the executive to comply with a citizen request" (Schiffman 2003; ABA 2002). Citizens' complaints against illegal actions of officials are supposed to be considered free of charge, and if the citizen's complaint results in institution of criminal proceedings, the citizen does not bear charges. However, Article 117 of the Civil Procedure Code provides that the costs can be charged against the citizen who instituted the case if the court decides against the citizen - which may cause a reluctance to bring such cases in the first place. Business people involved in legal disputes with government officials complain that court cases can drag on indefinitely, causing plaintiffs massive losses and making them ultimately drop even strong cases. Potential

complainants are also undoubtedly discouraged by the fact that the courts almost always side with the government (Schiffman 2003).

One interesting development in recent years is that the Ministry of Justice now can, and does, bring lawsuits on behalf of small and medium sized businesses who have suffered from illegal actions of government authorities. The offending action must be in writing (e.g. a decree or order), but even with this limitation, the MOJ brought approximately 400 such actions in a year's time and had an impact on deterring certain types of illegal actions by government officials (Schiffman 2003). There is also a resolution dated May 6, 2003 that charges the MOJ with defending the interests of foreign investors. Pursuant to this resolution, the MOJ will recommend eliminating violations of legislation, suggest remedial actions to be undertaken, and inform agencies to bring officials to justice when they have violated the rights of foreign investors or when they have not fulfilled their legal duties. The MOJ has the power to suspend actions or decisions of agencies if it found that those actions violated the rights of foreign investors. Although numerous cases have been initiated under this resolution, reportedly the MOJ has refused to consider cases against higher level authorities (Schiffman 2003).

A Department for Support and Protection of SMEs, also under the MOJ, was created in 2000. The purposes of this Department are to ensure SMEs and entrepreneurs' compliance with legislative and regulatory acts applicable to them; but also, to make proposals to improve existing legislation and the rights of entrepreneurs; to "ensure control over the legality of inspections by inspecting agencies," and to "monitor illegal interference in SME operations by state agencies, officials and authorities." (IFC 2003). There was reportedly growing awareness of this Department in its first three years of existence. At the same time, the number of complaints made to the Department remained low (IFC 2003).

A further legal check on government action is the liability of officials for misdeeds. This, of course, requires a careful balance to be drawn between equal application of the law and protection for those acting within their official duties. Article 18 of the Constitution, Article 1 of the Civil Code, and Article 5 of the Criminal Code each establish the equality of all Uzbek citizens before the law. However, at the same time, Article 6 of the Constitution and Article 30 of the Law of the Republic of Uzbekistan, provide that members of the Oliy Majlis cannot be subjected to criminal proceedings without consent of the legislature. Only the Prosecutor General can institute criminal proceedings against Oliy Majlis deputies.

Thus, although there appear to be numerous avenues for redress, in practice they are not often used. Lack of knowledge of the law prevents citizens from asserting rights they may have in the face of mistreatment by public officials. Even a party who has knowledge of the applicable law cannot be confident that his rights will be enforced or respected. For example, interviews revealed instances of firms that had all the proper documentation in order, yet were subject to improper seizures of their property. Businesses cited the need to have personal connections or to bribe judges in order to enforce their rights in court. Of course the ambiguity and inconsistency of the official rules further contribute to this practice, allowing unscrupulous officials to interpret the applicable documents at his/her discretion.

Ultimately, the procedures need to be clarified by which Uzbek citizens can effectively seek redress for wrongs suffered at the hands of public officials; the creation of such procedures is an important aspect of an effective administrative law and effective governance overall. An appropriate balance would be to impose legal responsibility on officials for serious abuses and

acts beyond their scope of authority. Although Uzbekistan has numerous laws aimed at regulating actions of officials, those laws should be part of any comprehensive re-evaluation of the body of Uzbek law, so that concise, consistent (both internally, and with regard to other laws) administrative law can be put into place.

A.3. Legal Framework for Access to Information

Access to information is another important component of good governance and an effective market system. Information is necessary to improve accountability and limit opportunities for corruption, and also to establish a predictable environment that economic actors can rely on in conducting their activities.

Under the Soviet system, access to information was highly controlled, and information that was released was tailored to suit particular government objectives. Since gaining independence, Uzbekistan has taken steps toward improving the flow of information. The Constitution states in Article 29 that "everyone shall have the right to seek, obtain and disseminate any information" Uzbekistan's Law on Principles and Guarantees of Freedom of Information, Article 1, provides for "rights of everyone to search, receive, investigate, disseminate, use, and keep information freely and without hindrance, as well as securing of protection of information and information safety of the person, society and state."

Although it is not unusual for freedom of information laws in other countries to contain limiting provisions, international best practice suggests that any exceptions to free access should be narrow and specified in the statute. In the case of Uzbekistan's statute, the exceptions are worded generally, and thus provide an opportunity for wide discretion in their interpretation and application. For example, the category of information determined to be "state secrets" can be construed very broadly. A Law on the Defense of State Secrets (1993) does purport to define state secrets, but the three categories as defined in that law can still be broadly construed: e.g., "State secrets consist of information, the revelation of which could exert a negative influence on the qualitative state of the military-economic potential of the Republic or attract other grave consequences for defense, state security, and the economic and political interests of the Republic of Uzbekistan" (emphasis added). Further classification of state secrets then becomes the responsibility of the Cabinet of Ministers under two resolutions, "On the manner of the definition and establishment of the degree of secrecy of information" and the "List of information liable to be classified as secret in the Republic of Uzbekistan." "In a practice highly unusual in both the region and by international standards, the Cabinet of Ministers resolutions and all associated official implementations instructions from state institutions on state secrecy are themselves classified as state secrets or for official use only and are therefore not made available to the public. . . . This 'double bind' of secrecy has significant consequences" (Hellman 2003 at 5).

Another aspect in which Uzbekistan's freedom of information policies differ from those in other countries is that Uzbek law guarantees public access to all laws and normative acts except those which are classified as secret. Again, there is considerable bureaucratic discretion over which laws are considered to be secret. Even laws which are otherwise published and available to the public may contain secret clauses. Examples of presidential decrees and resolutions of the Cabinet of Ministers which were found to contain secret clauses include:

- "On the forecast of basic macroeconomic indicators and parameters of the State Budget"

- "On the regulation of the importation of goods by physical persons on the territory of the republic of Uzbekistan"
- "On the investment program of the Republic of Uzbekistan in 2002"
- "On measures for the unification of exchange rates on the internal foreign exchange market"

Hellman (2003, at 8) notes that the "practice of classifying legally binding government acts, or portions thereof, as secret is highly unusual, even among countries of the former Soviet Union. International lawyers with experience in Kazakhstan, Kyrgyzstan, Russia and Ukraine report that there are no such provisions in these countries."

Unfortunately, in Uzbekistan, access to information in practice is even more restricted than a review of the laws suggests. Access to official information that should be available in principle is not readily obtainable; for example, figures and data about the national economy are often misreported (e.g. GDP) or are not published (e.g. the national budget). Again, comparisons to other Central Asian and former Soviet countries show that Uzbekistan is exceptionally secretive. Even though the law requires officials to respond to requests for information within 30 days, interviews revealed they will often wait until the last moment before releasing data, and the data are often inaccurate or outdated. Information of this kind is highly relevant to the functioning of a market economy (and to individual enterprises), and potential investors and other economic actors will be dissuaded if they are unable to predict how such secret provisions will affect them.

A.4. Conclusions and Recommendations

The preceding sections give numerous examples of how the current legal framework in Uzbekistan does not yet meet the criteria that have been recognized as essential for the "rule of law." For law to be effective, both citizens and officials must be able to understand what the law is, and must be able to be held accountable for failing to comply with the law. In Uzbekistan, however, the numerous contradictions and inconsistencies that exist, combined with the lack of standardized procedures for the promulgation and publication of laws, make understanding, and thus compliance, virtually impossible: that is, the legal framework is suffering from a lack of clarity. Such a situation invites inconsistency of application of the law, and provides opportunities for public officials to take advantage of their positions, without corresponding opportunities for citizens to seek redress. This further detracts from the rule of law. And the judiciary does not have a sufficient degree of independence to act as an impartial interpreter of the meaning and application of the law.

The legal framework for access to information is one illustration of the consequences of a legal system lacking consistency, clarity, and the other rule of law criteria. While it is true that the state must have the ability to monitor and restrict the flow of certain types of information for security reasons, it is also true that an accountable, transparent government cannot exist, and markets cannot function efficiently, without information. Thus, any review of Uzbekistan laws with the aim of reducing inconsistencies and extraneous laws should include compiling laws that pertain to freedom of information, and efforts should be made to assess the potential

impact of such laws on the flow of information that is necessary for effective governance and a functioning economy.

B. Regulatory Regimes

In this section, we address the core features of the regulatory framework in Uzbekistan. A regulatory regime, broadly speaking, is the concrete application of the rule of law to the various sectors comprising the economy. Thus, it includes primary and secondary legislation as well as organizations that enforce regulatory norms. The regulatory regime is founded upon the overall governance structure and reform strategy for the economy, which determine the kinds of regulatory norms and organizations required. We assess this overall governance aspect first, then move on to consider the organizational framework for regulation and the quality of its work. Last, we look at the scope and enforcement of property rights, which reflect patterns in overall governance and regulation, and which in turn play a central role in shaping the climate for investment.

B.1. Governance of Economic Sectors

Styles of economic governance are usually categorized as liberal, mixed, or statist. While these categories may not correspond neatly to actual economies, which tend towards a complex mixture of these elements, they are still useful in capturing broad tendencies. In particular, the structures and strategies inherent in different types of economies have major implications for regulation and the treatment of property rights. A liberal economy places great importance on the enforcement of contracts, the protection of private property, and the flow of information as mechanisms of market-based allocation. A statist economy, by contrast, requires strong administrative structures and controls to carry out its approach to production and allocation.

Transition countries in the former Soviet Union lie somewhere in the "mixed" category between these extremes, with most of them struggling to liberalize while protecting important social interests from undue disruption. This has proven to be a difficult path in most cases. Confusion and opportunism arise where state direction and markets coexist, especially if the transition strategy lacks clarity and the implementing institutions are weak. Thus, for example, a partially-privatized bank or industrial corporation could be pulled in different directions by political authorities, private shareholders, state administrators, and business managers. The outcomes range from a complicated balancing act to rampant asset-stripping. The evolving institutions of market governance, such as the stock exchange and the courts, have only limited power to discipline companies that report to state ministries. In Uzbekistan and other countries, this transitional setting poses special regulatory challenges.

The Government of Uzbekistan since independence has followed a gradualist strategy of economic reform, which emphasizes mitigation of transition shocks, economic security of the country and its citizens, self-reliance and government support to key industries. This approach helped prevent a major output collapse experienced by other successor states of the Soviet Union, but proved less conducive to economic growth.

The initial emphasis of the post-independence government's economic policies was on import substitution and massive public investments, with the main objectives of guaranteeing sufficient domestic production of food and energy and of modernizing Uzbekistan's economy. These objectives have been met, albeit with various degrees of success, but the economic

strategy of the mid-to-late 1990s proved to be quite costly and unable to reduce poverty and put the economy on a sustainable growth track. Market distortions produced by government's massive interventions in the economy hampered private investments and enterprise.

Uzbekistan thus exhibits the features of a transition economy that has not pursued fundamental restructuring. It has one of the highest rates of state ownership in the world, along with extremely heavy state direction and regulation. Although many smaller enterprises were said to be privatized by 1995, privatization of larger enterprises has been slow (World Bank CEM 2003). Private enterprises were said to account for some 45% of registered firms in 2000, but decisions on prices, output, and investment by even these non-state firms are not mainly under the control of the firm. The private sector in Uzbekistan is only weakly established. There are commercial banks, joint stock companies, and private farms on paper. However, state bodies (such as the trade associations) appoint company directors, while policymakers set interest rates and other controls.

The trade associations in Uzbekistan continue to play many of their pre-transition roles as sectoral ministries. Association heads, enjoying the rank of minister and a seat in CabMin, exercise influence on corporate boards out of proportion to the size of formal state ownership. Through these associations, the government provides directives for industry. Combining the role of owner with that of regulator, the associations set policy for their companies and the sector as a whole (Broadman 2000; World Bank CEM 2003). Elsewhere, environments of this kind have often proven ideal for waste and corruption in enterprise management.

State ownership of enterprise assets is said, to be higher than officially reported. For example, a company might be reported to be 25% state-owned where one-quarter of shares are reserved for government, but private investors still have not contributed much of the remaining equity - hence the de facto government equity holding might be closer to 90%. In the absence of even rudimentary transparency requirements for official data, economic statistics are in any case quite unreliable, according to interviewees.

The same absence of structural safeguards that permits high-level political intrusion into adjudicatory and regulatory processes allows similar intervention into corporate governance. This means that enterprises are at least as likely to be stripped as restructured. This also drives significant effort into lobbying to secure monopoly powers and other advantages, often by firms that would otherwise not be viable. As a result, regulations change quickly and property rights are insecure.

Bankruptcy processes are a major arena for restructuring in transition economies. In Uzbekistan, the Committee for Economic Insolvency of Enterprises (CEIE) plays a major role in this process. It is a "working body" authorized by a high-level Government Commission on Bankruptcy and Sanation, with special powers to intervene where partly state-owned companies become insolvent, or the Commission has declared the firm bankrupt. This organization was established in 1996 under the Ministry of Economy, but is a separate body reporting to CabMin and a Deputy PM, with employees who are formally staff of the Ministry. The CEIE illustrates the Government of Uzbekistan's approach to the organizational challenges posed by its strategy of gradual - and controlled - restructuring. A more hands-off approach typical of industrial economies with a larger share of private ownership would be to enable private stakeholders to drive the process and/or impose a bright-line requirement or "trigger" for mandatory bankruptcy. In that context, liquidation and restructuring processes are typically overseen by

specialized courts. In the Uzbek context, by contrast, a public sector body manages bankruptcy processes and appoints "court managers" (the equivalent of bankruptcy trustees). This places a special burden on government to ensure that the responsible body, CEIE, is independent, impartial, and professional.

In practice, a number of serious problems arise in bankruptcy processes. First, reports of improprieties are widespread, centering on company insiders, purchasers of company assets, and court managers. Second, there are many reports in this context about non-viable Uzbek enterprises having unrealistic restructuring plans approved. These enterprises included a valve factory that had not produced in years and showed a rusty valve as a sample. Its employees were on furlough, meaning they stayed at home with no pay, but retained their claim on their positions at the factory should it start working again. The plan was simply to get financing to buy new technology and start producing again -despite the apparent lack of demand for their product and the pervasiveness of inexpensive and relatively high-quality Russian valves. Another report involved a refrigerator factory that was re-tooled for assembly of imported parts into relatively high-cost and low-quality fridges. These were priced at nearly 200% of the much higher quality Samsung fridges currently on sale. The factory had produced around 100 fridges in the first half of 2004, and expected to increase this. Their plan for capturing the market was to lobby for trade barriers to keep the Samsungs out. These two examples illustrate the assumption prevalent among industrial firms that government funding and controlled markets comprise the way forward.

As part of the overall administrative reform package that it has been elaborating, the Government of Uzbekistan reports that it is focusing on economic governance. This part of the reform involves the reorganization of state economic management, which has been criticized for extreme top-down control over activities in the sector, including the appointment of company directors, control of management meetings, and the enforcement of state planning. These activities have been handled by appointees of the Cabinet of Ministers. An important dimension of this has been the system of state orders, whereby farms and industries are tasked with meeting production quotas, with prices set by administrative fiat.

The reform, set forth in the Presidential decree "On improving bodies of economic governance" (22 December 2003), purports to reduce state intervention. It aims to do so by drawing a line between public and economic governance, on the one hand, and giving responsibility in the economic sphere to joint stock companies and associations that handle sectoral issues of strategy, research and development, training, etc. This would be consistent with Uzbekistan's longstanding strategy of gradual reform. The fear now is that the new arrangement represents only a formal change, and that it will in practice be more intrusive rather than less.

B.2. Organization and Scope of Regulation

There is growing international consensus on what constitutes a good regulatory system. In brief, such a system provides rules designed to achieve socio-economic objectives in the most precise and efficient way and this is reflected in the organizational framework for generating and enforcing regulations. The World Bank states this in terms of two core regulatory principles: "First, regulate only when private ordering or litigation are not sufficient to induce good conduct. Second, regulate only if there is capacity to enforce" (World Bank 2004: 92). These principles translate into the following guidelines:

- Simplify and deregulate in competitive markets
- Enhance property rights
- Expand the use of technology
- Reduce court involvement in business matters
- Make reform a continuous process.

The essential idea here is to keep regulatory intervention by the state to the very minimum necessitated by any failures in markets and bilateral governance by the parties. This is not to suggest an ideal of no regulation. Rather, the scope of necessary regulation will vary with the strength of competition, enforcement of commercial laws, administrative capacity, and other factors. Where regulatory systems most frequently go awry is in over-regulating. World Bank data show that heavier regulation is associated with lower productivity, higher unemployment, a larger share of economic activity in the informal sector, greater inefficiencies in public institutions, and higher corruption - but not with better products and prices. Entry barriers to new firms have especially pernicious effects - and there is a clear pattern of lower barriers in more developed countries (World Bank 2004).

Uzbekistan is suffering from over-regulation and all the symptoms associated with an ever-increasing volume of regulation. Over-regulation of the economy appears to force much activity into the informal sector.

Over-regulation is visibly detrimental to economic growth in Uzbekistan. Pursuing an economic reform program aimed at accelerating its transition to a market economy that better complied to international standards, the government has often imposed measures having the opposite effect. It instituted numerous new and poorly designed laws which only served to damage the private sector, rather than accomplishing the government's stated goal of decreasing the informal sector and increasing the number of legitimate small and medium-sized enterprises (CIPE 2004). Oftentimes the government attempts to fix a problem caused by over-regulation by imposing further restrictions on the market, instead of removing the regulations that cause the problem (e.g. poor competitiveness of national industries which suffer from excessive red tape and under-development of domestic markets, led the government to impose severe restrictions on imports). The government also tends to make policies that support "traditionally influential elites," which reduces competition and slows economic growth (CIPE 2004).

Interviews with business people in Uzbekistan showed that although some aspects of starting a business have improved over the past several years, the regulatory barriers still remain high. Business registration has become easier, for example, but the restrictions imposed on withdrawal of funds and transferring money through banks impedes businesses' purchases of raw materials and inventor}'. Decrees constrain access to credit. A law forbidding "intermediaries," such as packing firms, has interfered with essential business relationships, for example causing businesses to lose entire distribution networks. Discriminatory prohibitions on the sale of certain products injure many small businesses. Taxes on businesses are high, and there are no laws providing incentives for business expansion, such as tax deductions or depreciation (CIPE 2004). And harsh, complicated inspections, conducted by powerful inspectors, where huge fines are imposed for small breaches, also present risks. (Inspections are coordinated and approved by the Cabinet of Ministers, but carried out by various agencies, including the Procuracy.)

These regulatory measures have hit smaller firms especially hard. Registration of small and medium enterprises (SMEs) has dropped drastically, and the cost of operating a business rose as SMEs have expended resources in efforts to bypass the law. "While remaining in the shadow is costly" - both in terms of money and in terms of giving up certain legal rights and access to courts and bank loans - "emerging into the official economy is even more so" (CIPE 2004). The government has even promulgated regulations regarding enforcement of contracts rather than permitting contractual freedom: administrative regulations called for administrative or criminal penalties for breaches of contract (Campbell et al. 2003).

For example, strict government controls placed on banks in Uzbekistan have had the effect of forcing activity into the informal sector. The government requires enterprises to make payments for buying and selling through a bank, yet at the same time restricts the amount of cash withdrawals. Additionally, banks are required to provide the intelligence service with information about bank accounts, and a regulation from September 2002 ordered banks to report any transaction greater than 6,500.00 sown to tax authorities. This discouraged people from using banks at all. Yet another example is a 2002 decree of the Cabinet of Ministers introducing new tariffs for shuttle traders (private importers of cheap consumer goods), who already were subject to numerous duties and taxes. Not only were the tariffs and accompanying paperwork required by the decree extremely burdensome, but officials immediately moved to enforce the decree, applying its provisions even retroactively to goods imported prior to the decree.

B.3. Regulatory Reform

Many countries have faced the situation where their regulatory structures are found to be overly burdensome. The accretion of regulations over time, and fresh insights from business and economics research, suggest the need for an overhaul. Uzbekistan is in the fortunate position of being able to benefit from international experience in this area.

Several approaches have been tried and found useful. For example, some countries have instituted periodic (usually annual) reviews to address the overall regulatory burden, the weight of regulation in given sectors, or the quality of regulatory coordination. Others have engaged in wholesale revamping, and removing old or inappropriate regulations from the record - either as a single reform, or better still as a process that is required at regular intervals. Controls can take hold at the beginning of a regulatory process, e.g. requiring an impact review before a rule can go into effect, or once a regulation is in place, for example fixing a "sunset" date by which a rule expires unless extended legislatively (World Bank 2004). Examples of such processes abound in the industrial, transition, and developing countries. Uzbekistan itself has followed international best practice by instituting a "one-stop-shop" for the registration of most types of businesses, and thereby modestly reduced registration delays. As we have suggested, the approaches that show the most impact are ones where the review or elimination of existing rules is required on a periodic basis. This could be a requirement imposed on the sectoral authorities, or it could be within the purview of a central (independent) agency responsible for regulatory review and streamlining.

Part of the quality equation, and at least as important as regulatory policies and instruments, is the organizational structure that deals with regulation. The practice now prevalent in the industrial countries, and increasingly followed in transition and developing countries, is to establish independent regulatory bodies (agencies or commissions). These organizations

translate government policies into both decisions affecting individuals and rules applicable to entire sectors of activity. The independent agency structure, and the controls placed on it, respond to the dilemma posed when rule-making and rule-enforcement responsibilities are housed under one roof. This is somewhat anomalous in a democratic order with a strongly-established separation of powers keeping the legislative and judicial powers distinct.

Independent regulatory agencies provide a useful answer here. They are established at arm's length from legislatures that enact laws and executives that set policies within their legal authority. They are bound by the relevant sectoral legislation and by the norms of administrative procedure defining how they make decisions and issue rules. The courts (general courts in common law countries, administrative courts in civil law countries) serve as an avenue of appeal from agency decisions, and the legislature monitors agency implementation of policies. Within this envelope of authorities and constraints, the independent agency conducts specialized analyses and issues rules and decisions accordingly (Zwart and Verhey 2003). Agency and commission structures, while they offer a way to reconcile regulatory with constitutional requirements, also serve a political need. Where their independence and expertise are credibly established, they can bolster the credibility of government's economic management to the extent that they act as impartial experts and honest brokers between the needs of industry and the public interest.

In Uzbekistan, this structural development is underway but far from complete. A number of commissions have been set up, analogous to the independent agencies just discussed. However, there remain several areas where ministries engage in direct regulatory intervention, with essentially no effective control by the courts. Further, even where commissions exist that purport to be independent, they are controlled either formally or informally by government, and therefore often respond to political imperatives. The latter could prompt dramatic action to underline government's policy stance at key junctures, or lead to the division of sectoral monopolies and rents to serve patronage needs.

B.4. Property Rights

It is now commonly accepted that appropriate protection of property rights is fundamental to economic development. This important insight deserves a clear explanation. It is not the same as saying that a fully liberalized economy is always the ideal. The import of the statement is, rather, that the demarcation of property — whether individual, corporate, community, or state — should be as clear as possible, and should be administered by the most efficient and effective adjudication mechanisms available. In other words, the economic strategy and institutional framework should maximize responsible ownership and facilitate voluntary transfers of ownership to efficient users. This means protecting ownership rights from instability and opportunism, and aligning the incentives of owners with economic objectives such as efficient and profitable use. The fundamental issues of who exercises control and who receives the benefit must be clearly and credibly decided. This, of course, has crucial implications in such areas as regulation of land use and transfer, corporate governance, bankruptcy, labor and environmental regulation, and secured transactions.

Transition countries face major challenges in designing and implementing effective property regimes. Path dependencies, coordination failure, political pressures, and narrow interests pose severe obstacles. Absent extraordinary circumstances, only those countries that have achieved an appropriate resolution to the key property rights issues have sustained robust economic

growth. Uzbekistan has faced a difficult struggle in this area. In general, the results have been severely disappointing. On the one hand, the state has retained a large share of economic control, and yet has not made itself a responsible owner. On the other hand, where private owners are involved, their rights are insecure and their incentives to pursue efficient and productive management are weak.

The mixed nature of property rights leads to inefficient results, for example in agriculture. Private farmers cannot own their own land, but must lease it from the state, and although in theory they can choose which crops to grow, in reality they are usually "forced to grow a certain percentage of cotton and sell it to the state at minimal prices" (ICG 2003 at 14). If farmers refuse to comply with such orders, they risk retaliation (e.g., having their water supply cut off or their fields expropriated). To meet the demands, farmers pay minimal wages for labor in the cotton fields. The cotton is bought, at low prices set by the government, by state-owned cotton processing factories. Eventually, government "cotton barons" who control the state monopoly earn a profit from the cotton crop, and most of the money goes into the state budget. This system is obviously an important revenue source for the state, and thus it will be difficult to change the system, even though at the local level, farmers are prevented from making optimal use of their land by determining which crops they prefer to grow, and children and other farm workers are engaged to meet the state's demand for cotton at the expense of their education or instead of being free to work at higher-paying activities (ICG 2003; World Bank CEM 2003).

Furthermore, Uzbekistan is full with stories of property confiscations. Many of these have involved the government's use of secret or new laws and decrees in ways that were clearly abusive (e.g. turning a technical infraction of a secret decree into a confiscation many years later when the enterprise is profitable), while others seemed to have no color of law to them whatsoever.

One group of investors described their experiences in resisting the confiscation of their business, a cotton processing plant. A secret decree was apparently issued in the mid-1990s saying that anyone who bought a privatized company (or at least a controlling share) had to pay in full within a short specified time (stated to be 5 days). Not knowing about it, the group paid the bid price in about 30 days. Over a period of some four years, they invested in the cotton plant, and the business grew and earned a profit. In 2002, invoking the secret decree, the government moved to seize the company. The businessmen tried administrative channels but got nowhere. Then, they filed a contract case in the Economic Court, but abandoned it when decisions went against them. Then, they appealed to the Higher Economic Court on the basis that the government's actions were illegal, or at least a capricious and abusive use of the law. They won a judgment in their favor, but the government continues to try to confiscate the property, first filing appeals and then seeking to change the decision by decree.

B.5. Conclusions and Recommendations

Uzbekistan's transition from a statist to a more "mixed" style of economic governance is progressing, but still faces many challenges. The state is still heavily involved in enterprises and industries, even those that have supposedly been privatized. As a result, the system suffers from inefficiencies. Uzbekistan still lags behind other countries in a number of aspects when it comes to creating an environment that encourages private enterprise: The regulatory burdens, costs of starting and maintaining a business, and other barriers to entry need to be eased.

Uzbekistan can benefit from the experiences of other transition countries that have been able to improve their regulatory environment to be more conducive to private enterprise.

The tenuous nature of property rights in Uzbekistan illustrates the consequences of over-regulation. Protection of private property is critical to the functioning of a market-based economy, and adequate protection is not available in Uzbekistan. The government is able to create regulations that affect property rights, and can exploit those regulations to the detriment of owners, who lack sufficient means to assert their own rights or to seek redress for wrongful confiscation of their property. Such a situation cannot serve as the foundation for a stable market economy, because investors, entrepreneurs, and owners, will be hesitant to invest or build businesses if they cannot predict how the regulatory environment will affect them in the future. Here, again, we see the consequences of a system that lacks transparency, predictability and accountability; such a system removes incentives for investment and economic growth.

Reforms aimed at reducing the volume of regulation, or at least slowing the introduction of additional regulation, combined with efforts to review and consolidate existing law, will help the continuing transition away from a statist style of economic governance. Such efforts should be accompanied by training for both judges and government officials, on the development of a body of administrative law, and on the changing role of government in an economy that is moving from a centralized to a market-based system. In this manner, Uzbekistan can work to protect the rights of private property and freedom of economic activity espoused in the Constitution.

VI. MULTILATERAL DONORS

International Monetary Fund (IMF)

Following the lapse of an unfunded staff monitored program in 2002, the engagement of the IMF has been limited to technical assistance and surveillance in the context of the annual Article IV missions, most recently in March 2005. The authorities consulted with the Fund in the second half of 2003, leading up to the adoption of current account convertibility under Article VIII of Fund's Articles of Agreement, and IMF staff continues to monitor compliance with the obligations under this article closely. At present the authorities are not seeking support from the IMF under any of its arrangements, and given the high level of official reserves, such an arrangement does not appear necessary. In any case the resumption of negotiations on such an arrangement would be contingent on demonstrating a track record of successful implementation of reforms.

World Bank

The World Bank has thus far supported projects targeted at the modernization of infrastructure, the reform of the rural economy, and the support for privatization and financial sector restructuring. It co-financed the Tashkent Solid Waste Project with the EBRD. The World Bank is not, at present, providing Structural Adjustment Loans (balance of payment and budgetary support loans) to Uzbekistan due to the slow reform progress and absence of program arrangements between the IMF and the Government. The World Bank is currently preparing a new Country Assistance Strategy, which will include a particular focus on basic human needs. It places a particular emphasis on regional cooperation both through targeted investments in individual countries with clear cross-border benefits, as well as significant analytical work, focused on the water-energy nexus and trade and transport facilitation.

The World Bank has cooperated closely with other IFIs in the nascent Welfare Improvement Strategy Paper (WISP) process in Uzbekistan. An interim WISP was prepared in early 2005 (called the Interim, or I-WISP) and the World Bank together with the ADB and UNDP, as well as with the support of bilateral donors, has agreed a package of technical and analytical support for the preparation of a full WISP, under the Poverty Reduction Strategy Paper (PRSP) Trust Fund. The new CAS will be based on the priorities contained in the I-WISP.

International Finance Corporation (IFC)

The IFC has worked on private sector development, and provided technical assistance for project identification, and capacity building in the financial sector, though little progress has been made in this area. The IFC has therefore focused its attention on SME credit lines and technical assistance in the areas of leasing, microfinance, and business regulation through its Private Enterprise Partnership (PEP) program. A regional leasing facility was approved in early 2005. The annual survey of SMEs will provide an important gauge of the private sector environment.

Asian Development Bank (ADB)

The Asian Development Bank (ADB) updated its 2000 Country Strategy and Programme in October 2004, envisaging lending levels of about US\$ 100 million to US\$ 150 million, including regional projects. Three loans totalling US\$ 95 million are planned for 2005: for land improvement in farming areas, rehabilitation of regional railways, and improvement of rural water supply and sanitation services. An ICT basic education project is also under review and is on standby for 2005. An education sector development program with loans totaling US\$ 108.5 million was approved in 2002, and the first tranche of US\$30 million was released in mid-2004, following ADB's acceptance of Government progress in four key reform areas, namely currency convertibility, agricultural reform, trade and statistics. The Government recently completed its medium term living standards strategy with technical assistance from ADB, which is being further developed into an interim poverty reduction strategy (PRSP). In addition to the living standards strategy assistance ADB undertook a number of thematic assessments in 2004 covering private sector development, agriculture, governance, gender. The purpose of these assessments being to help inform the targeting and formulation of ADB's future country strategy and program for the country, which is expected to be approved in mid-2005.

European Bank for Reconstruction and Development (EBRD)

The Bank's cumulative financing to date stands at EUR 584 million as of end-June 2005 in Uzbekistan with a diversified portfolio. A significant share of the Bank's funding has been directed to the financial institutions (29 per cent), natural resources and energy (29 per cent) and infrastructure (27 per cent) sectors. Most of the Bank's funding is in the form of debt (94 per cent) with 5 per cent in equity investments and the remaining 1 per cent in guarantees.

During the last strategy period, the Bank signed ten projects for EUR 66.2 million. The majority of the projects are private sector loans with foreign and local investors:

- Bursel Tashkent Textile JV (EUR 10.3 million);
- Uz-Arctech, Welding Electrodes (EUR 7.2million);
- DLF – Berad-Agro (EUR 0.5 million);
- DLF – Gisad O'zbek (EUR 0.9 million);
- DLF – Mekhnat Pivo (EUR 2.8 million).
- Nestlé Uzbekistan LLC (EUR 2.5 million);
- Unitel (equity - EUR 3.9 million, debt - EUR 24.5 million);
- MSE programme with Uzjilsberbank (EUR 3.8 million);
- MSE to Hamkorbank (EUR 2.3 million)
- Tashkent Water Supply Improvement (EUR 7.5 million).

The Board in approving a new Strategy covering the next two year period, has decided that the Bank will limit its activities to private sector operations and will not initiate public sector projects. Within the private sector a priority will be given to the development of SMEs and micro-business. In this context, the Bank is considering the possibility of establishing a microfinance bank.

Islamic Development Bank (IDB)

On 2 September 2003, at its 28th Annual Meeting, the Republic of Uzbekistan became 55th member of the IDB. Until that time IDB granted only donor financing, amounting to USD 1.9 million.

In 2004 the Board of Executive Directors of the IDB approved the following projects in Uzbekistan:

- State Medical Emergency Hospitals (US\$ 23.8 million),
- Road Construction and Maintenance Equipment Project (US\$ 12.6 million), and
- SME Credit Line to the National Bank of Uzbekistan (US\$ 15 million).

The bank is also considering the possibility of a grant for technical assistance with project preparation for Tashkent heat and water supply system modernization. The IDB has received proposals for the realization of the investment projects, amounting to US\$ 400 million of financing, within the framework of the Investment Cooperation Program of the Republic of Uzbekistan and IDB for 2005-2007.

United Nations

United Nations agencies (UNDP, UNESCO, UNFPA, WHO, UNICEF) are playing an important role in health and population, poverty reduction, environment, development of human resources and management capacities, gender and development, preservation of national cultural heritage, and strengthening of NGOs. There are a number of ongoing projects in Uzbekistan that UN agencies are either financing or implementing. Overall, according to a 2003 UNDP Human Development Report, in 2002 official development assistance to Uzbekistan amounted to almost US\$ 190 million, less than 2.5 per cent of the country's GDP.

European Union

The European Union's cooperation objectives with Uzbekistan are based on the Partnership and Cooperation Agreement (PCA) with Uzbekistan which came into force in July 1999. In October 2002 the European Commission adopted a new strategy for Central Asia for the period 2002-2006, of which the core objectives are

- promoting stability and security in the region;
- eliminating the sources of political and social tension; and
- assisting the pursuit of sustainable economic development, in particular by improving the climate for trade, investments and energy supplies.

The EC strategy builds on a regional approach for its cooperation with the countries of Central Asia, including Uzbekistan.

The EC cooperation program aims to promote good neighbourly relations and confidence building between the countries of the region and enhance opportunities to advance a comprehensive regional perspective for sustainable development, notably through the compatibility of reforms and the convergence of the legal harmonization processes.

These objectives are to be pursued through three 'tracks' for European Union/TACIS assistance:

- a regional cooperation program designed to promote good neighbourly relations and collaborative work between the Central Asian countries using a pragmatic, 'variable geometry' format in areas where the European Union has a strategic interest. These include transport and energy networks, sustainable use of natural resources (water, Kyoto Mechanisms) and implementation of international environmental conventions, justice and home affairs (border flow facilitation and improved management, the fight against all forms of trafficking). This track represents one third of the total budget.
- a regional support program, implemented at national level, addresses the main common challenges to sustainable economic development and poverty reduction. Adjusted to the needs of each country, it focuses on facilitating investment and trade through PCA implementation, WTO accession, statistics, improved customs, upgrading public administration and civil services, good governance and the rule of law, as well as supporting reforms to the general and technical higher education systems. In Tajikistan and Kyrgyzstan, EC assistance also supports the implementation of Poverty Reduction Strategy papers (PRSPs) in particular in connection with the EC aid instruments for sectoral reforms through budget support. For this track Uzbekistan will receive EUR 45 million for the period 2002-2006.
- pilot poverty reduction schemes in target regions, focusing on long term poverty alleviation, community driven rural development, centered on the most vulnerable groups. The focus in Uzbekistan has been on the Ferghana province, in particular the enclaves. Twenty per cent of the total budget is allocated to this track.

VII. BILATERAL ASSISTANCE

Canada

Funding for Canadian cooperation efforts with Uzbekistan is provided through the Canadian International Development Agency's (CIDA) Programme of Cooperation with Asia. Priority sectors in the region include technical training, governance and water resources management. CIDA's efforts in Central Asia are concentrated in Tajikistan.

Bilateral funds are supplemented by funding through CIDA's multilateral programming. Programs applicable to Uzbekistan include: the CIDA Industrial Cooperation Program, the South Europe and Central Asia Climate Change Support Fund, Canadian Human Rights Foundation training courses, the EBRD Trust Fund, Strategic Information Management Program (SIMP), and the Partnerships for Tomorrow Program II. Through the OSCE, CIDA supports the Environment and Security Initiative (ENVSEC) in order to promote the use of environmental management strategies to reduce insecurity, notably with 3 projects in the Ferghana Valley area, as well as gender equality capacity building programs.

CIDA also finances a US\$ 4 million Caspian Basin Greenhouse Gas Emissions Reduction Training Programme with the goal of developing the management and operational capacity within key sectors to identify and develop greenhouse gas emission reduction projects that would meet the rules of, and could be funded under, the Kyoto Protocol's Clean Development Mechanism or Joint Implementation. Eligible countries are Uzbekistan, Azerbaijan, Kazakhstan, and Turkmenistan.

France

French bilateral aid was EUR 4.56 million in 2000 and EUR 4.17 million in 2001.

Germany

Germany has committed EUR 192,2 million in Financial Cooperation mostly through KfW in the form of loans on IDA conditions and EUR 47,2 million in Technical Cooperation mostly through GTZ as grants to support the Government of Uzbekistan's program of reforms, with the long-term objectives of encouraging democratic and market-orientated institutions and providing technical assistance for economic policy advisory services, promotion of private entrepreneurship, restructuring of agriculture, transportation, legislation, professional training, and for environmental protection. The future cooperation has to focus on the priority area, 'economic reforms and establishing a market economy' (in particular the financial system, promotion of small and medium sized enterprises (SME) as well as vocational training). Moreover the German government supports the envisaged Financial Cooperation project 'Electrification of the railway line between Tashkent and Angren'.

In the framework of ongoing Technical Cooperation projects, priority areas are the improvement of the living conditions of the people around the Aral Sea (Karakalpakstan) and assistance to vocational training. Projects in the health sector will be continued within the framework of regional cooperation.

Japan

Japan commenced bilateral assistance to Uzbekistan in 1991. At the end of March 2005, total commitments of yen loans and grant financial aid together with disbursements of technical assistance totaled JPY 119.2 billion. This consisted of 82% of yen loans, 13% of grant financial aid and 5% of technical assistance.

Total disbursements in 2003 reached USD 63.2 million equivalent. According to DAC (OECD) data, Japan was the top bilateral donor in terms of disbursements in 1999-2000, and second in 2001-03 after the United States.

Yen loans were commenced in 1995. Recently, official notes were exchanged in May 2002 on a modernization project of a Tashkent thermal power plant (JPY 25.0 billion) and in July 2004 for the construction of a new Tashguzar-Kumkurgan railway line (JPY 16.4 billion).

Grant financial assistance was commenced in 1994 and has since been extended annually in such areas as medical care and food production increase. In January 2002, JPY 1 billion was donated to Uzbekistan as a part of assistance to countries neighboring Afghanistan.

The following priority areas were agreed at bilateral aid policy discussions held in Tashkent in April 2005:

- Human resources development and institutional development for economic and industrial development. Improvement of the financial and banking systems, trade, SME development, justice system reforms (civil and commercial laws) and tourism development;
- Restructuring of the social sector. Agriculture and rural development, education, health and medical care;
- Renewal and development of economic infrastructure. Transport and energy.

Spain

Spain has committed so far bilateral aid in excess of EUR 13.4 million, focused on health and water treatment sectors.

Switzerland

Based on the bilateral framework agreement on technical, financial and humanitarian cooperation signed in 2002 and the Regional Program Central Asia 2002-2006, the State Secretariat for Economic Affairs (seco) and the Swiss Development Cooperation (SDC) are both engaged in cooperation with Uzbekistan. Including regional activities covering Uzbekistan, funds amount to US\$ 6-10 million per year and cover natural resources management, infrastructure, vocational training, private sector development as well as macroeconomic policy and conflict prevention. They involve government partners on various levels as well as non-government partners.

A special priority is given to **infrastructure development** and **natural resources management**. US\$ 9 million have been granted to cofinance a World Bank project to refurbish and improve the management of water supply networks in Bukhara & Samarkand. Switzerland has allocated in 2002 US\$ 4.3 million for a cofinancing of the EBRD District Heating Rehabilitation Project in Andijan. Switzerland is also supporting a regional hydro-meteorological project based in Tashkent.

Switzerland has also been supporting the **economic development** of Uzbekistan by financing credit guarantees and project preparation through the Public-Private Infrastructure Advisory Facility (PIIAF) as well as regional training and advisory programs on the customs administration and international economic relations.

With respect to **private sector development**, Switzerland is currently supporting Uzbek SMEs through technical assistance projects and finance. In the past two years Switzerland funded a comprehensive survey of the Uzbek SMEs, developed a training program for local consultants, and supported the development of the leasing industry. seco is also a shareholder of a private equity fund investing in Uzbekistan. As for the EBRD projects, Switzerland is contributing to the Central Asia Risk Sharing Support Fund (CARSSF) through its participation in the Trade Facilitation Program. Further, seco is currently considering a contribution to the EBRD/BAS program in Uzbekistan.

With regard to **macroeconomic policy**, seco has financed a regional technical assistance project in public debt management for Uzbekistan. The project aims at assisting the Uzbek government to improve the management of external debt and to strengthen the legal and institutional framework for public debt as warranted.

Turkey

According to the governmental protocol in 1992, Turk Eximbank allocated a credit line of US\$ 250 million for Uzbekistan. In 1993, US\$ 125 million of this line was fully utilized for the export of Turkish goods. The remaining amount of US\$ 125 million was allocated to three big projects: the first and second phases of 'Construction of International Trade and Exhibition Centre' and the 'Sugar Factory' projects.

As a result of an excellent repayment record of Uzbekistan, an additional US\$ 125 million was extended in 1995 with the second governmental protocol. Under this line, so far three projects have been financed: 'Integrated Woollen Products' project of Kasansay-Tekmen by means of a parallel financing with EBRD, 'Plant of Production of Minibuses, Trailers and Semi-Trailers' project, and a transportation project financed by IDB backed by Turk Eximbank. Both lines required the sovereign guarantee of the Uzbek Government. As a whole, disbursements have reached US\$ 347 million.

Apart from those two governmental protocols, Turk Eximbank extended a total amount of approximately US\$ 44 million credit to the National Bank of Uzbekistan for four projects (renovation of three hotels and an exhibition centre) in Uzbekistan in 2002. Currently, the Loan Agreements for two of those projects have come into force.

As for the future work, Turk Eximbank will continue to take into evaluation the applications of Uzbek side on project basis.

United Kingdom

The UK's strategy is to work with other key partners to support the improvement of living standards, reduce poverty and support economic and governance reforms. DFID's bilateral assistance framework for Uzbekistan is GBP 750,000 for 2005-06. This assistance focuses on three main areas:

- Joint work with UNDP on cross-border cooperation with Tajikistan to improve growth and reduce poverty in the Zarafshan Valley;
- Cooperation with the World Bank and other partners on a regional program to provide technical assistance for the development, implementation and monitoring of national HIV AIDS programs;
- Provision of assistance through a World Bank Trust Fund to help improve the quality of national statistics related to living standards and poverty.

Following the events at Andijan, DFID has suspended its support for the work on national poverty statistics (component 3 above) which entails provision of support to central Government. They intend to review this decision at the end of July/August.

The UK's share of multilateral aid to Uzbekistan was GBP 1.7 million for 2002-03. This was primarily through the European Commission and the United Nations.

United States

Between 1992 and 2001 the United States allocated approximately US\$ 286.18 million to programs in Uzbekistan. In 2002 there was a one-time tripling of assistance to approximately US\$ 224 million, following the 9/11 attack in 2001 and the war in Afghanistan. Priority has been given to training and exchange programs that target Uzbekistan's next generation of leaders. U.S. Government assistance is also directed towards building the capacity of non-governmental organizations through a system of training and small grants, in addition to continued support for security and improved health care programs.

The United States Agency for International Development (USAID) is active in private sector development, banking and finance, fiscal policy reform, legal regulation, taxation, small-scale agricultural development, and drinking water supply.

USAID funds have focused on support to small business, democracy and governance, energy and environment and social sector reform. USAID is moving away from support to related agencies of the Government of Uzbekistan for economic reform at the national level to private enterprise development. USAID is currently supporting fiscal and banking sector reform programs as well as those to back WTO accession, an independent media, and participation in environmental conventions. At a regional level, USAID focuses on the expansion and reform of primary health care and promotes water and energy cooperation.