# Uzbekistan
# Integrated State-Owned Enterprises Framework (iSOEF) Assessment

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# UZBEKISTAN

## Integrated State-Owned Enterprises Framework (iSOEF)

## Assessment

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# Contents

iv

List of Figures



List of Tables



List of Boxes





v

## ABBREVIATIONS AND ACRONYMS

| | |
|---|---|
| AMC | Antimonopoly Committee |
| ASR | Agency of Strategic Reforms |
| BOS | WBG Global Businesses of the State database |
| CEO | Chief Executive Officer |
| CMSA | Centre for Management of State Assets |
| CPCPC | Competition Promotion and Consumer Protection Committee |
| ECA | Europe and Central Asia |
| GoU | Government of Uzbekistan |
| IFRS | International Financial Reporting Standards |
| JSC | Joint Stock Company |
| KPI | Key Performance Indicator |
| LLC | Limited Liability Company |
| MEDPR | Ministry of Economic Development and Poverty Reduction |
| MoEF | Ministry of Economy and Finance |
| MoF | Ministry of Finance |
| PSOs | Public Service Obligations |
| SAMA | State Assets Management Agency |
| SB | Supervisory Board |
| SOBs | State-Owned Banks |
| SOEs | State-Owned Enterprises |
| SUEs | State Unitary Enterprises |
| UFRD | Uzbekistan Fund for Reconstruction and Development |

# Executive Summary

i. **This report assesses Uzbekistan´s SOE sector and its current reform trends.** The report provides one of the first comprehensive applications of the integrated State-Owned Enterprises Framework (iSOEF) in the Europe and Central Asia (ECA) region by first providing a landscape of SOEs in Uzbekistan and their performance and then addressing the five critical issues: SOEs and the market, fiscal impact, distributional impact, corporate governance and accountability and finally communication strategies. This multidimensional assessment looks at the interrelationships of the challenges and opportunities faced by Uzbekistan´s SOEs to propose sequenced recommendations to strengthen governance and performance.

ii. **Despite several waves of privatization, available information indicates that the central government owns more than 2,000 SOEs in Uzbekistan**. Many SOEs were privatized as part of the transition process from a centralized to a market economy—more than 50,000 small companies were privatized by 1994. However, the privatization process slowed down in the following years. Privatization attempts made in 2001-2005 were selective, focusing mostly on reorganization and transformation of state entities into different legal forms, while keeping them—directly or indirectly—under state ownership. In 2016, the GoU identified 14 strategic joint-stock companies (JSCs), in which all shares were held by the state and could only be privatized after presidential approval. The number of strategic SOEs changed slowly over time through several pieces of legislation. The size and composition of the SOE portfolio in Uzbekistan is not precisely measured and differs depending on which data source is chosen. According the WBG Global Business of the State (BOS) database, the main data source for this report, the GoU had majority ownership (at least 50 percent of total shares) over 2,023 SOEs in FY 2019—the only year for which comprehensive information was available—which is a relatively high number compared to both global and regional peers.

iii. **Available financial information, while limited and outdated, enables a description of the SOE portfolio composition and its main features in this report.** First, as mentioned above, there were 2,023 SOEs majority owned by the central government in 2019, which employed at least 529,600 workers and generated over USD 18.44 billion in operating revenues (32 percent of GDP) that year. Second, more than 70 percent (1,435) of those SOEs were not yet corporatized—mostly State Unitary Enterprises (SUEs), and 31 percent belonged to the financial sector—State-Owned Banks (SOBs)[1] and insurance companies. Third, while SOEs are present across all economic activities, they are highly concentrated (by number) in competitive sectors—around 1,600 out of the total 2,023—where entry barriers related to cost structures are generally low and there is no clear economic rationale for state ownership. Fourth, SOE economic activity is highly concentrated—only 19 SOEs generated USD 15.9 billion in operating revenues in 2019, i.e., 86 percent of total SOE revenues that year (27 percent of GDP) and accounted for 48 percent of estimated total SOE employment. Most of these SOEs are JSCs operating in key strategic markets such as mining, electricity, energy, communications, railways, and air transport. Fifth, these SOEs (excluding those from the financial sector) generated net profits of almost USD 400 million in 2019, and the bulk of these profits were generated by SOEs operating in the mining, manufacturing, and energy sectors.

iv. **Several SOE reform measures were taken by the GoU in 2019, and efforts continued in the same direction in subsequent years, despite the global disrupting effects of the COVID-19 pandemic and the crisis in Ukraine**. The GoU introduced in 2019 the State Asset Management Agency (SAMA), which is currently working on building a sound corporate governance framework and introducing a system of centralized financial oversight of SOEs' performance and has direct ownership over about 400 central government SOEs—the rest remain owned and supervised by local authorities, line ministries, the

[1] According to the IMF, SOBs hold 85 percent of total banking system assets.

Ministry of Economy and Finance (MoEF)[2], and other government agencies. In 2020, measures were taken for large size SOEs in terms of both adopting International Financial Reporting Standards (IFRS) and elaborating Key Performance Indicators (KPIs). Also, further limits were placed on the creation of new SOEs, the privatization of hundreds of SOEs was proposed, and 32 of the largest SOEs were identified to remain under state ownership— specifically under MoEF control and supervision— while subject to corporatization and enhanced governance. In 2021, the SOE Ownership Strategy was introduced which proposed a sharp reduction of the SOE portfolio during 2021-2025, while also offering a detailed roadmap for implementing solid principles of SOE corporate governance. Accordingly, in 2022, a Presidential Decree was issued for the pre-sale preparation, including negotiations with investors, to privatize large SOEs—several of which are included in the list of strategic SOES which were under MoEF control—as well as three large state-owned banks (SOBs). More recently, in early 2023, shares of these 32 large and strategic SOEs were transferred to the Agency for Strategic Reforms (ASR)[3], while UzAssets Investment Company, created in 2020, was entrusted with managing the shares of these companies to improve their operational efficiency, ensure their transparency, and strengthen their corporate governance practices.

### *SOEs Effects on Markets*

v. **Institutional and regulatory safeguards to promote competition and a level playing field between SOEs and private firms remains under active development in Uzbekistan.** World Bank (2021)[4] and World Bank (2022)[5] reports explain in detail the remarkable efforts of the GoU in recent years to foster private sector development and reduce state participation (and related distortions) in markets. Despite much progress, perceptions-based indicators suggest that much more remains to be done to foster dynamic markets. According to the Economist Intelligence Unit 2022 data, there is a perceived high risk of unfair competitive practices, discrimination against foreign companies, and price controls, all of which may affect firms' ability to compete effectively and may reduce the incentives to invest in the country. Moreover, the pace of entry of new firms remains well below the regional average, which may be indicative of market frictions, including the significant presence of large, often dominant, SOEs in markets and an unlevel playing field between SOEs and private firms.

vi. **A competitive neutrality gap analysis presented in this report indicates that certain aspects of the legal framework, combined with preferential treatment for SOEs, and a system of ad-hoc subsidies create an unlevel playing field.** First, SOEs are not subject to the same competitive pressure as private peers because of soft budget constraints and the lack of separation among commercial activities and public service obligations (PSOs)[6]. Second, even though most rules are equally applicable to both SOEs and private sector firms, some notable exceptions remain. For instance, SOEs that tend to anchor an entire town—such as large metallurgy and mining companies, around which towns are often built—enjoy a longer grace period for external management to bring a company back to solvency.

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[2] In December 2022, the government launched a major public administration reform, and the Ministry of Finance was turned into the Ministry of Economy and Finance.

[3] In August 2023, the shares of strategic SOEs were transferred back to the Ministry of Economy and Finance, as per Presidential Decree # 283.

[4] World Bank. 2021. *Assessing Uzbekistan's Transition. Country Economic Memorandum*.

[5] World Bank. 2022. *Toward a Prosperous and Inclusive Future: The Second Systematic Country Diagnostic for Uzbekistan*

[6] When public service obligations are imposed on SOEs which operate in the marketplace, or services are offered at non-market prices (e.g. in sectors with regulated prices), according to good practices SOEs should be compensated for non-commercial requirements and such compensation should be based on additional costs that these requirements impose.

vii. **Critical gaps in the regulatory framework include**:

- Corporate governance rules are not yet mainstreamed through all SOEs, which creates a lack of transparency with respect to the public funding SOEs receive.
- There is no official method for the calculation of compensation for the delivery of public service obligations (PSOs), which leads to situations of over and under-compensation.
- SOE are not required to earn market-consistent rates of return on their sale of assets, goods and services.
- SOEs benefit from a few exemptions from laws that encourage market discipline, including the Insolvency law.
- Certain types of SOEs are exempt from standard licensing requirements based on their legal status (e.g., SUEs).

viii. **In addition, the *implementation* of the current regulatory framework and the way government agencies interact with SOEs requires further attention to ensure competitively neutral markets:**

- SOEs enjoy preferential access to finance through SOBs and/or government guarantees.
- SOEs receive significant state on-lending and *ad hoc* subsidies, on an as-needed basis.
- SOEs appear to receive preferential access to land.
- SOEs receive *de facto* preferential access to public procurement opportunities because of the overall structure and operation of the procurement legislation.

ix. **Overall, to reduce risks to competition and create better conditions for private sector development, the Government needs to scrutinize its direct and indirect interventions in markets and strengthen the associated legal framework.** Governments can intervene directly in markets, as a provider of goods and services through SOEs, and indirectly, through regulation and market oversight (e.g., price controls, subsidies, and antitrust enforcement). These interventions can reinforce the dominance and monopoly positions of state-owned incumbents. To achieve the GoU's goals of increasing the competitiveness of the national economy and obtaining a sharp increase in private investment— as set out most recently in Presidential Decree #101 (April 2022), it is crucial that: (i) SOEs are subject to greater market discipline, (ii) preferential treatment in favor of SOEs is phased out and there is increased transparency on subsidies to SOEs as well as to the private sector, and (iii) state ownership is limited to markets in which there is a strong economic or strategic justification. To move in this direction, the adoption of laws, policies, and procedures that support competitive neutrality, in addition to recent progress —as reflected by Law on State Property Management governing SOE-related matters, approved by the Senate in June 2022, and enacted in March 2023— is considered essential.

### *Fiscal Impact*

x. **Because of its large size, the SOE sector has profound fiscal implications in Uzbekistan**. While the government´s macro-fiscal position appears to be relatively sound (the average overall fiscal deficit over 2016-2021 was 3.1 percent of GDP and the overall risk of external debt distress was evaluated as low), the SOEs sector poses significant risks. This is mainly because some of the SOEs, including large utilities operating as natural monopolies incur chronic and substantial quasi-fiscal deficits, which are financed mainly off budget by a combination of borrowing at subsidized interest rates and underinvestment in essential repairs and maintenance. The liabilities which these SOEs have accumulated because of their quasi-fiscal deficit are likely to become a future cost to the budget.

xi. **Data obtained on financial transactions indicate that the SOE sector makes a net positive contribution to the government budget, though these records may be incomplete.** While benefiting from significant tax and customs exemptions, from 2019 to 2021, SOEs paid taxes accounting for

approximately half of total central government tax revenue (8.5 percent of GDP) but over the same period they made negligible contributions to government revenue from dividends (amounting to less than 0.7 percent of total budget revenues in 2021). SOEs receive only minimal explicit budget subsidies (0.1 percent of GDP in 2021, according to estimates provided by the former MoEF for the purpose of this report), but they benefit from much larger flows of financial support through the National Investment Program (no specific data was obtained to estimate this effect), and concessional "policy-based" loans from the budget (2 percent of GDP on average during 2019-2021). The explicit subsidies might be an underestimate as the GoU has not yet published a consolidated table of the revenues and expenditures of all budget funds, broken down into detailed economic categories.

xii. **SOE debt and future investment requirements are two main sources of fiscal risk**. Total non-financial SOE sector debt liabilities were approximately equivalent to one-third of GDP at end-2020, and almost all SOE borrowing involves an explicit or implicit contingent liability of the State. In addition, large infrastructure gaps due to chronic under-investment by SOEs have left much of their capital assets beyond their normal service life, thus impeding the ability of SOEs to satisfactorily meet the demand for energy and other key services in a reliable manner. For example, over 60 percent of the components of the electricity transmission and distribution grids have been in service for over 30 years, which has contributed to average transmission and distribution losses of 2.7 percent and 12.5 percent, respectively. The power sector requires significant investments, estimated at over $8 billion, to replace aging infrastructure and meet the increasing demand in a manner consistent with Uzbekistan achieving a net zero target for carbon emissions by 2060. These fiscal risks have been also exacerbated by the accumulation of sizable SOE quasi-fiscal deficits, especially those related to non-commercial SOE activities, often termed as PSOs. The most prominent example of these quasi-fiscal deficits is the sale of energy at subsidised prices through tariffs set below full cost recovery levels.

xiii. **The scale of these risks is closely linked to the financial performance of a few large and loss-making SOEs**. A few large SOEs —accounting together for 46 percent of the total SOE liabilities in 2020— made aggregate losses in the 2019-21 period, notably Uztransgas, Uzbekiston Temir Yullar, Uzbekistan Airways, and National Electricity Networks. The risk posed to public funds by unsustainable debts of SOEs was demonstrated in 2020 when the Uzbekistan Fund for Reconstruction and Development (UFRD) wrote off loans, including capitalized interest, amounting to UZS 16.8 trillion (2.5 percent of GDP) to three SOEs, of which UZS 15.6 trillion were liabilities of Uzbekneftegas.

### *Distributional Impact*

xiv. **This iSOEF describes potential social and distributional impacts of SOE reform and privatization, especially focused on poverty, employment, and vulnerable groups**. The findings suggest that: (i) although poverty and unemployment is less common among workers formerly employed by SOEs than other comparable groups, women and older workers are at higher risk; (ii) in recent years, new jobs were largely created outside of the SOE sector, but have been less accessible than SOE employment to women and people aged 45 and older; (iii) while Uzbekistan's severance payments scheme significantly reduces the negative effects of job loss, it does not eliminate short-term poverty risks, and (iv) retraining and other active labor market policies mitigate risk for vulnerable workers, but their implementation remains challenging.

xv. **The distributional assessment also highlights geographic areas with high concentration of SOE employment that may be at elevated risk of impacts.**

### *Corporate Governance and Accountability Mechanisms*

xvi. **The SOE legal framework is currently being strengthened.** Approved by the Senate in June 2022, the "Law on State Property Management governing SOE related matters" was promulgated in March 2023 by the President of Uzbekistan. So far, Uzbek legislation related to SOEs has been fragmented and regulated by numerous legal instruments, sometimes conflicting with each other. This Law marks an important step in institutionalizing ongoing SOE reforms. It is expected to largely resolve the issue of SOE legislative fragmentation, clearly define the responsibilities of the SOE ownership agencies, and assign the board appointment function to the respective agencies. Nonetheless, some key issues are not directly addressed by this new legislation, such as a clear and proper segregation of duties between the SAMA and the ASR which recently took over the ownership responsibilities for largest SOEs.

xvii. **In recent years, Uzbekistan has transitioned from a decentralized ownership model to a more centralized one.** In the past, line ministries were responsible for SOE ownership, and the Center for Management of State Assets (CMSA) was responsible for SOE oversight. In 2019, the SAMA was established as a single state agency responsible for policy issuance and administration in the areas of state assets management, SOEs privatization and transformation, corporate governance implementation, and financial and economic performance monitoring. SAMA is accountable to both the President and the Prime Minister. Most SOEs must report to SAMA, which, by gradually taking over functions formerly exercised by line ministries, is mandated to act as SOEs' shareholder, implement good corporate governance practices, appoint SOE board members, monitor financial performance, and develop and enforce key performance indicators. However, beginning in October 2020, the MoF carried out the main functions of shareholders with respect to 32 large and strategic SOEs, but this function was moved to ASR from the newly consolidated MoEF at the beginning of 2023[7].

xviii. **The SOE performance measurement system as monitored by SAMA has significantly improved in recent years.** The SOE performance monitoring system has evolved significantly starting in 2016 with the introduction of a detailed and elaborate set of KPIs. Since then, all SOEs have been required to follow and report on KPIs. The new system of monitoring covers a wide range of themes, including a mix of financial and non-financial indicators. There are currently 13 mandatory performance indicators and 18 supplementary ones. The performance of an enterprise is measured using the so-called "integrated efficiency indicator," where each of the main key 13 KPIs is assigned a weighted value. Also, as per regulation, SOEs are encouraged to develop additional KPIs based on the SOE industry/sector nature, market conditions, and strategic goals. SAMA monitors the performance of SOEs and regularly publishes KPIs and associated targets for each SOE on its website.

xix. **Additional reform is required to align SOE board procedures with good international practices**. First, supervisory board (SB) members' qualifications and background may vary, as these boards are in practice still dominated by civil servants. Second, the concept of an independent SB member—introduced by the Corporate Governance Code in 2016—is still rare in practice. Third, the degree of autonomy of SB members in determining strategic and operational decisions is frequently constrained. Fourth, SBs do not appear to have full legal autonomy in appointing members of the management board and the company chief executive officer (CEO), even in the case of large and strategic SOEs. Finally, the establishment of SB committees, while mentioned in the SOE Corporate Governance Rules and in recent presidential resolutions and decrees, remains an ongoing process.

xx. **Despite recent progress, transparency and disclosure challenges remain.** The lack of systematic and comprehensive financial information for SOEs has had a direct impact on the analysis offered by this iSOEF, as explained in Chapters 1 and 2. A first basic aggregate report on the Uzbek SOE portfolio was

[7] In August 2023, the ownership of strategic SOEs was transferred back to the Ministry of Economy and Finance as per Presidential Decree # 283

recently published by SAMA, and it is expected to further enhance the level of transparency by incorporating more detailed information and covering the overall SOE portfolio. In terms of accounting standards, the government mandated many SOEs gradually adopt IFRS and aims to migrate all SOEs to IFRS before the end of year 2025. However, substantial capacity building activities and strengthening of internal accounting systems are needed to achieve this goal. External Audits of SOEs' financial statements are conducted in accordance with International Standards on Auditing (ISA). However, only large SOEs can afford external audits to be conducted by international audit firms, while smaller and/or less profitable SOEs use the service of local audit firms some of which may not have sufficient capacity for high quality audits. The Supreme Audit Institution (SAI) is also involved in the audit of SOEs, but its scope is targeted, specific (related to budget funds utilization), and mostly linked to the efficiency and/or performance audits, as well as validation of expenses.

xxi. **The procurement process for SOEs is covered by the 2021 Public Procurement Law and government regulations. While no overt legal privileges exist, in practice there is evidence of continued preferential treatment to SOEs in some cases.** Besides the Public Procurement Law, adopted in 2018 and revised in 2021, SOEs in Uzbekistan follow relevant government regulations and should not have any privileges over private firms under the public tenders. The 2021 revision of this Law abolished the unique procurement approaches enjoyed by 21 SOEs of strategic importance (concerning direct contracting, procurement procedures, thresholds, etc.). But while no overt legal privileges exist, in practice there is evidence of continued preferential treatment to SOEs in some cases. Implementation of legal requirements is also imperfect. While large SOEs often have specialized procurement departments tasked with implementing government regulations and directives, many staff may not have the required knowledge or skills. To secure fairness and transparency, the GoU aims to conduct all public procurement electronically, including a new mechanism for procurement complaints supported by World Bank technical assistance. Some SOEs conduct procurement through electronic government procurement (e-GP) platforms in advance of the introduction of the national e-procurement system scheduled to be installed in 2023.

### *Main Options for Reform*

xxii. **This iSOEF proposes a series of recommendations to improve SOEs governance and performance, promote competitive neutrality principles, and reduce fiscal costs and risks.** SOE reforms are multidimensional and require a holistic and integrated approach. As such, this iSOEF focuses on four intertwined options for reform, chosen on strategic relevance and feasibility. Other reform options are explored in Chapter 8, where a detailed and sequenced matrix including all proposed reforms is offered.

1. **Institutional arrangements for SOE oversight.** Clarify the roles and responsibilities of agencies in charge of SOEs (SAMA, ASR, line ministries, etc.) to avoid ambiguity in oversight and governance. Strengthen the capacity and authority of SAMA to oversee the entire SOE portfolio, and enable it to fully propose, and lead decision making with respect to SOEs under its oversight. For strategic and prioritized SOEs, set tiered timelines for due implementation of the Law on State Property Management, the SOE Strategy requirements, and other related decrees.

2. **SOE transparency, reporting, and disclosure.** Enhance SOE aggregate reporting (by SAMA) covering the overall SOE portfolio. Publication should include at a minimum: SOE legal status, share of state ownership, economic size (by assets/revenues) and sectoral distribution. For strategic and prioritized SOEs, reporting should include a general statement on the ownership policy, details on its implementation, as well as non-financial information bearing on environmental, social and governance practices. Enforce SOE publication requirements and ensure audited financial statements are publicly disclosed by SOEs. Migrate most SOEs to IFRS

and require SOE financial statements be audited under ISA. For strategic and prioritized SOEs, enforce ISA standards and independent audits provided by reputable firms to strengthen scrutiny of financial reporting. Publish a joint MoEF and SAMA annual fiscal risk report on SOEs with a focus on debt liabilities, quasi-fiscal deficits, and received subsidies.

3. **SOE portfolio size, divestiture, and the role of market institutions.** Continue to reduce state ownership, especially for the case of SOEs operating in competitive sectors- i.e., sectors with low entry barriers (based on cost structure and technology), which are not characterized by sub-additivity costs, and which are not related to negative or positive externalities. Adopt a new privatization law[8], refine the methodology ("rule of 5") regarding SOE creation to consider potential market effects, and leverage the CPCPC – former AMC - role in the creation of SOEs to minimize potential market distortions. Develop criteria for identifying subjects of natural monopolies based on economic rationale (including implications for price regulation).

4. **SOEs´ public service obligations (PSOs) and transparency of subsidies targeting SOE.** Ensure PSOs are properly costed and implementation decisions using public resources are made transparently through the budget process. This will provide SOEs with stronger cash flows and thereby enable them to undertake timelier investment and maintenance of capital assets. In turn, this would allow more optimal capital asset spending. Transparent compensation of SOEs´ PSOs through the budget should be separated from the revenues derived by SOEs from commercial activities to avoid risks of cross-subsidization and to avoid distorting prices of goods and services provided in competitive segments. Finally, increasing overall transparency on subsidies granted to SOEs as well as the private sector will contribute to a more level playing field.

[8] During the current report's preparation, the Law was in the second reading stage in Parliament. After the completion of this report, the new Privatization Law received approval in the Senate in November 2023 and is currently awaiting ratification by the President's Office.

## Matrix of proposed options for SOE reforms

| Reform Area(s) | Recommendation | Time Horizon | Responsible Agency (ies) |
|---|---|---|---|
| | **I. Main Recommendations** | | |
| **SOE Corporate Governance and Accountability Mechanisms (iSOEF Module 4)** | **1. Institutional arrangements for SOE oversight** | | |
| | • Clarify the roles and responsibilities of government agencies in charge of SOEs to ensure proper segregation of duties and avoid ambiguity with respect to the role of various ministries and agencies (SAMA, ASR, line ministries, etc.) in overseeing and governing SOEs. | ST to MT | SAMA, ASR |
| | • Strengthen the capacity and authority of SAMA to oversee the entire SOE portfolio, and enable it to fully propose, lead and engage in strategic policy actions and decision making with respect to SOEs under its oversight. | MT | SAMA |
| | • **For strategic and prioritized SOEs**, set tiered timelines for duly implementation of the SOE Strategy requirements and other related decrees. | ST to MT | SRA |
| **SOE Corporate Governance and Accountability Mechanisms (iSOEF Module 4)** | **2. SOE transparency, reporting and disclosure** | | |
| | • Enhance SOE aggregate reporting (by SAMA) covering and defining the overall SOE portfolio, and including SOE legal status, share of state ownership, economic size (by assets/revenues) and sectoral distribution. **For strategic and prioritized SOEs**, also include a general statement on the ownership policy and its implementation, as well as non-financial information bearing on environmental, social and governance practices. | ST | SAMA, SRA |

| Reform Area(s) | Recommendation | Time Horizon | Responsible Agency (ies) |
|---|---|---|---|
| | • Enforce SOE publication requirements, ensuring audited financial statements are publicly disclosed by SOEs. Follow the current plan to migrate most SOEs to IFRS and to promote that SOE financial statements are audited under ISA. **For strategic and prioritized SOEs**, enforce ISA standards and strengthen scrutiny of financial reporting by requiring independent audits provided by reputable firms. | ST | SAMA, SRA |
| | • Request the MoEF, with the assistance of / in coordination with SAMA, to elaborate and make public an annual fiscal risk report on SOEs —with a focus on SOE debt liabilities, quasi-fiscal deficits, and received subsidies. | ST to MT | MoEF |
| **SOEs Effects on Markets (iSOEF Module 1)** | **3. SOE portfolio size, divestiture, and the role of market institutions** | | |
| | • Continue to reduce state ownership, especially for the case of SOEs operating in competitive sectors. | ST and MT | MOEF, CPCC, SAMA |
| | • Adopt a new privatization law, refine the methodology ("rule of 5") regarding SOE creation to consider potential market effects, and leverage the CPCPC – former AMC - role in the creation of SOEs to minimize potential market distortions | MT | MOEF, CPCC, SAMA, SRA |
| | • Develop criteria for identifying subjects of natural monopolies based on economic rationale (including implications for price regulation). | ST to MT | CPCC, SAMA |
| **Fiscal Impacts (iSOEF Module 2) /**<br>**SOEs Effects on Markets (iSOEF Module 1)** | **4. SOEs´ public service obligations (PSOs) and transparency of subsidies targeting SOE** | | |
| | • Ensure PSOs are properly costed and implementation decisions using public resources are made transparently through the budget process. This will provide SOEs with stronger cash flows and thereby enable them to undertake timelier investment and maintenance of capital assets. Transparent compensation of SOEs´ PSOs through the budget should be separated from the revenues derived by SOEs from commercial activities to avoid risks of cross-subsidization and to avoid distorting prices of goods and services provided in competitive segments. | ST to MT | MoEF, SAMA and SRA |

| Reform Area(s) | Recommendation | Time Horizon | Responsible Agency (ies) |
|---|---|---|---|
| **Social and distributional Impacts (iSOEF Module 5)** | • Use protection measures included in the newly approved labor code to ensure adequate coverage for downsized workers. Those workers with formal contracts currently in force include standard severance provisions of up to three months following job termination, in addition to in-kind unemployment assistance in the event a worker is unable to find work during that time.<br>• Identify differences in long-term unemployment risk driven by the spatial density and workforce composition within affected districts, and other district-specific factors. Use discretionary tools outlined in the labor code to supplement support in cases where communities or individuals are disproportionately affected by reform. | ST to MT | MoEF, SAMA, MoEPR |
| **II. Other Recommendations** | | | |
| **SOE Corporate Governance and Accountability Mechanisms (iSOEF Module 4)** | **SOE Performance Management** | | |
| | • Ensure that performance monitoring units at SAMA and at the ASR have sufficient capabilities. Implement a ranking of SOEs based on KPIs´ performance and classified by economic sector. | ST to MT | SAMA, ASR |
| | • Link KPI (both financial and non-financial) and associated targets to the SOE strategy and objectives, to facilitate the measurement and evaluation of results. | ST | SAMA, ASR |
| | • Enhance financial and non-financial monitoring web-portal functionality to enable more sophisticated analysis and reviews of the SOEs performance—e.g. by sectors, business development (exports, market destination, product line, innovations, etc.), assets, human resources employed, etc. | ST | SAMA, ASR |
| | • **For strategic and prioritized SOEs**, extend the set of KPIs to cover financial, service delivery, human resources/social and environmental aspects. | MT | ASR |

| Reform Area(s) | Recommendation | Time Horizon | Responsible Agency (ies) |
|---|---|---|---|
| **SOE Corporate Governance and Accountability Mechanisms (iSOEF Module 4)** | **SOE Boards** | | |
| | • Introduce a transparent and comprehensive system for selection of SOE board members aiming to attract independent parties into the selection process and establish a pool of potential board candidates. | MT | SAMA, ASR |
| | • Empower supervisory boards to properly exercise their functions in terms of strategic SOE oversight and management supervision and act as effective governance bodies. | MT | SAMA, ASR |
| | **For strategic and prioritized SOEs**:<br>• Revise the role of the civil/public servants´ participation in the Boards by gradual reduction of their participation on SOE boards to a minimum which will bring the corporate governance structure in line with the good practices;<br>• Set professional requirements for board members;<br>• Comply with recently adopted regulations to establish supervisory board committees to support SOE supervisory boards in taking well-informed decisions, i.e., audit committee, remuneration committee, and other committees depending on the needs of specific SOEs, and consider staffing board committees with board members possessing appropriate skills and experience, preferably headed by independent board members;<br>• Comply with the SOE Strategy requirement of independent supervisory board representing at least one-third of total board members;<br>• Introduce independent board members with the skills matching each SOE's long-term strategy and need;<br>• Consider engaging out-of-country expertise;<br>• Implement adequate training programs, peer exchanges, and learning opportunities for potential candidates and existing SOE board members.<br>• Review and periodically update the SOE Strategy | MT | ASR |
| | **Competitive Neutrality Principles** | | |

| Reform Area(s) | Recommendation | Time Horizon | Responsible Agency (ies) |
|---|---|---|---|
| **SOEs and the Market (iSOEF Module 1):** | • Make the competitive neutrality principles binding, e.g., requiring SOEs to earn a profit on commercial activities and implement cost allocation systems to separate commercial from non-commercial activities in accounts, as outlined in the 2021 SOE Ownership Strategy, the 2020 Competition Policy Strategy, and the 2023 Law on State Property Management. | ST | MOEF, CPCC, SAMA, and line ministries |
| **SOEs and the Market (iSOEF Module 1) /**<br><br>**SOE Corporate Governance and Accountability Mechanisms (iSOEF Module 4)** | **Separation of state functions** | | |
| | • Separate ownership and oversight activities of SOEs from line ministries/regulators to minimize conflict of interest and market distortions. | ST to MT | |
| | • Gradually transfer all SOE ownership responsibilities to SAMA/ASR. | MT | |
| **SOEs Effects on Markets (iSOEF Module 1) /**<br><br>**SOE Fiscal Impacts (iSOEF Module 2)** | **Management of government subsidies** | | |
| | • Create and maintain a public registry of all central government subsidies and corresponding recipients, including SOEs. Require all government agencies involved in central government subsidy design/grant to share information with CPCPC. | ST | CPCC, MOEF and all line ministries |
| | • Develop a fully-fledged subsidy control framework (ex-ante, ex-post control) for all granting agencies; ensure CPCPC plays a central role in reviewing subsidy notification and analysis from a competition point of view. | MT | CPCC, MOEF and all line ministries |
| | **Utility Tariffs** | | |

| Reform Area(s) | Recommendation | Time Horizon | Responsible Agency (ies) |
|---|---|---|---|
| **SOE Fiscal Impacts (iSOEF Module 2)** | • Gradually raise utility tariffs to full cost recovery levels, to mitigate SOE fiscal risks. Wholesale tariffs for gas and electricity should be raised to levels which cover the full cost of supply, plus a competitive return on capital. | ST to MT | MoEF and line ministries |
| | • Set end-user tariffs for consumers and businesses at levels which cover the costs of supply of the transmission and distribution utilities, unless the Government decides to explicitly subsidise the energy consumption of specific groups of customers, in which case the full cost of the subsidy (PSO) should be paid for from the budget and transferred to the relevant utility | MT | MoEF and line ministries |

*Legend:*
ST: Short term – 6 months
MT: Medium term – 6-24 months

*Key:*
SAMA – State Assets Management Agency
ASR–Agency of Strategic Reforms
MoEF – Ministry of Economy and Finance
Competition Promotion and Consumer Protection Committee (CPCPC)

# Chapter 1. Introduction

1. **This report assesses Uzbekistan´s SOE sector comprehensively and its current reform trends using the integrated SOE Framework (iSOEF).** The report provides one of the first comprehensive applications of the World Bank's integrated SOE framework (iSOEF) in the ECA Region, by outlining an SOE landscape in Uzbekistan, and then addressing key aspects for assessing SOEs. The themes include SOEs and the market, fiscal impact, corporate governance, and accountability mechanisms. Other relevant topics covered by the iSOEF methodology, namely, "Distributional Impact" and "Communications", are also addressed by this report, which makes it one of the most comprehensive iSOEF reports made so far. Leveraging the World Bank's expertise across its EFI Practice Group, this multidimensional assessment looks at the interrelationships of the challenges and opportunities faced by Uzbek SOEs to propose holistic and sequenced recommendations to strengthen their governance and performance.

2. **The main objective of this iSOEF is to assess the economic and fiscal impact of the SOE portfolio and identify ways to strengthen the performance and corporate governance of SOEs**. The primary audience of the iSOEF is the Government of Uzbekistan (GoU), in particular the Ministry of Economy and Finance (MoEF), the State Assets Management Agency (SAMA), the Agency of Strategic Reforms (ASR), the Competition Promotion and Consumer Protection Committee (CPCPC) – replacing the former Antimonopoly Committee (AMC), and other relevant stakeholders. The report is also intended to inform the design of World Bank engagement in the sector, and as a public good for stakeholders and the public.

## Data Availability

3. **This report relies on the WBG Global Businesses of the State (BOS) database due to the absence of systematic SOE information from national sources**. Available data on SOEs in Uzbekistan is fragmented, and conclusions differ, sometimes significantly depending on the source considered. The absence of systematic SOE-level information is one significant challenge limiting the transparency and disclosure dimension of SOEs' corporate governance. In this context, the WBG BOS database has been chosen as the main source of information on the size and composition of the SOE portfolio (see Box 1, in Chapter 2 for a brief discussion about methodological procedures adopted to identify the SOEs). The database reports a total 3,815 SOEs with confirmed ownership links to the GoU for FY 2019, of which 2,023 are held directly by the central government with at least 50 percent of total shareholding, which is the standard procedure for portfolio selection in iSOEF reports. Chapter 2 presents an in-depth analysis of the SOE portfolio in Uzbekistan as identified by the WBG BOS dataset.

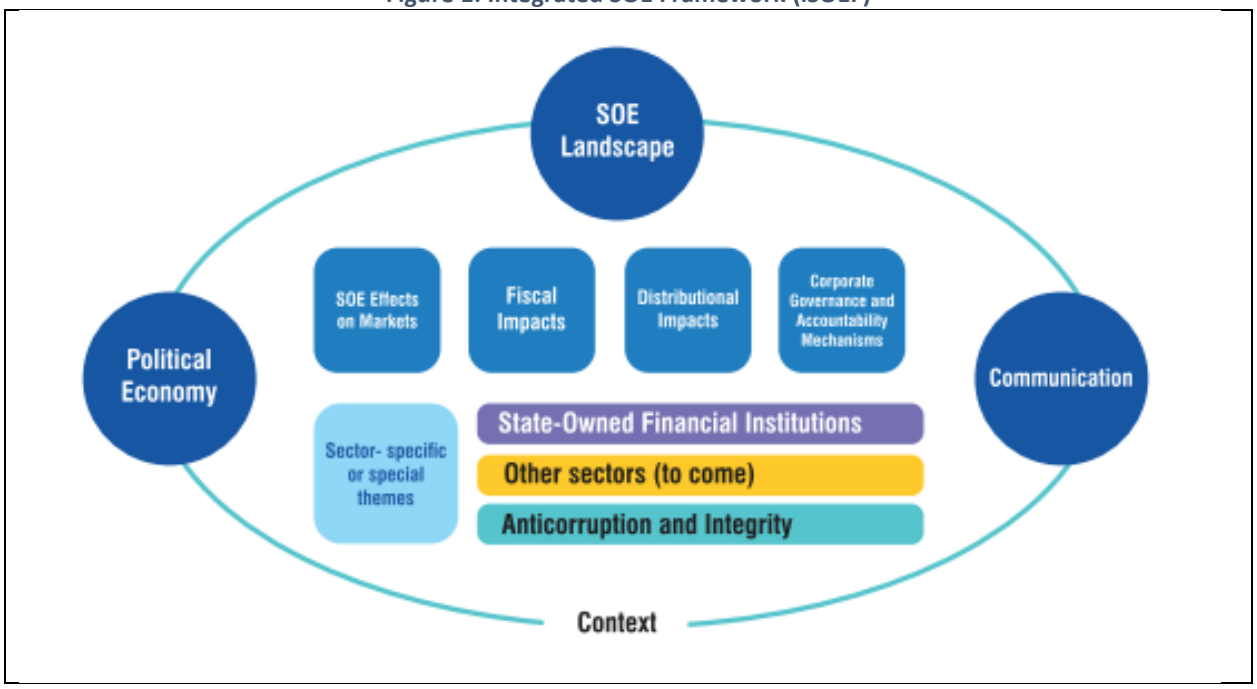
4. **When posssible, SAMA´s official database and other government sources were also considered as an alternative reference**. Due to the lack of authoritative and comprehensive information on SOEs—e.g., the WBG BOS database's most updated information dates from 2019—SAMA´s database was also considered as a referential source in severalsections of this report. According to SAMA, as of November 8, 2022, the GoU maintains shares of various amounts (non-specified) in 2,247 SOEs.[9] Out of these, 1,152 are Limited Liability Companies (LLCs), 870 are SUEs (not corporatized), and 225 are JSCs.[10] Other relevant sources, such as SOE-related legislation, are also references in this report.

[9] See official count on the UzSAMA website, here: https://davaktiv.uz/en/corporate, last viewed November 8, 2022.

[10] See: https://davaktiv.uz/en/corporate

## Methodology

**Figure 1: Integrated SOE Framework (iSOEF)**




Source: WBG Integrated State-Owned Enterprises Framework (iSOEF)- Overview (2019)

**5. The report followed the modular structure of the iSOEF, recently developed by the World Bank[11].** The report follows the modular structure of the iSOEF approach (Figure 1). It covers the landscape and performance of the SOE sector and provides a comprehensive analysis encompassing the four iSOEF modules, thus capturing all key aspects of the SOE sector, namely: "SOEs Effects on Markets" (iSOEF Module 1); "Fiscal Impact" (iSOEF Module 2); "Distributional Impacts" (iSOEF Module 3); and "Corporate Governance and Accountability Mechanisms" (iSOEF Module 4). The thematic iSOEF module on "Strategic Communication" for SOE reform (iSOEF Thematic Module 3) is also included. While several World Bank reports have described some of these issues in the past, this is the first attempt to make a broader assessment of the overall SOE sector in Uzbekistan across the above-mentioned dimensions.

## Structure of the Report

6. **The report structure is composed of 8 chapters**. After this introduction in Chapter 1, Chapter 2 analyzes the size, sectoral composition, and financial and operational performance of SOEs, drawing on the WBG Global Business of the State (BOS) database. Chapter 3 discusses the effects of SOEs presence on market functioning, while Chapter 4 analyzes financial flows between the government budget and the SOE sector, and overall fiscal risk stemming from SOEs. Chapter 5 discusses the distributional impacts from SOE-related reforms while Chapter 6 reviews the SOE governance frameworks. Chapter 7 overviews some key dimensions of the government's communications practices around economic reforms, including SOEs reforms. Chapter 8 summarizes the main reform recommendations.

[11] The World Bank, "Integrated State-Owned Enterprise Framework" (iSOEF) Washington D.C, June 2019.

# Chapter 2. The SOE Landscape and Performance

## Background and Recent Developments in the SOE Sector

7. **Uzbekistan began its transition from a planned economy to a market-based economy in 1991**. It started with the liberalization of a few prices and, through the privatization of some companies, creating a nascent private sector in a largely agricultural-based economy. To avoid a sharp decrease of social sector government spending, which relied on transfers from Moscow, the government pursued the so-called "Uzbek Model" of transition. This approach involved a more prominent role of the state in the economy and central planning compared to other CIS and ECA countries in the post-Soviet era such as Poland and the Baltic States (Estonia, Latvia, Lithuania), where faster and more comprehensive reforms took place in the early 1990s.

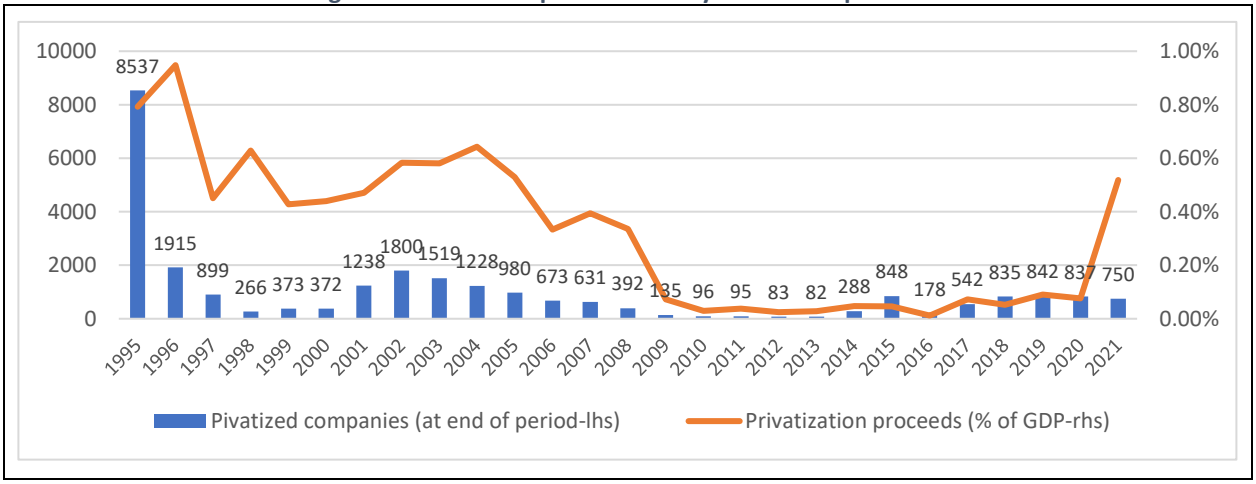
8. **The privatization process in Uzbekistan has been through several waves since the 1990s, but in most cases expected results were not achieved over time**. A significant number of privatizations and corporatization of SOEs were launched by the 1991 Law "On Denationalization and Privatization,"[12] covering mainly small enterprises in retail trade, consumer services, public catering, and other spheres. In fact, more than 50,000 small companies were privatized by mid-1994, mainly in retail trade, consumer services, public catering, and local industry.[13] Although the law also allowed the privatization of especially large SOEs operating in key sectors of the economy such as telecommunications, pharmaceuticals, transport, and fundamental industries—including oil, gas, mining, transport, and electricity—these large companies remained under state ownership, nonetheless. Subsequent privatization plans introduced during the 1990s focused mostly on medium and large SOEs. Despite a successful start, these plans were never fully realized, and the privatization process slowed in the following years (see Figure 2). Attempts at privatization from 2001 onward were selective and focused mostly on reorganization and transformation of state entities into different forms, while still being controlled—directly or indirectly—by the government.[14]

[12]"Denationalization" refers to transfer of State assets/enterprises into corporate form.

[13]EBRD, 1995, Transition Report 1994, London.

[14]For example, in 1996 the "Law on joint-stock companies and protection of shareholder rights" was approved, beginning the corporatization process for several large SOEs and setting relevant corporate governance parameters.

**Figure 2. Uzbekistan privatization dynamics and proceeds**




Source: Statistics Committee of Uzbekistan (www.stat.uz) (2007 –2021); Center for Effective Economic Policy (CEEP), Ministry of Economy of Uzbekistan (www.uzbearingpoint.com) (1995 – 2006)

9. **To keep entities that are of special importance under state ownership, in recent years legal instruments have identified "strategic" SOEs.** In 2016, the GoU identified 14 strategic joint-stock companies in which 100 percent of ordinary shares were held by the state but which could be privatized subject to Presidential action.[15] In 2017, a list of strategic objects that could not be privatized was issued, covering principally State Unitary Enterprises involved in activities such as defense procurement, bank-note printing, cadaster services, and JSC SOEs such as JSC Uzbekneftegaz and JSC Uzbekistan Airways.[16] In 2018, the GoU identified a list of 24 enterprises of strategic importance for which a special procurement regime was established.[17] Then in 2020, Presidential Decree #-6096 identified 32 of the largest SOEs (by valuation) as strategic and set out ambitious corporate governance improvements for them, including the adoption of IFRS accounting standards, requirements for annual independent audits, and the preparation of corporate improvement and financial recovery strategies.[18] Most recently, the Law on State Property Management (approved by the Senate in 2022 and enacted in March 2023) indicated that only SOEs of strategic interest and security to the population, as well as natural monopolies should be retained in state ownership.[19] While the concept of strategic is not clearly defined in the Uzbek legislation, a common theme across these legal instruments is that these SOEs either operate in fundamental industries, as defined by the 1991 Law "On Denationalization and Privatization", or in sectors designated as "natural monopolies.[20] , or in sectors where private sector participation was not feasible.

10. **The GoU also adopted measures to institutionalize the SOE ownership function and centralize oversight.** In 2019, the GoU established the State Asset Management Agency (SAMA), as an attempt to

[15] For example, Presidential Resolution No. PP-2635, dated October 17, 2016 "On measures to further Improve corporate governance in joint-stock companies with prevailing State shares".

[16] President of the Republic of Uzbekistan dated June 16, 2017 No. PP-3067, "Unified list of strategic objects of the state property not subject to privatization.

[17] Presidential Resolution No. PP-3487 "On measures to support the activities of companies and enterprises of strategic importance" signed on January 22, 2018. The Resolution was abolished on July 03, 2021.

[18] For a list of 32 largest SOEs, see Appendix 1 of Presidential Decree No. UP-6096 "On measures for accelerated reforming of enterprises with participation of the state and privatization of state assets", signed on October 27, 2020. As per the same Decree, ownership of these 32 largest SOEs was transferred to MoF.

[19] https://davaktiv.uz/en/news/the-law-on-the-management-of-state-property-was-approved-by-the-senate-of-the-oliy-majlis-of-the-republic-of-uzbekistan

[20] The Law of the Republic of Uzbekistan N 398-I "On Natural Monopolies", signed in April 24, 1997.

start centralizing SOE ownership and oversight, as well as to improve SOE performance and advance the privatization agenda.[21] Following its establishment, SAMA assumed the shares and ownership responsibilities of nearly all small and medium-sized SOEs. As of today, SAMA has direct ownership of about 400 central government SOEs, while the rest are owned and supervised by line ministries and other government agencies.[22] In parallel, Presidential Decree #-6096, from 2020, assigned the MoF with similar functions vis-a-vis the 32 largest-strategic SOEs[23].[24]

11. **Several other important measures were taken in 2020, confirming the will of the GoU to advance in the SOE reform agenda despite the disruption of the COVID-19 pandemic**. First, Presidential Resolution #-4611 sought to increase transparency by requiring adherence to IFRS accounting standards for large-size companies (both private sector firms and SOEs, including several large JSCs) and the elaboration of KPIs. Second, Presidential Decree #-6019 placed limits on the creation of new SOEs and emphasized creating competitive markets through further transformation and privatization of existing SOEs.[25] Third, Presidential Decree #-6096 provided for large scale SOE restructuring and privatization efforts. Besides tagging the 32 largest SOEs as strategic and setting out restructuring milestones for them, the Decree also identified 39 medium-size SOEs that immediately began a process of pre-privatization to improve operational performance and financial transparency.[26] Moreover, the Decree identified 479 smaller SOEs, about 17 percent of all SOEs, for immediate valuation and sale through a competitive and transparent auction process.[27]

12. **The 2021 SOE Ownership Strategy proposed a sharp reduction in the SOE portfolio by 2025, with a detailed roadmap for improving SOE corporate governance.**[28] The Strategy, proposed through Resolution No. 166 of the Cabinet of Ministers, provided that state ownership would only be allowed for enterprises whose main activity involves a natural monopoly, the provision of public goods (based on the reasoning that the private sector will underprovide due to unprofitability), fields of strategic interest, or performing important systemic functions for the economy (e.g., national security and defense, nuclear activities, extraction of precious metals, and major infrastructure projects). The Strategy outlined the GoU's commitment to foundational aspects of SOE establishment, maintenance, and corporate governance, including: (i) provide a rationale for SOE ownership; (ii) establish types and categories of state ownership; (iii) segregate regulatory and ownership functions; (iv) set out major corporate governance

[21] As per Presidential Decree No. UP-5630, dated January 14, 2019 "On measures to radically improve the system of managing state assets, antimonopoly regulation and the capital market". According to this Decree, SAMA results from the merger of two former state agencies: i) The State Committee for the Promotion of Privatized Enterprises; and ii) the Development of Competition and Center for State Assets Management.

[22] As of Mach 2023, the portfolio of UzSAMA included 406 SOEs which consist of 129 JSC, 259 LLCs and 18 State Unitary Enterprises

[23] As defined under Presidential Decree No. UP-6096, ownership of the 32 largest SOEs – listed in Annex 1 of the same Presidential Decree - are transferred to MoF.

[24] In early 2023 strategic SOEs ownership was transferred to ASR, and subsequently in August 2023 – to the Ministry of Economy and Finance, as per Presidential Decree # 283.

[25] Presidential Decree No. PP-6019, "Additional measures to further develop the competitive environment and reduce state participation in the economy," signed in July 2020.

[26] a Presidential DecreeNºUP-6096 "On measures for accelerated reforming of enterprises with participation of the state and privatization of state assets" signed in October 27, 2020.

[27] These enterprises were estimated at values less than UZS 100 million (about US$10,000) each and were selected based on their poor financial performance and the existence of strong domestic private sector capacity that could absorb the operations of these enterprises.

[28] Strategy for Reforming Management of Enterprises with State Participation (ownership) for the period 2021-2025, approved by the Resolution No. 166 of the Cabinet of Ministers, dated 29 March 2021.

policies; and (v) develop SOE financial accountability mechanisms, particularly to separate commercial from non-commercial activities, as well as transition policies to market-based mechanisms. Moreover, the Strategy targeted reducing the number of SOEs by 75% by 2025.

13. **Further measures were introduced in 2022 and 2023, stressing further the GoU´s commitment to SOE restructuring and privatization.** In February 2022, Presidential Decree #-123 set a plan to privatize "all SOEs working in markets where five or more companies are already operating", and introduced a plan to ban the creation of new SOEs, as well as subsidiaries and branches.[29] In April 2022**,** Presidential Decree #-101 tasked the SOE UzAssets Investment Company (JSC), created in 2020, to conduct the pre-sale preparation, including negotiations with investors, to privatize large SOEs—several of which are included in the list of strategic SOES under the control of MoEF (as such JSC "Uzbekneftegaz"; JSC "Thermal Power Plants"; and JSC "Uzbekistan Airways"), as well as three large state-owned banks (SOBs). In July 2022, the GoU submitted, for Parliamentary approval, a draft Privatization Law which will provide a unified legislative framework for privatization.[30] More recently, in 2023, Presidential Resolution #-83 transferred the shares of the 32 strategic SOEs to the balance sheet of the new Agency of Strategic Reforms (ASR)[31]. In parallel, UzAssets was entrusted with managing the shares of these companies to improve their operational efficiency, ensure their transparency, and strengthen their corporate governance practices.[32]

## The SOE Portfolio

14. **Despite the attention given to SOEs and their reform in recent years, it is still a challenge to determine the precise number of SOEs held by the central government of Uzbekistan.** Likewise, it is difficult to identify the economic sectors where they operate, their contribution to GDP, public employment, etc. Available data on SOEs in Uzbekistan is presented in several different ways by different sources —e.g., legislation, SAMA, external databases from credited international institutions, etc., and the information obtained from these sources usually differs, sometimes significantly, depending on which source is considered.

15. **The WBG BOS database, chosen as the main source of information for the purpose of determining the size and composition of the SOE portfolio, reports 2,023 SOEs in Uzbekistan for FY 2019**. Focusing only on SOEs where the central government directly owns at least 50 percent of total shareholding, which is the standard procedure for iSOEF reports, the BOS Database indicates a total of 2,023 SOEs in FY 2019. See Box 1 for a brief discussion about methodological procedures adopted to identify the SOEs. As shown in Figure 3, this is a relatively high number as compared to regional peers. Of those 2,203 SOES mapped in the WBG BOS dataset, 1,435 SOEs are not yet corporatized—mostly State Unitary Enterprises; the remaining 565 SOEs are non-corporatized (see Figure 4). Of the 31 SOEs mapped

[29] Presidential Decree No. PP-123 of 2022 "On measures to accelerate reforming of state institutions", February 2022 (and amended in March 2022)

[30] During the current report elaboration, the Privatization Law was at second reading stage in the Parliament. After the completion of this report, the new Privatization Law received approval in the Senate (in November 2023) and is currently awaiting ratification by the President's Office.

[31] In August 2023, under Presidential Decree # 283, these SOEs were transferred back to MoEF.

[32] As per Presidential Resolution No. PP-83, "On measures to accelerate the processes of reforming enterprises with state participation", UzAssets is entrusted with several reforming tasks of these 31 strategic SOEs, including: appointing members of the executive body and the supervisory board, introducing ESG principles; increasing profitability and operational efficiency; ensuring financial stability; attracting domestic and foreign qualified managers to the executive body and the supervisory board of enterprises, etc.

in the same dataset operating in the finance sector, as State Owned Banks[33] and insurance companies[34], 21 have been corporatized and the remaining ten have not.

**Figure 3.SOE Density**
(#of mapped SOEs per 100k inhabitants)

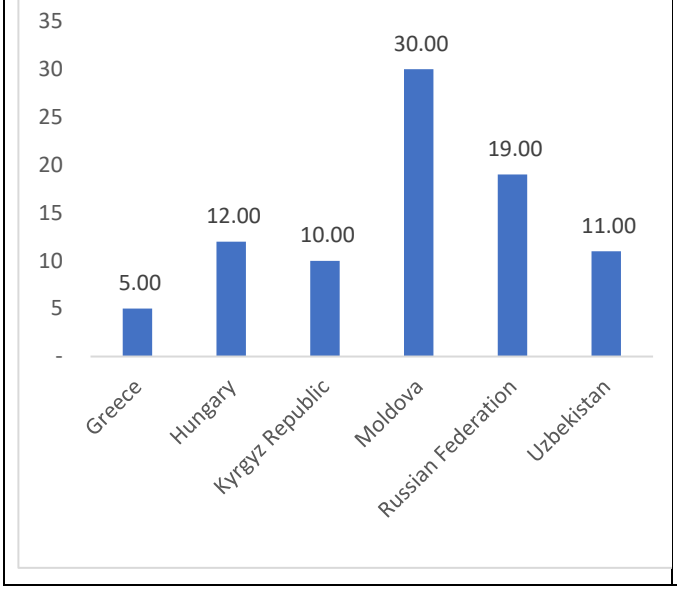
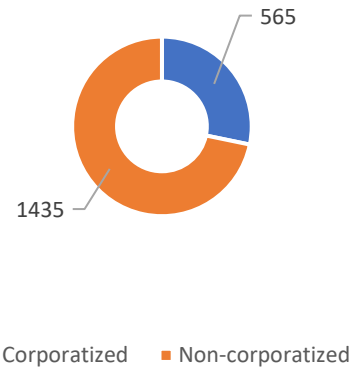



**Figure 4.Corporatized versus non-corporatized SOEs, 2019** (total # of mapped SOEs=2,023)




Source: WBG BOS database for Uzbekistan, as of November 2022.
Note: Corporatized legal forms include JSCs, LLCs, and other corporate legal forms. Non-corporatized SOEs in Uzbekistan are typically legally established as SUEs. The legal form could not be confirmed for 23 entities, and these were excluded from the chart.

[33] According to the IMF, SOBs hold 85 percent of total banking system assets.

**Box 1.WBG BOS Database**

The WBG Businesses of the State (BOS) Database, developed by the Equitable Growth, Finance, and Institutions VP, contains firm-level information on companies with confirmed ownership links to the state. As of March 2022, the WBG BOS database covers over 90 countries and is expanding worldwide. The BOS database includes all entities that are: (i) owned directly or indirectly owned by the state with 10 percent or more participation, (ii) capable of generating a profit or other financial gain for their owners, (iii) recognized by law as legal entities separate from their owners who enjoy limited liability, and (iv) set up for purposes of engaging in market production. This definition excludes companies operating in sectors such as Public Administration and Defense, Education, Human health activities, and Activities of extraterritorial organizations.

This approach offers, for the first time, a comparable landscape of the state footprint in markets and unveils the different forms and dimensions on how the state is involved in the economy including central and subnational firms, direct and indirect ownership (i.e., subsidiaries), and a broader set of sectors beyond network sectors or infrastructure activities and covering also competitive activities (e.g., agriculture, manufacturing, wholesale, and trade) where the private sector might be viable. The WBG BOS database rests on three methodological innovations:

i) a uniform definition of state ownership using an ownership threshold of 10 percent that allows for cross-country benchmarking and analyses at different ownership levels (i.e., minority vs. majority or full participation);
ii) the identification of complete ownership structures to trace state participation (direct and indirect government ownership through subsidiaries);
iii) a novel sector-taxonomy that classifies 560 four-digit level sectors in the NACE system into three categories based on their economic structure, underlying market failures, and rationale for state participation: competitive, partially contestable, and natural monopoly, which also serves to tailor potential options of reform.

Dall'Olio et al. (2022a)[35] further explain the methodological steps to construct the WBG BOS dataset and Dall'Olio et al. (2022b)[36] describe the sector taxonomy applied to classify economic activities performed by firms with state participation.

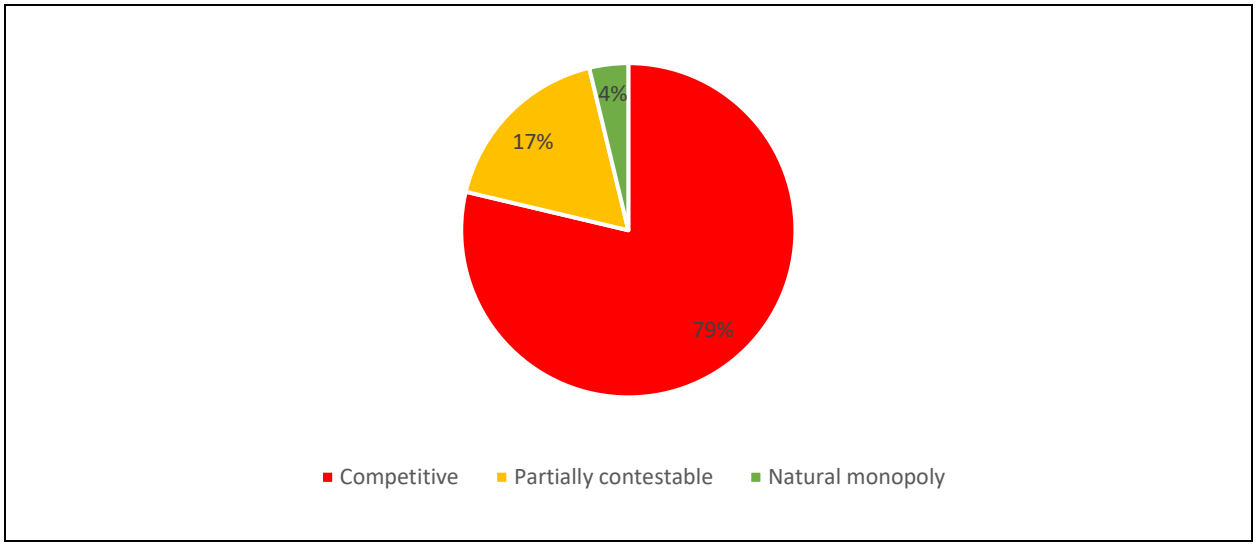
These rules determine the types of entities that are captured as Businesses of the State in the database and overcome the shortcomings of past efforts which relied heavily on local legal definitions (which vary substantially across countries), did not include complete ownership structures to understand upstream/downstream relationships, and used higher ownership thresholds, giving only a partial view of state presence in markets ignoring other potential channels such as minority holdings. Indeed, initial analysis of the countries included in the WBG BOS dataset so far reveals that non-majority BOS, on average, the state also might have a significant level of influence in markets through minority participation, which account up to 25 percent of all entities captured, and the number of entities increases by 32 percent when firms indirectly owned by the state are included (World Bank, 2022)[37]. It also reveals that more than half of the BOS worldwide operate in fully competitive sectors, where there is limited rationale for state ownership and greater risks for crowding out the private sector.

The cross-country comparisons that the WBG BOS database provides can help reduce controversy and support evidence-based recommendations when addressing potential reforms on BOS and state asset management with governments. As such, the database increases the potential entry points to discuss the reform agenda with governments and is already informing core WB corporate products and shaping government dialogue.

[35] Dall'Olio,Andrea Mario; Goodwin,Tanja K.; Martinez Licetti,Martha; Orlowski,Jan Alexander Kazimierz; Patino Pena,Fausto Andres; Ratsimbazafy,Francis Ralambotsiferana; Sanchez Navarro,Dennis. Using ORBIS to Build a Global

16. **While SOEs are present in all economic sectors in Uzbekistan, they are highly concentrated (by number) in competitive sectors, where entry barriers related to cost structures are generally low, and there is no clear economic rationale for state ownership.** SOEs mapped by the WBG BOS dataset can be classified into three broad sectors (competitive, partially contestable, and natural monopoly) based on the economic rationale—the intrinsic features and associated market failures—that justifies SOE presence in the industry. See Box 3 for a detailed explanation. Across all 2,023 SOEs mapped in the dataset in Uzbekistan, 79 percent are found in competitive sectors, and only 4 percent in natural monopoly sectors where the rationale for state ownership is strongest (Figure 5). Considering the specific sectors where these 2,023 SOEs are present, around 20 percent are engaged in typically competitive activities as in manufacturing, wholesale and retail activities sectors, 14 percent in competitive professional, scientific, and technical services (such as architecture, engineering and legal services), 9 percent in competitive construction activities (such as building and utility construction), and around 8 percent are found in competitive real estate and business services activities (such as land and fixed property rental and management) (see Figure 6).

**Figure 5.Distribution of SOEs by sector contestability,2019** (total # of mapped SOEs=2,023)




Source: WBG BOS database for Uzbekistan, as of November 2022.
Note: SOE are classified based on their activities at the NACE-4-digit level. Of the 2023 total SOEs captured, 4 are missing sector information and are not counted in the above chart.

Database of Firms with State Participation. WBG Policy Research working paper WPS 10261 Washington, D.C. : World Bank Group

[36] Dall'Olio,Andrea Mario; Goodwin,Tanja K.; Martinez Licetti,Martha; Alonso Soria,Ana Cristina; Drozd,Maciej Adam; Orlowski, Jan Alexander Kazimierz; Patino Pena,Fausto Andres; Sanchez Navarro,Dennis. Are All State-Owned Enterprises Equal? A Taxonomy of Economic Activities to Assess SOE Presence in the Economy (English). Policy WBG Research working paper 10262 Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/099951412132222133/IDU0e7057cdf09fa8044eb09d8a058ea7dfe2831

[37] World Bank (2022). Who's the BOSs: Shedding New Light on Businesses of the State. Equitable Growth, Finance and Institutions Notes. Washington, DC. World Bank. https://openknowledge.worldbank.org/handle/10986/37889 License: CC BY 3.0 IGO."

**Figure 6.Distribution of SOEs across sectors and sector types, 2019** (total # of mapped SOEs=2,023)


Source: WBG BOS database for Uzbekistan, as of November 2022.

Note: SOE are classified based on their activities at the NACE-4-digit level. Of the 2023 total SOEs captured, 4 are missing sector information and could not be counted in the above chart.

17. **The WBG BOS database confirms that these 2,023 SOEs employed at least 529,600 workers and generated over USD 18.44 billion in operating revenues (32 percent of GDP) in 2019.[38]** These numbers increase to 666,800 workers and USD 27 billion in operating revenues (47 percent of GDP) if all SOEs held by the central GoU—including minority holdings and subsidiaries—are considered (i.e., excluding only those held by local-level governments).[39] Although the WBG BOS data is incomplete and preliminary,[40] these figures are in line with recent IMF estimates that SOEs account for almost half of recorded output.[41]

18. **Out of these SOES, a small number of very large ones (with operating revenues greater than USD 100 million) make an especially significant contribution to GDP and formal employment.[42]** As per the WBG BOS dataset, while there are more than two thousand SOEs in Uzbekistan that are majority owned and directly held by the central government, 19 SOEs each generated over USD 100 million in operating revenues in 2019—i.e., totaling USD 15.9 billion and accounting for 86 percent of total SOE revenues (27 percent of GDP). Similarly, these 19 SOEs employed 254,500 workers, 48 percent of

[38] Operating revenues captures revenues from primary business activities for each SOE and excludes exceptional payments or passive income.

[39] These numbers increase only marginally when locally-held SOEs are included—total employment increases to 683,000 workers and total revenues increases to USD 27.23 billion.

[40] Of the 2023 SOEs focused on for purposes of this iSOEF, revenues data was available for only 804 (i.e., 1219 are missing); and employment data available for only 1121 (i.e., 902 are missing).

[41] IMF. 2021. *Republic of Uzbekistan: 2021 Article IV Consultation-Press Release; and Staff Report*, stating: "SOEs account for nearly half of (recorded) output and more than three quarters of tax revenues."

[42] The total number of strategic SOEs according to Presidential Decree No.UP-6096 from 27.10.2020 is 32 companies; just 18 were selected for in-depth study based on their size and availability of data.

estimated total SOE employment. Most of these are JSCs operating in key strategic markets such as mining, electricity, energy, communications, railways, and air transport (Table 1).

**Table 1.Largest 19 SOEs (based on operating revenues) and their key role in the Uzbek economy, 2019**

| Name | Sector | Operating Revenues (million USD) | Employees |
|---|---|---|---|
| Navoi Mining and Metalurgy Complex | Mining | 3,446.3 | 58,019 |
| Almalyk Mining and Metallurgical Combine JSC | Mining | 1,957.8 | 36,863 |
| Uzbekneftegaz JSC | Mining | 1,067.8 | 14,283 |
| Uzbekistan Metallurgical Combine JSC | Manufacturing | 567.8 | 9,770 |
| Coca-Cola Ichimligi Uzbekistan LLC | Manufacturing | 164.8 | 1,650 |
| National Electric Networks of Uzbekistan JSC | Electricity | 935.9 | 4,403 |
| Talimarjan Thermal Power Plant JSC | Electricity | 214.3 | 1,251 |
| Toshkent Issiqlik Elektr Stansiya Aksiyadorlik Jamiyati | Electricity | 156.9 | 1,096 |
| New Angren Thermal Power Plant JSC | Electricity | 156.5 | 1,706 |
| Committee of Motorways of the Republic of Uzbekistan (Andijan branch) | Construction | 1,844.1 | 205 |
| Repair and restoration service SUE | Construction | 525.8 | 6 |
| Uztransgaz JSC | Energy transport | 2,458.3 | 8,002 |
| Uzbekistan Railways JSC | Railways | 936.7 | 89,270 |
| Uzbekistan Airways JSC | Air transport | 231.8 | 5,519 |
| Uzbektelecom JSC | Communications | 308.6 | 16,232 |
| Uzbekistan National Bank (O‘zbekiston Respublikasi Tashqi iqtisodiy faoliyat milliy banki) | Banking | 237.4 | n.a. |
| Industrial Construction Bank (SQB) | Banking | 157.8 | 3,902 |
| Asaka Bank JSC | Banking | 108.5 | 2,135 |
| Uzshahar (“O‘zshahar”) Qurilish Invest LLC | Management consulting | 428.0 | 188 |
| **TOTAL:** | | **15,904.97** | **254,500** |

Source: WBG BOS database for Uzbekistan, as of November 2022.

Notes: Uzbekneftegaz JSC was reorganized into three independent companies as per Decree PP4388 on July 9, 2019.

## Performance of the SOE Sector

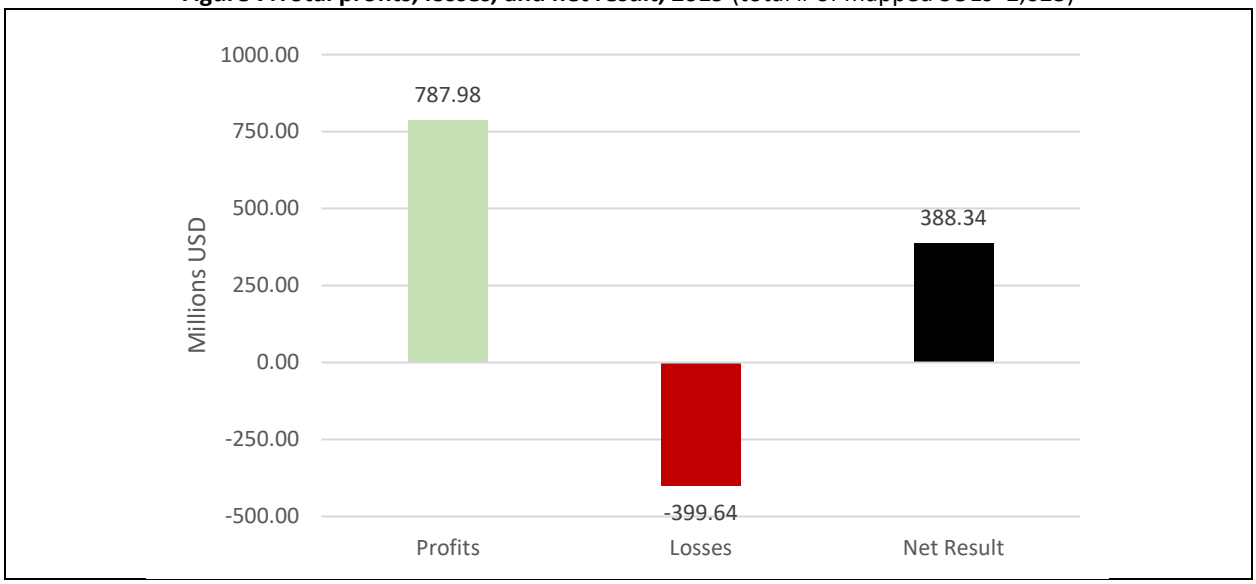
19. **The ways in which SOEs perform are closely interrelated**. For example, financial stress due to fixed prices (tariffs) and operational inefficiencies may be directly linked to poor access and poor service delivery quality, especially in the utility and infrastructure sectors. Against this backdrop, the current section briefly assesses two specific dimensions of SOE performance. First, the financial performance

analysis focuses on SOE profitability and draws from financial SOE data provided by the WBG BOS database for 2019. SAMA's database was also used for the profitability analysis of large SOEs in 2020. Second, the analysis of service delivery performance refers to the coverage and quality aspects of transport, energy, telecommunications, and water and sanitation services. Operational performance was not considered due to data constraints.

### *Financial Performance*

20. **A snapshot of profits and losses drawn from the WBG BOS Database indicates that overall, SOEs (excluding those from the financial sector) generated net profits of almost USD 400 million in 2019** (Figure 7). The bulk of these profits were generated by SOEs operating in sectors such as mining, manufacturing, and energy.

**Figure 7.Total profits, losses, and net result, 2019** (total # of mapped SOEs=2,023)




Source: WBG BOS database for Uzbekistan, as of November 2022
Note 1: Caveat: This provides information for about 40 percent of the entities in total, for which data about profits and losses is available.
Note2: 31 SOEs from the financial sector were excluded.

21. **As expected, these results were mostly driven by the financial performance of a few large companies**. According to the WBG BOS database, the top 10 profit-making and top 10 loss-making SOEs (excluding those in the financial sector) reported a net income of USD 690 million and negative USD 379 million in 2019, respectively. Most highly profitable SOEs belong to the extractive and manufacturing sectors, while high losses are observed in SOEs operating on electricity and transportation (see Table 2). Also, according to SAMA's information, based on 1,903 SOE financial statements for 2020, the most profitable 20 SOEs made UZS 9.5 trillion (USD 912 million) in profits, while the total losses of the 10 poorest performing SOEs was UZS 6.1 trillion (USD 586 million).[43]

[43] Local currency figures were converted to USD values using the official exchange rate as of 31 December 2020 according to the Central Bank of Uzbekistan.

**Table 2.Top 10 profit-making and loss-making SOEs in Uzbekistan,2019**

| Company | Sector | Profit/Loss (USD million) |
|---|---|---|
| **Top 10 profit making** | | |
| Almalyk Mining and Metallurgical Combine Joint Stock Company | Mining of other non-ferrous metal ores | 250.5 |
| Navoi Mining and Metallurgy JSC | Mining of other non-ferrous metal ores | 241.4 |
| Uzbekneftegaz JSC | Extraction of natural gas | 48.0 |
| Uzavtosanoat JSC | Manufacture of motor vehicles | 45.4 |
| Uzbekistan Metallurgical Combine JSC | Manufacture of basic iron and steel and of ferro-alloys | 37.8 |
| Regional Electric Networks JSC | Trade of electricity | 24.4 |
| Coca-Cola Ichimligi Uzbekistan LLC | Manufacture of soft drinks; production of mineral waters and other bottled waters | 8.1 |
| Tashkentvino Combine JSC | Manufacture of wine from grape | 6.2 |
| Self-navigation center SUE | Service activities incidental to air transportation | 5.2 |
| Uzbekgeofizika JSC | Other manufacturing n.e.c. | 241.4 |
| **TOTAL:** | | **690.41** |
| **Top 10 loss making** | | |
| Uztransgaz JSC | Transport via pipeline | -215.5 |
| Transportation Power UK | Steam and air conditioning supply | -47.6 |
| Uzbekistan Railways JSC | Freight rail transport | -37.1 |
| Talimarjan Thermal Power Plant JSC | Production of electricity | -23.7 |
| Angren Thermal Power Plant JSC | Production of electricity | -20.8 |
| BucKa Cotton Ginning Plant JSC | Preparation and spinning of textile fibres | -9.9 |
| Uzbekkomir Coal Mining and Sale JSC | Mining of lignite | -8.4 |
| Paxtakor Footbol Club ("Paxtakor Futbol Klubi") PLC | Activities of sports clubs | -6.1 |
| New Angren Thermal Power Plant JSC | Production of electricity | -5.8 |
| Angren Heat Energy SUE | Steam and air conditioning supply | -4.2 |
| **TOTAL:** | | **-379.17** |

Source: WBG BOS database for Uzbekistan, as of November 2022
Note: Figures of profits and losses are net after taxes.

22. **The overall financial performance of the 19 largest SOEs (with operating revenues greater than USD 100 million) is mixed (**Table 3). Overall, these SOEs made a consolidated net profit of USD 484 million in 2019, accounting for 61 percent of all SOE profits. However, some of the largest SOEs also present particularly poor financial performance, such as Uztransgaz, which recorded losses of USD 215 million in

2019. The persistent and increasing losses of Uztransgaz may be explained at least in part by the subsidized fixed price. Despite restructuring of the sector in 2019 aimed ultimately to liberalizing prices, the pandemic prompted the government to fix the prices at the 2019 level.[44] These prices are significantly lower as compared to regional median of countries of Europe and Central Asia, and do not allow for the recovery of costs or modernization of outdated technological equipment.[45] For the case of JSC Thermal Power Plants and its regional power plant companies, the resulting consolidated losses are mostly due to the inefficiencies of the power-generation process.

**Table 3. Financial performance of the largest 19 SOEs, 2019 (based on operating revenues)**

| Name | Sector | Net Profits (million USD) |
|---|---|---|
| Navoi Mining and Metalurgy Complex | Mining | 241.4 |
| Almalyk Mining and Metallurgical Combine JSC | Mining | 250.5 |
| Uzbekneftegaz JSC | Mining | 48.0 |
| Uzbekistan Metallurgical Combine JSC | Manufacturing | 37.8 |
| OOO SP "Coca-Cola Ichimligi Uzbekistan" | Manufacturing | 23.4 |
| National Electric Networks of Uzbekistan JSC | Electricity | 2.2 |
| Talimarjan Thermal Power Plant JSC | Electricity | -23.7 |
| TOSHKENT ISSIQLIK ELEKTR STANSIYA AKSIYADORLIK JAMIYATI | Electricity | -3.6 |
| New Angren Thermal Power Plant JSC | Electricity | -5.8 |
| REGULAR USE OF UP ANDIZHAN ROADS | Construction | 2.9 |
| Repair and restoration service SUE | Construction | 0.0 |
| Uztransgaz JSC | Energy transport | -215.5 |
| Uzbekistan Railways JSC | Railways | -37.1 |
| Uzbekistan Airways JSC | Air transport | 2.4 |
| Uzbektelecom JSC | Communications | 1.3 |
| Uzbekistan National Bank (O'zbekiston Respublikasi Tashqi iqtisodiy faoliyat milliy banki) | Banking | 83.1 |
| INDUSTRIAL CONSTRUCTION BANK (SQB) | Banking | 63.6 |
| Asaka Bank JSC | Banking | 12.7 |
| Uzshahar ("O'zshahar") Qurilish Invest LLC | Management consulting | 0.8 |
| **TOTAL:** | | **484.4** |

[44] Presidential Decree of 9 July 2019 reorganized JSC Uzbekneftegaz into three independent companies: JSC Uzbekneftegaz, JSC Uztransgaz and JSC Hududgaztaminot. (JSC Thermal Power Plants company, JSC National Electric Networks of Uzbekistan and JSC Regional Electric Networks).

[45] See World Bank (2021). *Assessing Uzbekistan's Transition. Country Economic Memorandum*, p. 195

Source: WBG BOS database for Uzbekistan, as of November 2022.

### *Service Delivery Performance*

23. **Financial stress due to price controls and operational inefficiencies may translate into weaker overall service delivery performance, such as poor access and quality of key services.** This section considers market outcomes in terms of coverage, reliability, and quality of services for several key sectors including transport, energy, telecommunications, and water, i.e., all sectors where large SOEs are present and their potential to have a large positive (or negative) social and economic impact is significant.

*Transport*

**24. With Uzbekistan being a double landlocked country, trading costs would be high notwithstanding the relatively poor quality of logistics infrastructure and services, time delays, and uncertainties imposed by present trade regulations.**[46] The number of trade partners both on the export and import side have been increasing and diversifying in recent years—increasing pressures on existing infrastructure and supplying quality and efficiency improvements, as well as expansion of transport networks.[47] Rail and road transport are the two leading modes of transport, and SOEs are highly prevalent in both sectors.[48] While railway remains key for transporting traded goods, the share of road transport increased steadily during 2015–2018, particularly for export cargo—but service quality remains relatively low.[49] Long-haul road transport and civil aviation are emerging as especially strong competitors for high-value, time-sensitive merchandise, especially containerized freight.[50]

25. **Although Uzbekistan has taken important steps to improve transport corridors and associated services, it still lags most of its neighbors.** While Uzbekistan's rank in the World Bank's Logistics Performance Index rose from 118$^{th}$ in 2016 to 88$^{th}$ in 2023, the country still lags Kazakhstan (79$^{th}$). High transportation costs are a key challenge in the Uzbek transport sector—for example, farmers and small and medium enterprises face transport costs of up to 200 percent of production costs. In road transport, a limited and aging domestic trucking fleet only exacerbates poor quality of service, inefficiencies, and high costs, with the result being that foreign companies carry more than 80 percent of tradable goods. According to the World Bank (2021)[51], the dominance of SOEs in air and railway transport sectors in Uzbekistan is one of the main impediments to services trade development going forward.[52]

*Electricity*

[46] See: World Bank (2021). *Assessing Uzbekistan's Transition. Country Economic Memorandum*.

[47] According to the Eurasian Research Institute, China and Russia remain as key export partners, despite the impact of the COVID-19 pandemic. On the import side, the largest providers are China (22 percent), followed by Russia (20 percent) and Kazakhstan (10 percent). See https://www.eurasian-research.org/publication/transport-strategy-of-uzbekistan-current-developments/

[48] In rail, the state-owned owner and operator "Uzbekiston temir yullari" (UTY) remains as the only owner of physical assets and provider of railway transport services to consumers, including Metropoliten services in Tashkent. UTY also has extensive holdings (33 subsidiaries, according to the BOS database), including in sectors unrelated to rail, such as agriculture. In road, there are around 20 SOEs engaged in freight logistics services and 50 in urban and suburban passenger transport; considering road construction, at least 140 SOEs are captured by the BOS database for this sector.

[49] Eurasian Research Institute, referring to CAREC (2021). *Railway Sector Assessment for Uzbekistan.*

[50] World Bank (2020). *Uzbekistan. Building Blocks for Integrated Transport and Logistics Development. Policy Paper.* .

[51] See: World Bank (2021). *Assessing Uzbekistan's Transition. Country Economic Memorandum*.

[52] See: World Bank (2021). *Assessing Uzbekistan's Transition. Country Economic Memorandum*., p.132.

26. **Overall coverage in the energy sector, particularly downstream for consumers and businesses, has improved significantly in recent years, though more is needed to reduce energy insecurity.** Since 2012 electricity coverage has reached 100 percent of the population,[53] but blackouts are relatively frequent. In 2019, Uzbekistan experienced outages 1.9 times/month, which is higher than regional comparators, such as Kazakhstan (0.5/month), Kyrgyzstan (0.9/month) and Russia (0.2).[54] Scheduled blackouts, especially during winter months, are frequent due to the need to carefully balance supply with surges in demand. During peak load periods, up to 93 percent of thermal power plant (TPP) capacity is in use, which is why power consumption restrictions were introduced.[55] Leakages are also a problem in the transmission and distribution networks—in 2020 approximately 2.7 percent of electricity was lost in the main transmission network and another 12.8 percent in the distribution networks.

27. **Despite broad based reform in 2019 to transition from an SOE-intensive and heavily subsidized energy sector model to a more competitive market, energy insecurity persists.** Uzbekenergo, the former vertically integrated SOE, was restructured into three separate SOEs covering electricity generation (Thermal Power Plants JSC and Uzbekhydroenergo), transmission and distribution (National Electricity Grid of Uzbekistan JSC) respectively. But energy security is still a challenge: blackouts are only expected to worsen with population and economic growth, especially if critical investments in Soviet-era equipment are delayed.[56] As such, equipment upgrade and network expansion along with market reforms with a view to improving service delivery remain high on the GoU's current agenda. The establishment of an independent market regulator, privatization of energy assets, and eventually tariff deregulation are already in the pipeline and will be central to efforts to establish a more efficient market and improve service delivery.[57]

*Telecommunications*

28. **Uzbekistan is well-positioned to profit from a vibrant digital economy, but shortcomings in internet coverage persist, despite improvements in recent years.** Uzbekistan is the largest market in Central Asia by population, with a large young, rapidly growing labor force. As of 2018, the ICT sector reportedly employed around 29,000 people, working in 1,400 related enterprises, for a total contribution to GDP equivalent to 2.2 percent.[58] Notable progress in recent years includes improvements in the speed of mobile and fixed Internet—mobile internet increased by almost 55 percent between 2021 and 2022, while fixed internet speeds increased by around 97 percent.[59] Nevertheless, almost 30 percent of the population still do not have access to the internet, and annual growth is small—internet users increased

[53] World Bank Global Electrification Database from "Tracking SDG 7: The Energy Progress Report").
[54] See World Bank Enterprise Surveys data, available here: https://data.worldbank.org/indicator/IC.ELC.OUTG.
[55] IEA Energy Policy Review for Uzbekistan 2022, available here: https://iea.blob.core.windows.net/assets/0d00581c-dc3c-466f-b0c8-97d25112a6e0/Uzbekistan2022.pdf
[56] The grids of the three ex-Soviet republics Kazakhstan, Kyrgyzstan, and Uzbekistan are interconnected, and via Kazakhstan are linked to the Russian power grid which they can use to cover unexpected shortages. Widespread blackouts occurred in November 2020, early 2021, and most recently in January 2022, when a massive power outage caused by a short circuit in the electricity system of Uzbekistan left Kyrgyzstan, Uzbekistan and part of Kazakhstan without power.See IEA 2022, referring to KEGOC (2022), "The cause of the 25 January 2022 accident in the power grids of Kazakhstan, Uzbekistan and Kyrgyzstan has been revealed," https://www.kegoc.kz/en/press-center/press-releases/155880/..
[57] Currently, electricity is sold by generators at regulated prices that are expected to cover all generating costs, and electricity is in turn sold to consumers, including large industrial users, at fixed rates.
[58] IFC-World Bank (2018) Country Private Sector Diagnostic (CPSD) for Uzbekistan (unpublished), page 20.
[59] According to data collected by Ookla and reported via Datareportal, at https://datareportal.com/reports/digital-2022-uzbekistan

by only 1.4 percent between 2021 and 2022.[60] In addition, domestic internet transport costs are high and generally unaffordable for the majority of the population.[61] Meanwhile, mobile connections are equivalent to 86.6 percent of the total population in January 2022, representing an annual growth of around 7 percent.

*Water*

29. **The water services and sanitation infrastructure in Uzbekistan dates principally from the Soviet era and requires extensive rehabilitation and renewal.** Despite continued efforts and spending to reform and upgrade the water services and sanitation infrastructure and services, asset replacement, maintenance and system expansion has been insufficient.[62] As a result there has been a stagnation or decline in water services, particularly in rural areas and district towns (or small and medium-sized cities), where most of the population resides,.[63] Data collected by UNICEF and the WHO indicates that access to piped connections is relatively high (87 percent), but those that receive safely managed water is considerably lower (59 percent)[64] Water supply access issues in rural areas and district towns are further exacerbated by higher-than-average population growth rates. Furthermore, continuity of service is a common and serious issue across the country, with many systems supplying water for less than 12 hours per day.[65] Outdated and oversized pumps, which lead to high operational costs, and power outages are often cited as causes of the intermittent services.

30. **Service-delivery challenges persist, notwithstanding notable improvements in recent years in the operational efficiency of water service providers**—comprised primarily of 14 regional "Suvokovas" (organized as SUEs).[66] Staff efficiency indicators are relatively good compared to global standards and bill collection efficiency has improved, from between 50-70 percent in 2011 to more than 90 percent in 2018. Similarly, since 2010 financial performance has also improved: while in 2010 many water service providers were not able to cover their costs, with net losses totaling US$2.5 million, most are now considered profitable—even if only marginally.[67] Despite these improvements, however, recent diagnostics by the

[60] Datareportal, at https://datareportal.com/reports/digital-2022-uzbekistan
[61] CPSD for Uzbekistan (unpublished), page 42.

[62] For example, from 1995 to 2014, Uzbekistan's total borrowing for improvements to these services amounted to US$ 344.1 million, the highest total for any country in Central Asia. See https://www.worldbank.org/en/news/feature/2017/08/30/uzbekistan-syrdarya-water-supply-project-photo-story
[63] Approximately 64 percent of the population resides in rural areas (including district towns).
[64] Up to 30 percent of water quality samples in non-urban areas were found not compliant with national standards. Joint Monitoring Program (JMP): Progress on household drinking water, sanitation and hygiene 2000-2017. Special focus on inequalities. New York: United Nations Children's Fund (UNICEF) and World Health Organization, 2019.
[65] World Bank Project Appraisal Document Report No: PAD3040, February 2020, for a Water Services and Institutional Support Product (P162263).
[66] Each region of Uzbekistan has its own Suvokova, plus Tashkent city is an independent Suvokova (14 Suvokovas in total) – legally created in January 2016. A review of 2018 Ministry of Housing and Communal Services (MHCS) data indicates that around 17.3 million people (53 percent of total population) access water supply services through the Suvokova. An estimated 6.4 million people (19 percent) receive services from other providers (small scale private operators and community-based organizations) and some 9.1 million (28 percent) have no piped service or reliant of self-supply.
[67] Based on unverified 2017 data from Ministry of Housing and Communal Services, cited in World Bank Project Appraisal Document Report No: PAD3040, February 2020, for a Water Services and Institutional Support Product (P162263). This is also consistent with the profits data captured in the BOS Database for Uzbekistan.

World Bank identified institutional and resource limitations, as well as the absence of an enabling environment, for private entry to be key constraints to improved sector performance.

# Chapter 3. SOEs Effects on Markets

31. **Institutional and regulatory safeguards to promote competition on a level playing field are under active development in Uzbekistan.** World Bank (2021) explains in detail the remarkable efforts of the GoU in recent years to foster private sector development and reduce state participation (and related distortions) in markets.[68] Despite much progress, perceptions-based indicators suggest that much more remains to be done to foster dynamic markets. According to the 2022 Bertelsmann Stiftung's Transformation Index (BTI), Uzbekistan still lags regional peers with respect to market organization and competition policy—which broadly captures barriers to market entry, competition law and enforcement, and distortive subsidies.[69] This is despite improvements on the BTI between 2016 and 2020 and reflects the relatively limited impact (to-date) of competition-related institutional reforms, particularly in relation to SOEs.

32. **The private sector faces important risks associated with weak competition.** According to the Economist Intelligence Unit 2022 data, there is a perceived high risk of unfair competitive practices, limited integrity of accounting practices, discrimination against foreign companies, and price controls, all of which may affect firms' ability to compete effectively and may reduce the incentives to invest in Uzbekistan.[70] These perceptions may explain, at least in part, why the entry of new formal firms remains well below the regional average, and is lower than predicted by Uzbekistan's income per capita.[71] Moreover, as these formal firms do not grow over time, this may be due to market frictions, including the significant presence of large, often dominant, SOEs in markets and the existence of an unlevel playing field as between SOEs and private firms.[72]

33. **Risks to competition and perceived challenges to private sector development merit scrutiny of both direct and indirect market interventions by the government**—directly as a provider of goods and services through SOEs and indirectly through regulation and market oversight (e.g., price controls, subsidies, and antitrust enforcement), which can reinforce dominance and monopoly positions of state-owned incumbents. To achieve the GoU's goals of "increasing the competitiveness of the national economy," and obtaining "a sharp increase in private investment" as set out most recently in Presidential Decree #-101 (April 2022), it is critical that SOEs are subject to greater market discipline, preferential treatment in favor of SOEs is phased out, and state ownership is limited to markets in which there is a strong economic or strategic justification.

[68] See: World Bank (2021). *Assessing Uzbekistan's Transition. Country Economic Memorandum*.
[69] Uzbekistan ranks 10th of 13 Post-Soviet Era countries as classified by BTI on both the *Market Organization* and *Competition Policy* indicators. For more information, see the BTI 2022 Codebook for Country Assessments, available here: https://bti-project.org/fileadmin/api/content/en/downloads/codebooks/BTI2022_Codebook.pdf
[70] Uzbekistan scores 95 out of 100 on the EIU legal and regulatory risk index.
[71] For an overview, see also Iootty, Ospanova, and Beksultan, "Boosting private sector development in Uzbekistan", available at: https://blogs.worldbank.org/europeandcentralasia/boosting-private sector-development-uzbekistan
[72] Analysis based on data from the 2019 World Bank Enterprise Surveys indicates that formal private firms, especially in manufacturing and service sectors, have not grown as quickly in comparison to those in other major transition economies such as Vietnam and Russia.

## How can SOEs affect competition and private sector development?

34. **Widespread state ownership of assets—especially in sectors where the economic rationale for state ownership is weak—is frequently associated with distortions to competition and compromised viability and profitability of private companies.** This is because SOEs often enjoy privileges and immunities not available to their private-owned rivals which may distort competition in the market. For example, distortions can emerge from the regulatory framework (e.g., price regulation, de jure monopoly rights), from situations where SOEs are not subject to the same market discipline as private sector firms (e.g., exempt from antitrust and bankruptcy laws, no requirement to earn a commercial rate of return), and from SOEs playing both the role of regulator and market participant (e.g., an SOE sets utility tariffs while also operating as a producer/supplier or acts as a main shareholder in producers/suppliers). Other possible distortions may include preferential access to financing (e.g., low-interest and state-backed loans), reduced-fees (or non-payment) for access to essential facilities such as electricity or water, and outright cash transfers or other compensation mechanisms that are not available under similar conditions to private sector firms.

35. **In this context, the adoption of laws, policies, and procedures that support competitive neutrality is essential to level the playing field between SOEs and private sector firms.** Competitive neutrality is defined as a set of principles that can inform law and policy, as well as implementation by government agencies, according to which all enterprises, public or private, domestic or foreign, should face the same set of rules, and where government's contact, ownership or involvement in the marketplace (in fact or in law) does not confer an undue competitive advantage on any actual or potential market participant. Competitive neutrality policy assumes that markets that are competitively neutral foster a level playing field, which allows resources to flow to efficient producers, regardless of whether they are either privately or state owned. In this sense, competitive neutrality is a critical element of an effective competition policy framework; it advocates for a subsidiary role of the state in the market (limiting direct involvement through ownership to situations of market failure); it supports entry by new (private) players and competition; and it promotes greater efficiency and productivity, which can lead to a more efficient allocation of resources.[73] The fundamental theoretical components of competitive neutrality are:

- SOEs must be subject to the same rules, regulations and policies as private peers in commercial sectors so as to create a level playing field.
- Contact with the State (e.g., through state support measures, procurement, licensing, etc.) should not bring any undue competitive advantages to any market participant.

## Subsidiary role of the State in the economy: what rationale underpins State ownership?

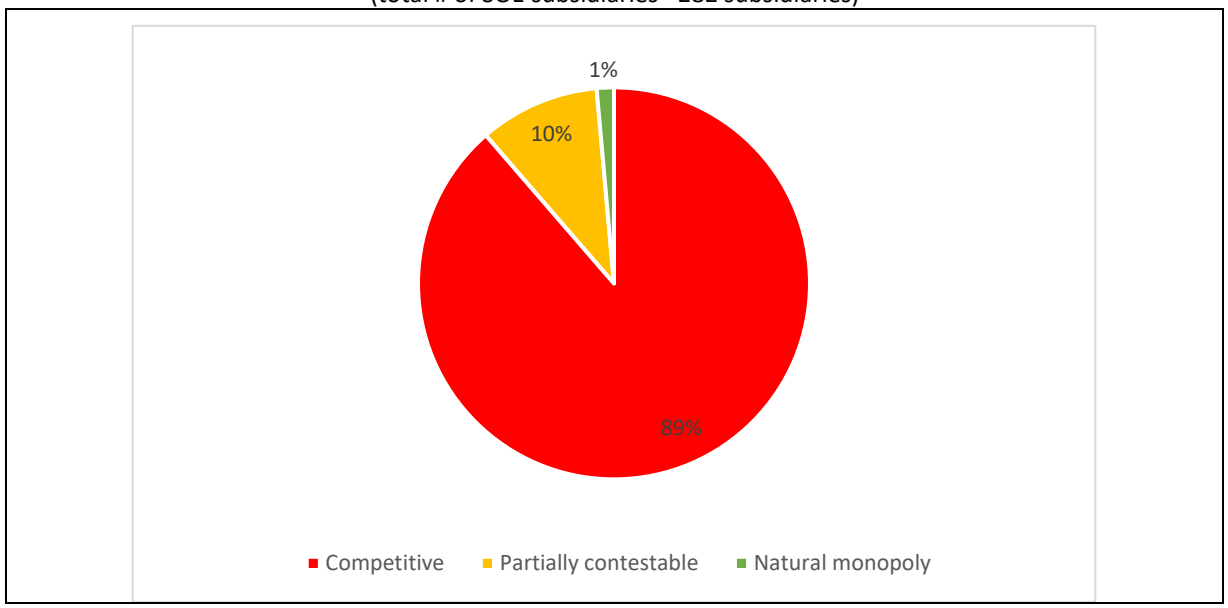
36. **Traditionally, Uzbekistan has created SOEs to deliver goods and services across all sectors of the economy, regardless of the need to correct a market failure—**a situation where private sector firms would consequently provide goods and services in suboptimal quantities, resulting in an inefficient market equilibrium and a social welfare loss.[74] According to the principle of subsidiarity, the government should

[73] OECD. 2009. *Policy Roundtables, State Owned Enterprises and the Principle of Competitive Neutrality*, Introduction.

[74] Market failures can be objectively identified based on the underlying characteristics of the specific markets—these can be defined as cases where private actors would provide goods and services in suboptimal quantities, resulting in an inefficient market equilibrium and a social welfare loss. See Dall'Olio et al. (forthcoming) for further detail.

play a subsidiary role in markets unless direct ownership is justified based on the existence of market failures – where the private sector would not provide the service/good in a competitive and efficient manner without some form of government intervention. However, in cases where the private sector could provide the service/good in a competitive and efficient manner, the presence of an SOE is harder to justify from an economic perspective – and the potential negative effects on the market and development of the private sector could be more pronounced. If this is the case, it is typically more efficient and effective for the State to act as a regulator. Applying this principle to the case of Uzbekistan, it is arguably difficult to justify from an economic perspective the existence of SOEs in some sectors, such as commercial banking, production and sale of bread and wine, or hotel accommodation. In addition, there are many SOE subsidiaries in downstream or ancillary competitive sectors in Uzbekistan. According to the WBG BOS database, there are at least 282 subsidiary SOEs that are part of larger SOE conglomerate groups. Almost 90 percent (250) of these entities are present in typically competitive sectors (Figure 8) such as wholesale and retail trade, manufacturing of food, textiles, and chemicals, warehousing and storage, and financial services. These relationships likely crowd out private players and could distort prices along entire value chains.

**Figure 8.SOE subsidiaries by sector type, 2019**
(total # of SOE subsidiaries =282 subsidiaries)




Source: WBG BOS database for Uzbekistan, as of November 2022

37. **Aside from limited circumstances where state ownership has been legally required—based on national security and public safety—the legal framework underpinning state ownership of assets is nascent.** The Constitution states only that ownership in any form is protected by the law. The Property Law explicitly requires exclusive state ownership for certain assets and sectors of the economy, including, among others, "enterprises of national significance."[75] These enterprises are not explicitly defined by the

[75] Other assets and sectors where state ownership is mandated include cultural and historical heritage, public financial institutions and banks, and educational and social institutions, among others. For the full list see Art. 9 of the Law "On Property [Ownership] in the Republic of Uzbekistan" No. 152-XII, dated October 31, 1990. The full list of activities where state ownership is mandated as follows: (i) land and its subsoil, internal waters, flora and fauna,

Law, but are understood to concern those entities and activities related to national security or public safety.[76] The same law grants the President the authority to include other assets and enterprises in the list of "state-owned assets", and in several cases this authority has been exercised. For example, Presidential Resolution No. 2635 from 2016, provided for a list of "strategic SOEs", which are fully owned by the state and not eligible for privatization.

38. **Some legal limitations have been placed on the creation of new SOEs since 2020.** Pursuant to Presidential Decree #-6019 of 2020, the creation of economic entities owned at least in part by the Government or entities affiliated with them—with the exception of the areas of defense and national security—is not allowed if: (i) there are *five or more* private sector firms already operating in the relevant market ("the rule of 5"); or (ii) it relates to markets where State bodies have the powers of licensing, registration, accreditation, and issuance of permits. The Decree also provides that SOEs that are *de facto* single suppliers (or designated as such by the Government), or occupy a dominant market position, should not create affiliated entities in related areas (see Box 2). Moreover, the Decree tasks the former AMC – now the CPCPC - and SAMA with scrutinizing proposals to establish new SOEs against these criteria and indicates that CPCPC consent should be obtained prior to the establishment of new SOEs. This is also reflected in the final version of the Competition Law, approved by the Senate in March 2023.[77]

air basin within the territory of the republic; (ii) property of public authorities and administration of the Republic of Uzbekistan; (iii) cultural and historical heritage; (iv) the Republican budget, republican and state banks, insurance funds, reserve and other state funds; (v) enterprises of State [national] significance, state higher educational institutions, social and cultural facilities and other state property that are vital for the sovereignty and economic independence of the republic. In the case of non-agricultural land, a 2021 law now allows natural and legal persons to privatize non-agricultural land plots for commercial or housing purposes (see Law of the Republic of Uzbekistan No.ZRU-728 "On the privatization of non-agricultural land plots" (dated 15.11.2021)).

[76] See Article 4 of the Law of the Republic of Uzbekistan No. 425-XII "On denationalization and privatization", dated November 19, 1991. The entities and activities explicitly excluded from privatization are: i. enterprises associated with the military services; ii. enterprises and facilities that carry out research, development work, development, production and sale of X-ray equipment, instruments and equipment using sources of ionizing radiation; iii. enterprises and facilities engaged in mining, production, transportation, processing of radioactive elements, disposal of radioactive waste, sale of uranium and other fissile materials, as well as products made from them; iv. enterprises engaged in the development, production, repair and sale of weapons and ammunition, protective equipment, military equipment, spare parts, components and devices for them, pyrotechnic products, as well as special materials and equipment for their production; v. enterprises and organizations engaged in the production, repair and sale of hunting and sporting firearms and ammunition, as well as edged weapons (except for knives of souvenir national types); v. enterprises for the production of potent poisons, narcotic and poisonous substances, as well as those engaged in sowing, cultivation and processing of crops containing narcotic and poisonous substances; vii. specialized enterprises and organizations engaged in construction and installation works, operation and repair of facilities (installation of equipment, systems and apparatus) of nuclear energy and strategic facilities; specialized enterprises transporting explosive and toxic substances.

[77] The new Competition Law entered into force in October 2023, after the completion of the current report.

**Box 2.SOEs identified by the competition authority as "dominant" in relevant markets**

Many Uzbek SOEs operating in competitive sectors are key market players have been classified as "dominant" and are listed in a central registry maintained by the former Antimonopoly Committee (AMC), now the Competition Promotion and Consumer Protection Committee.(CPCPC).[78] Maintenance of a registry of dominant firms is not in line with international best practices[79] because classifying companies as dominant based solely on market shares is not sufficient, reliable data is difficult to obtain, and any such list is difficult to maintain as market shares shift over time.[80] Nevertheless, the AMC identified five SOEs operating in the metal and machinery manufacturing as being dominant in their respective markets.[81] In food production, of the 10 enterprises classed as dominant at least 8 are SOEs—engaged in activities such as the production of cooking oil.[82] In motor vehicles manufacturing, including parts and accessories, and electrical and electronic equipment for such, 4 SOEs have been classed as dominant by the AMC.[83]

39. **Although these criteria place some bounds on state ownership, they do not constitute a full subsidiarity analysis to determine whether there is a clear justification for it.** The current framework results in a static analysis that does not require consideration of *potential* private entry in the absence of an SOE, which could be encouraged through other tools such as subsidies or regulatory reform. Nor does it explicitly provide for a determination against state ownership on the basis that the most efficient approach would be to import a given product or service. More insight regarding the necessity for direct state participation in markets via SOEs could be gleaned if the AMC also considered market failures, inherent cost structures in the activity, current market dynamics, and the potential role for private sector firms. Importantly, Presidential Decree #-6019 tasks the former AMC – now the CPCPC- with identifying constraints to competition such as pervasive price controls, distortive state aid, extensive SOE presence, and presence of legal monopolies, but these aspects are not yet formally incorporated into the assessment for establishing or divesting SOEs.

40. **The Law on State Property Management—approved by the Senate in June 2022[84] and signed by the President of the Republic in March 2023—introduces additional limitations on state ownership.**

[78] See the full list here: https://antimon.gov.uz/en/open-data/the-state-register-of-business-entities-that-occupy-a-dominant-position-in-the-product-or-financial-market/

[79] According to the International Competition Network (ICN), dominance may be defined in behavioral, structural and/or durability terms. The EU, Canada, the United States, Australia, and most Latin American countries, among others, use a behavioral definition, which takes into account the ability of firms to act independently from the competitive constraints of the market. See http://www.internationalcompetitionnetwork.org/uploads/library/doc353.pdf.

[80] Rather, the existence of dominance should be established by defining a relevant product and geographic market and proving the existence of power over price or rivals through criteria such as market share, in addition to entry barriers, demand elasticity, strength of rivals, market dynamism. Since dominance will ultimately vary based on the market scrutinized and market dynamics may change, maintenance of a registry can be misleading and impractical.

[81] These are: JSC "Almalyk MMC", JSC "Uzbek plant for procurement and processing of scrap, non-ferrous metal waste", JSC "Uzmetcombinat", DP "Andijan Mechanical Plant", and JSC "Aggregate Plant".

[82] These are: JSC "Biokimyo", JSC "Andijan Biochemical Plant", JSC "Bektemir spirt" experimental plant, JSC "Kokand Biokimo" (chemicals production), a Group of 16 entities that make up the Association "Uzyogmoysanoat" (cooking oil prod.), JSC "Uchqo'rgon-yog" (cooking oil), JSC "Turon-Xojeli" (cooking oil), LLC "Vangosi Agroexport.

[83] JSC "UzAutoMotors", JSC "Avtooyna" (front glasses for vehicles), JSC "Samavto" (coach/bus production), JSC "Jizzakh Battery Plant".

[84] https://davaktiv.uz/en/news/the-law-on-the-management-of-state-property-was-approved-by-the-senate-of-the-oliy-majlis-of-the-republic-of-uzbekistan

Specifically, according to this law, the government should retain only objects of strategic interest and security of the population, natural monopolies (that are otherwise unprofitable for the private sector), and entities legally excluded from privatization (e.g., those related to defense and security). In addition, the law proposes to "withdraw" state assets that are deemed to be "excessive, unused or misused."

41. **Although not legally required, state ownership is frequently found in cases of natural monopoly entities.** "Natural monopoly entities" are officially designated by former AMC[85]- now CPCC - as those active in sectors where "due to technological features, it is impossible or economically inexpedient to create competitive conditions for meeting the demand for a certain type of goods, works and services."[86] The Law on Natural Monopolies does not generally mandate state ownership of entities operating in natural monopoly sectors, but it establishes mandatory State regulation over the activities of entities in certain sectors, including price controls;[87] indeed, SOEs operating in these sectors are generally also entities of strategic significance which may be privatized pursuant to Presidential decision.[88] According to Presidential Decree #-6019 of 2020, the former AMC – now CPCC - is tasked with revising the criteria for classifying sectors as natural monopolies and reducing the number of such areas, as well as improving the conditions of competition therein.[89] As of January 2023, the State Register of Enterprises of Natural Monopolies lists 134 natural monopoly enterprises for 11 types of goods (works, services).[90]

42. **Few CPCC-designated "natural monopoly entities" operate in sectors exhibiting such characteristics.** For example, manufacturing and construction in railways are typically considered in most countries as competitive activities, based on observed cost structures, barriers to entry, and market failures, while passenger and freight transport services are classified as partially contestable due to network economies (see Box 3). In Uzbekistan, however, rail-related activities are classified as "natural monopolies". Also plumbing services—generally considered to be competitive—was listed by the AMC as a service provided by a "natural monopoly enterprises" and, in accordance with the Law, the State maintains a mandatory regulation over the entities functioning in the sector.

43. **In addition to owning assets in natural monopoly sectors, the government also regulates these sectors through price controls.**[91] This is the case, for example, for utility tariffs, rail transport, and fertilizers, among others. Due to significant sub-additivities[92] in cost structures and consequent economies of scale, it is most efficient for only a single market player to operate in natural monopoly markets, and governments often choose to control the market power of the monopolist through price regulation and/or

[85] The full list of natural monopolies can be accessed here: https://antimon.gov.uz/en/open-data/the-state-register-of-natural-monopolies/

[86] Law N 398-I "On Natural Monopolies", April 24, 1997.

[87] These are the sectors where the State maintains mandatory regulatory control: i) transportation of oil, oil products and gas through the pipeline; ii) production and transportation of electrical and thermal energy; iii) rail transportation, taking into account the use of railway infrastructure; iv) public postal services; v) plumbing and sewerage services; vi) air navigation services, ports and airports.

[88] Presidential Resolution No. PP-2635, dated October 17, 2016 "On measures to further Improve corporate governance in joint-stock companies with prevailing State shares". Through this, the GoU identified 14 "strategic" joint-stock companies in which 100 percent of ordinary shares were held by the state but which could be privatized subject to later Presidential action.

[89] Presidential Decree No. UP-6019, Roadmap Item 23.

[90] https://antimon.gov.uz/ru/uslugi/otkrytye-dannye/reest-subektov-estvestvennyh-monopoliy/

[91] The Law "On Natural Monopolies" prescribes that "draft prices (tariffs) for commodities, which are produced by natural monopoly entities, shall be assessed by an authorized state body within one week, taking into account their influence upon products for customers".

[92] Cost sub-additivity implies that the cost of a combined business operation is less than the sum of the cost of two separate businesses.

direct provision, through SOEs. In fertilizers, for example, SOEs dominate both the production and distribution sides, and price regulation applies to producers (with profitability set at 10 percent of the cost).[93] In rail, which is considered a "natural monopoly" activity, price controls apply to freight transport, but at a level that reportedly is not competitive with road transport options for perishables, time-sensitive cargo, and high value goods.[94] Since SOEs also often operate within soft budget constraints and may even play a role in setting the level of such regulated prices, it is difficult to set prices at such a level that can allow for meaningful market provision by private peers or for appropriate cost recovery.

**Box 3.A new taxonomy of sectors to guide SOE interventions in markets**

The analysis relies on a methodology developed by Dall'Olio et al. (2022b) to classify the sectors where SOEs operate - see Box 1 for more information on the WBG BOS Database. This methodology classifies all economic activities at the NACE 4-digit level into three broad sectors (competitive, partially contestable, and natural monopoly) based on the economic rationale—the intrinsic features and associated market failures—that might justify state ownership in an industry.

- Competitive sectors: those in which it is economically viable for many operators to provide the good/service; inherent market characteristics in these sectors, such as cost structure or demand characteristics, do not typically lead to significant market power and entry barriers are low (e.g., manufacturing of food and beverages, and taxi operation).
- Natural monopoly sectors: those in which it is more efficient to have one operator to provide the good or service as compared to many producers (e.g., energy transmission; water utilities, and postal activities with universal obligation); these sectors are characterized by high entry barriers that are the consequence of cost sub-additivity and economies of scale.
- Partially contestable sectors are a residual category in which it is economically viable for more than one operator to provide the good/service but there exist common market failures that often motivate direct provision through an SOE. The most common is under-provision because of some degree of market power.

This taxonomy allows SOEs to be classified based on their primary sector activity into one of the three main groups, which provides a snapshot of where governments participate most in the economy.

## Shaping SOE incentives and operating conditions to level the playing field

44. **A competitive neutrality gap analysis for Uzbekistan indicates that certain aspects of the legal framework combined with preferential treatment to SOEs, and a system of ad-hoc subsidies create an unlevel playing field.** First, SOEs are not subject to the same competitive pressure as private peers because of soft budget constraints and the lack of separation among commercial activities and public service obligations (PSOs). Second, even though most rules are equally applicable to both SOEs and private sector firms, some notable exceptions remain— e.g., "large towns forming" SOEs - such as large metallurgy and mining companies, around which towns are built - enjoy a longer period for external management to bring the company back to solvency. Therefore, creating more open and competitive markets to support private sector development will require not only to revise the legal framework to

[93] The Resolution of the Cabinet of Ministers of the Republic of Uzbekistan No. 149, dated February 28, 2018, introduced a mechanism for the sale of mineral fertilizers through exchange trading with 100 percent prepayment since January 1, 2018 and kept certain elements of State price regulation by setting a marginal level of profitability for producers of mineral fertilizers at 10 percent of the cost.

[94] See: CAREC (2021). Railway sector assessment for Uzbekistan. p.18-19 (accessed at https://www.carecprogram.org/uploads/2020-CAREC-Railway-Assessment_UZB_4th_2021-5-20_EN.pdf)

ensure SOE incentives are more aligned with those of private sector firms in terms of productivity growth and efficiency, but also to remove SOE legal exemptions and rationalize SOE subsidies (see Figure 9).

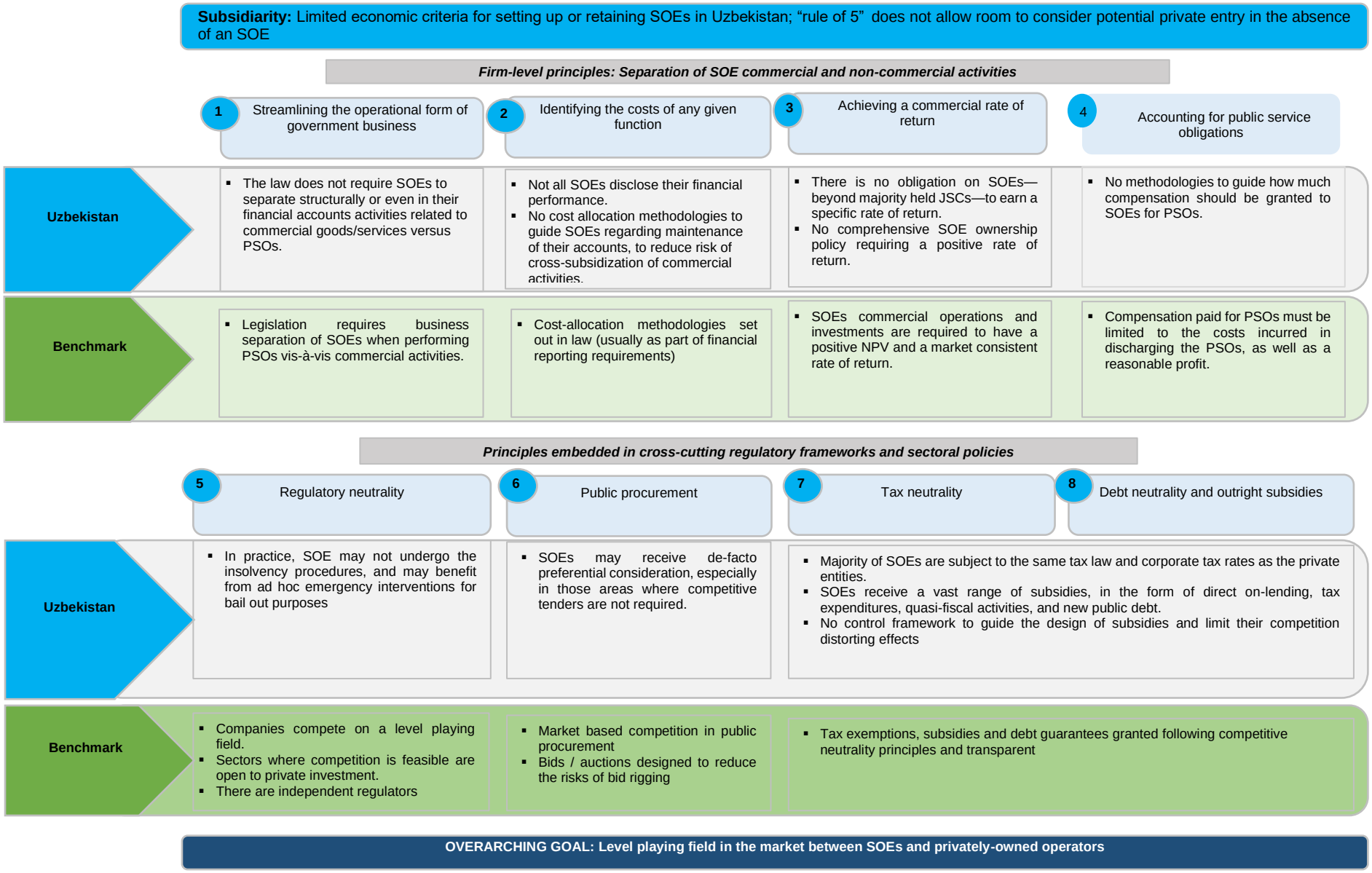
45. **On the one hand, there are several gaps with respect to the overall regulatory framework, including**:

(i) Corporate governance rules are not yet mainstreamed through all SOEs, which creates a lack of transparency with respect to public funding SOEs receive.
(ii) There is no methodology for the calculation of PSOs, which leads to situations of over and under-compensation.
(iii) SOE are not required to earn market-consistent rates of returns on their sale of assets, goods and services.
(iv) SOEs benefit from a few exemptions from laws that encourage market discipline, including the insolvency law.
(v) Certain types of SOEs are exempt from standard licensing requirements based on their legal status (e.g., SUEs).

46. **In addition, the *implementation* of the current regulatory framework and the way government agencies interact with SOEs requires further attention to ensure competitively neutral markets:**

(i) SOEs enjoy preferential access to finance through SOBs and/or government guarantees.
(ii) SOEs receive extensive state on-lending and ad hoc top-up subsidies, apparently on an as-needed basis.
(iii) SOEs appear to receive preferential access to land.
(iv) SOEs receive *de facto* preferential access to public procurement opportunities as a result of the overall structure and operation of the procurement legislation.

**Figure 9.A competitive neutrality gap analysis for Uzbekistan**



*Shaping SOE incentives and tightening budget constraints – creating competitive neutrality at the firm level*

47. **Certain key obligations should be placed on SOEs, and agencies tasked with their financing to create competitive pressure, strengthen budget constraints, and foster transparency.** Specifically, SOEs should be required to maintain separate accounts (or even functionally and legally separate structures) for their commercial activities, follow standardized cost allocation mechanisms, and earn a commercial rate of return on their commercial activities, to reduce the risk that public funds cross-subsidize commercial activities. In addition, the legal framework should be transparent regarding how the compensation paid to SOEs for PSOs will be calculated, and the compensation provided must be market based.

48. **The 2021 SOE Ownership Strategy[95] addresses key issues promoting competitive neutrality, but these issues would need to be transformed into legal obligations for meaningful impact.** First, per the Strategy, commercial activities are defined as those "aimed at increasing profits in an open and competitive market under conditions of fair competition or effective operation in a regulated market." Second, the Strategy claims that "SOEs should delineate between commercial and non-commercial activities, and report on them separately on a quarterly basis". Third, it stipulates that "SOEs engaged in commercial activities must be managed on the basis of a business plan that ensures the payment of dividends and sustainable profits". Fourth, it commits to introduce "clear and transparent mechanisms" for compensation to SOEs associated with PSOs—currently, no differentiation is made between commercial activities and PSOs when determining the amount to transfer to SOEs.[96] Finally, the 2021 Strategy commits to transform all commercial SOEs into JSCs or LLCs by 2025. Such key issues remain to be developed and adopted in practice, and, most importantly, they were not reflected in the Law on State Property Management that was approved by the Senate in June 2022 and promulgated by the time of finalization of this report.

49. **Enhanced corporate governance and public disclosure obligations for state majority owned SOEs corporatized as JSCs can incentivize improved performance and competition with existing or potential private peers.** As of 2016, SOEs corporatized as JSCs with at least 50 percent of state ownership must comply with the Corporate Governance Code, which is an otherwise voluntary set of rules focusing on the mandatory disclosure of financial information.[97] In particular, these SOEs—as opposed to other non-corporatized SUEs or minority-share JSCs—are required to maintain financial accounts in accordance with IFRS, complete annual financial audits, set specific investment targets, and achieve market efficiency,

[95] The Strategy builds on OECD Guidelines on Corporate Governance of State-Owned Enterprises and the World Bank's Toolkit on Corporate Governance of State-Owned Enterprises. Strategy for Reforming Management of Enterprises with State Participation (ownership) for the period 2021-2025, approved by the Resolution No. 166, dated 29 March 2021 of the Cabinet of Ministers.

[96] Based on discussions with government counterparts during a World Bank mission during 6-24 June 2022.

[97] The rules were adopted by the Commission on Improving the Efficiency of Joint-Stock Companies and Improving the Corporate Governance System, under SAMA. Decree No. PP-2635 (2016) https://www.norma.uz/nashi_obzori/utverjden_kodeks_korporativnogo_upravleniya_ao

profitability and high dividend yield.[98] The GoU adopted additional public disclosure obligations in 2020[99] requiring all majority (50 percent and beyond) state-owned JSCs and LLCs, as well as SUEs, to disclose various information on their websites starting in 2021, including quarterly and annual financial information, management and board composition, employment, and performance indicators. This was in addition to regulations specifying how JSC and LLC performance should be assessed, which involved principally an assessment of performance against past forecasts and did not go so far as to distinguish between PSOs and commercial activities or stipulate that SOEs should seek to make a commercial rate of return on the latter.[100] Comprehensive oversight and disclosure requirements in part aim to incentivize SOEs to improve performance.

### *Shaping SOE operating conditions and ensuring a level playing field (cross-cutting competitive neutrality principles)*

50. **A comprehensive implementation of competitive neutrality between SOEs and private sector firms also involves fostering a balanced operating environment.** This requires regulators to look beyond individual SOE incentive structures and consider whether SOEs receive preferential treatment in other ways, either de jure—e.g., through exemptions from competition or tax laws, preferences in procurement processes—or *de facto*, in terms of benefits (financial advantages or otherwise) SOEs may receive when they interface with government agencies and related actors, such as SOBs.

#### *a. Regulatory neutrality*

51. **SOEs frequently receive preferential treatment in cases of bankruptcy and economic insolvency.** For example, Presidential Resolution #-3253 of 2017 wrote off the uncollectible debt of several specific SOEs in the gas and fertilizer sectors, in conjunction with restructuring more broadly for firms deemed to operate in "fundamental sectors".[101] For example, Uzbekneftegaz (JSC) benefited from further debt restructuring on its loans through the Uzbekistan Fund for Reconstruction and Development (UFRD) at the GoU's initiative in 2018.[102] Furthermore, SOEs operating in the mineral fertilizer sector may benefit from selective exceptions in investment agreements—e.g. "Samarkandkimyo" (JSC) plant is exempted from certification of goods and materials, spare parts, technological units, instruments, spare parts for vehicles, fuels and lubricants.[103] The insolvency framework has been modernized recently with the enactment of the new Law on Insolvency, in April 2022; among other features, the Law removes several exemptions to SOEs, which used to be outside the scope of the insolvency procedures and could not be restructured in court. However, a few exceptions remain, like the possibility of "large towns forming" SOEs

[98] Other compliance requirements in Presidential Decree No. PP-2635 include the publication of annual reports and other information subject to mandatory disclosure, implementation of international best practice with respect to the transparency and accountability of their executive body, ensuring operational technologies are up-to-date and investment policy is geared towards such, and pursuing the continuous improvement of the professional level staff.
[99] Resolution No. 674 of the Cabinet of Ministers, "On measures to improve the system for disclosing information on business entities with the participation of the State and state unitary enterprises." (dated 30.10.2020)
[100] See "Regulations on the criteria for evaluating the performance of joint-stock companies and other business entities with a state share," approved by the Decree of the Cabinet of Ministers of the Republic of Uzbekistan dated July 28, 2015 N 207 (with latest amendment in 09.12.2020).
[101] See Presidential Resolution No. PP-3253, dated 04.09.2017 "On Preliminary Measures of State Support to the Fundamental Sectors of the Economy in the Period of Currency Markets Liberalization".
[102] Presidential Resolution No. PP-4029, dated 24.11.2018 "On Priority Measures of State Support to JSC Uzbekneftegaz. The UFRD is a 100% state-owned fund that finances investment projects in Uzbekistan.
[103] Resolution of the Cabinet of Ministers of the Republic of Uzbekistan No. 61, dated February 5, 2020.

- such as large metallurgy and mining companies around which towns are built - enjoying a longer period for external management to bring the company back to solvency. [104]

52. **In procurement, although recent reforms provide for non-discriminatory treatment and seeks to ensure that competitive selection methods are mostly applied, SOEs may still receive preferential treatment facilitated by the law** (see Box 4). For example, SOEs in the mineral fertilizers sector enjoy a preferential public procurement regime—public procurement law favors domestic fertilizer producers, through a price preference in the amount of 15 percent for each lot, applying to economic entities carrying out industrial production (performance of work, provision of services). Similarly, SOEs operating in other sectors—e.g., mineral fertilizers and road construction—are allowed to conclude contracts directly, without competitive bidding, regardless of the amount involved, due to their "single supplier" status.

**Box 4. (*De facto*) advantages granted to SOEs in public procurement**

In the procurement context, there do not appear to be any explicit laws or policies that directly or indirectly favor SOEs in tendering and bidding processes. Nevertheless, private sector operators consistently report non-transparent public procurement practices, and the Law may facilitate some advantages. For example, in some situations procurement may be conducted under direct contracts without competitive tenders, including the procurement of goods or services from entities registered as single suppliers (in natural monopoly sectors), and public procurement of goods and services that are subject to prices controls[105]—such cases would principally involve SOEs. Another advantage held by SOEs relates to tender requirements designed so that only large entities can compete, favoring large SOE incumbents as a result. There could be situations where the tender requires the construction or supply of several different objects or services simultaneously by a single entity, which again would favor large SOEs and the various holdings within their conglomerate groups.

53. **The 2021 SOE Ownership Strategy[106] sets clear goals of separating ownership from regulatory functions of state bodies—even if privatization is not foreseen.** In addition, it provides that government bodies, when developing laws and regulations should do so "taking into account the need to establish equal conditions" for SOEs and private sector firms. However, this does not appear to require the proactive review and reform of the current laws and policies that may already unlevel the playing field. Again, however, until this is transformed into law and existing laws revised to take this rule into account, SOEs will likely continue to receive certain de jure preferential treatment.

54. **In line with the Strategy, the GoU has taken steps in some sectors to ensure SOEs do not combine both commercial and regulatory powers that can create conflicts of interest.[107]** For example, reforms taken by 2018 resulted in the unbundling of the previously integrated "Uzbekistan Airways" and separation of policy from operations, as well as a corporatization of airline and airport into separated

[104] The new Law on Insolvency (enacted on April 2022) allows local government bodies, ministries, state committees and other governmental bodies to submit a petition to the court requesting to extend the term of external management procedure up to five years, subject to their respective submission of a surety for monetary obligations of otherwise insolvent large towns forming SOE. See Article 174, Law of the Republic of Uzbekistan "On Insolvency", dated April 12, 2022 No. ZRU-763 at: https://lex.uz/ru/docs/5957616 ) .

[106] The Strategy builds on OECD Guidelines on Corporate Governance of State-Owned Enterprises and the World Bank's Toolkit on Corporate Governance of State-Owned Enterprises. Strategy for Reforming Management of Enterprises with State Participation (ownership) for the period 2021-2025, approved by the Resolution No. 166, dated 29 March 2021 of the Cabinet of Ministers.

[107] See: World Bank (2021). *Assessing Uzbekistan's Transition. Country Economic Memorandum*., page 176.

independent state-owned companies.[108] Also, the state-owned owner and operator of rail infrastructure "Uzbekiston Temir Y"llari" (UTY)[109] was transformed back in 2001 from an entity engaged in both commerical activities and sector regulation to an open JSC (with the MoF as the sole shareholder), and regulatory functions were transferred to the new Ministry of Transport in 2021 (see Annex 1).[110] Despite these reform efforts, as of 2022, UTY is still the only owner of physical assets and provider of railway transport services to consumers, including Metropoliten services in Tashkent.[111] The legal framework continue to define the transport sector in general as a strategic sector of the country's economy, as a natural monopoly, and provides for exclusive State ownership via UTY of physical infrastructure.[112] Another example is the energy sector, where sector oversight functions were consolidated under the Ministry of Energy in 2019, although an independent regulator remains to be established to set and adjust energy tariffs until these can become fully market determined.[113] Currently, an interdepartmental commission under the Cabinet of Ministers, established in 2018 and led by the MoEF, is in charge of determining electricity tariffs.

55. **In some cases, the enforcement of the regulatory framework for SOEs is weakened by virtue of the dual role of SOEs as both market players and regulators.** For example, although the Uzbek fertilizer distributor (UKH) was liquidated in July 2021 (see Annex 2), efforts are still underway to separate the regulatory and commercial functions of its counterpart on the production side (UKS). In particular, the national conglomerate of state-owned fertilizer production plants and distribution companies, JSC "Uzkimyosanoat" ("UKS"), continues to negotiate input purchasing contracts on behalf of all producers in the sector, including private firms. As such, it is tasked with reporting both input and production volumes upstream to the (former) Ministry of Economic Development and Poverty Reduction (MEDPR)—allowing it access to business confidential information of private firms. At the same time, UKS acts as a quasi-regulator and supervisor, tasked with the development of technical standards[114] and sector strategy[115] for the chemical sector.[116]

[108] Presidential Decree No. 5584, dated November 27, 2018.

[109] Established by the Presidential Decree N UP-982 (1994).

[110] For corporatization, see Decree of the President of the Republic of Uzbekistan dated March 2, 2001 No. UP-2815 "On measures for demonopolization and corporatization of railway transport". For establishment of Ministry of Transport as regulator, see Article 10, the Law of the Republic of Uzbekistan dated August 9, 2021 N. ZRU-706 "On Transport". MoF is the sole shareholder.

[111] Law of the Republic of Uzbekistan of 24.04.1997 N 398-I "On natural monopolies" (New edition. Approved by the Law of the Republic of Uzbekistan of 19.08.1999 N 815-I). As noted above, the law does not mandate state ownership of entities in natural monopoly sectors; rather since these enterprises qualify as being of "strategic significance", they can be privatized pursuant to Decisions of the President.

[112] See Article 3 - Ownership in railway transport, the Law of the Republic of Uzbekistan dated April 15, 1999 N 766-I "On Railway Transport".

[113] After the completion of this report, the GoU issued a Presidential Decree #166 - in September 2023 - which created an independent energy regulator tasked with overseeing unified regulation of the energy sector. The setup, staffing, and operational launch of the new regulator are slated for completion by the end of 2023 or the beginning of 2024.

[114] See Presidential Decree No PP-2884, which directs UKS to develop and maintain a unified technical policy for the industry.

[115] See Presidential Decree #PP2884 dated 12 April 2017 on development of the chemical sector development strategy for 2017-2021. 2) Presidential Decree #PP4992 dated 13 February 2021 on the program of strategic development of the chemical and gas-chemical industry until 2035.

[116] After the finalization of this report, the GoU issued a Presidential Resolution #169 ( in October 2023), which changed the chemical sector's organizational structure. Among other things, the Resolution unbundled Uzkimyosanoat (UKS) and transferred the regulatory and SOE shareholding functions of UKS to responsible government bodies.

56. **Similar challenges exist in the road sector, where a single entity (Committee for Automobile Roads, CAR) is responsible for policy, planning, and operations.** This is leading to conflict of interest, lack of accountability and transparency, and apparently, poor value for money in the use of public resources. The private sector is effectively unable to enter and compete, as over 150 CAR-owned construction SOEs are regularly awarded with road works procurement contracts through administrative fiat rather than a competitive tender—around 90 percent of maintenance and 70 percent of road capital works are awarded to these CAR-owned SOEs.[117] Despite government expenditures on the road sector reaching 1.8 percent of GDP in 2016 and 2017, the quality of the regional road infrastructure remains poor creating a drag on the economy.[118] In this context, consolidating these road sector SOEs into larger self-standing entities, or divesting entirely, and opening up procurement to competitive tender processes, would be key steps towards improving the quality of road infrastructure.

### *b. Tax neutrality, debt neutrality, and outright subsidies*

57. **Neither the annual Budget Laws nor the Budget Code[119] provides for the allocation of funds to SOEs.** The latter broadly refers to "other expenses in accordance with the legislation" that may be incurred. It also provides for "budget loans and credit lines to legal entities", without identifying SOEs. The Budget Code provides only for two PSOs in urban transport and the production of heat energy, where SOE costs may be covered by the government budget.[120] The 2020 Governmental Strategy for Budget Reforms explicitly recognizes that the annual consolidated budget does not take into consideration or reflect several government expenditures or information on individual cash flows—including for the activities of SOEs and other state assets and liabilities.[121] Also, although the annual budget does itemize the funds directed towards the UFRD, which is where most government backed loans come from, it is not possible to identify the number, size, and beneficiaries of those loans in a systematic manner.

58. **SOEs are subject to the same tax law as private sector firms.** The same tax rates apply in both cases, and there are no preferential provisions allowing SOEs to take more deductions or benefit from additional tax credits that would otherwise allow them to reduce their taxable income. Indeed, tax laws generally provide for tax incentives only for entities with foreign capital, as a way to attract FDI.[122] The Tax Code provides that tax incentives cannot be granted to an individual entity, meaning such benefits must be sector, industry or territory oriented.[123] Although this can reduce competition distortions by not favoring a given company over others, where sectors or industries are already serviced by an incumbent, dominant SOE, the non-discriminatory nature of such tax incentives would to some extent be irrelevant.

59. However, reports indicate that SOEs continue to receive a wide range of financial support in the form of direct transfers, on-lending, and public debt that may not be available to private sector under the same market conditions.[124] According to the data obtained for World Bank (2021)[125], on-budget subsidies to SOEs in Uzbekistan in 2018 were at around 1 percent of GDP, but it was estimated that there were at

[117] World Bank. 2019. Uzbekistan: Building Blocks for Integrated Transport and Logistics Sector Development. © World Bank."
[118] Ibid.
[119] The Budget Code of the Republic of Uzbekistan (approved by Law No.360 of 2013).
[120] Article 71 of the Budget Code.
[121] Resolution of the Cabinet of Ministers N 506, (2020) "On approval of the Strategy for improving the public finance management system of the Republic of Uzbekistan for 2020-2024.
[122] Articles 471-472 of the Tax Code.
[123] Article 75 of the Tax Code.
[124] See: World Bank (2021). *Assessing Uzbekistan's Transition. Country Economic Memorandum*. p.77.
[125] World Bank. 2021. *Assessing Uzbekistan's Transition. Country Economic Memorandum*.

least an additional 6 percent of GDP in quasi-fiscal deficits underpinning the SOE operating model.[126] For purposes of this report, the former MoF provided an official figure of UZS 1 trillion paid to Uztransgas as irregular one-off subsidies in 2021, amounting to 0.14 percent of GDP. [127] This might be an underestimate as the Government does not yet publish a consolidated table of the revenues and expenditures of all budget funds, broken down into detailed economic categories (for further discussion, see Chapter 4 "iSOEF Module 2: Fiscal Impact" in the current report).

60. **SOEs also receive indirect support through their interactions with government agencies.** For example, many SOEs reportedly do not pay fees which otherwise would be due, such as licensing fees—this is reportedly the case for SUEs, which are not considered separate from the government.[128] SOEs also benefit from state ownership links to access inputs *de facto* free of charge or at reduced prices, and reportedly enjoy preferential or discretionary access to land, infrastructure, and other inputs, often at below-market prices. In the fertilizer market, private sector firms are fully dependent on the supply of key inputs (gas, raw materials) from SOE suppliers, and are reported to face discriminatory supply conditions from UKS. The result is the reinforcement of the market power of SOEs operating in downstream fertilizer production sector. Compounding this, UKS benefits from below-market prices when accessing to infrastructure and essential inputs.[129] Also in the chemicals sector, a recent 2022 Presidential Decree allocated a portion of vacant land to a 49 percent government owned joint venture to produce soda ash, exempting the joint venture from payment of any deposit for the land and directing various other government agencies to allocate funds for necessary engineering and communications works.[130] Although such State support measures may help expand production capacities and create jobs for the local communities, their wider distortive effects on competition should be critically assessed.

61. **Further, state support (including tax incentives) is provided on an ad hoc basis through separate legislative acts**. Presidential acts (Resolutions and Decrees) are a primary source for state support to selected markets in Uzbekistan. For example, Uztelecom (a 100 percent owned JSC which owns and operates all international gateway infrastructure and dominates domestic backbone infrastructure) is exempted from paying license fees for a period of 5 years for the right to design, construct, and operate telecommunications infrastructure, and provide mobile phone services.[131] Uzmobile, meanwhile, is

[126] See: World Bank (2021). *Assessing Uzbekistan's Transition. Country Economic Memorandum*. p.177. By comparison, EU Member States together spent 0.81% of GDP (EUR 134.6 billion) on state aid according to national expenditure reports for2019. See the European Commission State Aid Scoreboard 2020 available here: https://ec.europa.eu/competition-policy/state-aid/scoreboard_en#:~:text=The%20Scoreboard%20is%20the%20European,Commission's%20State%20aid%20control%20activities.

[127] Such information was shared by the Ministry of Finance following interviews during a World Bank mission during 6-24 June 2022.

[128] In accordance with the Civil Code and the Decree of the Cabinet of Ministers No 215, dated 16.10.2006 (Regulation on the SUE), the State Unitary Enterprises are commercial legal entities but not separate from the State. The State bears subsidiary liability for the obligations of the state unitary enterprise in case of insufficiency of its property. The conclusion regarding the competitive advantage is drawn from the provision in the Law on Licensing, which states that State enterprises may be engaged in activities subject to a license without obtaining a license if so provided in the governmental decisions.

[129] IFC (2022). *Transforming the Fertilizer Sector in Uzbekistan*.

[130] Resolution of the Cabinet of Ministers No. 279, May 2022 "On Measures for the Implementation of the Investment Project to Increase the Production of Soda Ash up to 250 Thousand Tons per year in the Period of 2022-2025 at the Joint Venture LLC Kungrad Sodium Plant".

[131] Uztelecom is also tasked with data transmission, broadcasting television and radio programs, and ensuring information security.

exempted from paying spectrum fees.[132] In the wine industry—where at least 4 SOEs operate—a 2021 Presidential Resolution provided that the MoF shall annually allocate subsidies of up to UZS 100 billion (approximately USD 9.2 million)[133] to support this industry and provides for additional reductions in excise tax and exemptions from customs duties for relevant imports (barrels, containers, and other equipment).[134]

62. UTY, the national rail owner and operator, provides a good example of a large SOE receiving the majority of its annual financing from the government. Only 32 percent of UTY's financing comes from its own funds.[135] In 2021, this SOE received transfers, government loans, and state guarantees in the amounts of 14.6 percent, 10.3 percent, and 33 percent of its total capital expenditure, respectively. .[136] UTY´s major investment projects—even those attracting foreign and private investment, such as a recent high-speed train purchase ("Talgo", produced in Spain)—typically involve additional financial support from the GoU.

63. **Moreover, SOEs have consistently received subsidized loans from SOBs and state guarantees.** Government funding to the UFRD ultimately reached SOEs through concessional loans granted by SOBs—estimated to be 1.7 percent of GDP in 2018.[137] In end-2019, the GoU implemented a crucial reform that stopped the direct on-lending of the UFRD funds through SOBs to SOEs.[138] It is worth highlighting, however, that SOBs continue to lend to SOEs but do not use funds from the UFRD to finance this. Besides preferential lending, SOEs could, at least until recently, engage in debt restructuring more easily than private sector firms and on preferential terms. For example, pursuant to a 2018 Presidential Decree, the fertilizer SOE UKS restructured and wrote off a portion of its state-guaranteed debt and had the terms extended.[139] Creditors were the UFRD and a SOB (National Bank for Foreign Economic Affairs). In telecoms, a 2009 rural development project of Uztelecom was 95 percent funded by a state-backed loan from China´s EximBank, in the amount of almost $11 million USD at a rate of 2.5 percent over a 20-year term. In addition, all the equipment, materials and spare parts imported for the project were exempt from all customs charges (except customs clearance fees).[140] Finally, SOEs generally received favorable treatment in the circumstance of non-performance: a 2017 Presidential Resolution wrote off the debt of several

[132] Resolution of the Cabinet of Ministers No. 66 "On Measures to Creating Conditions for Accelerated Development of the National Mobile Operator's Network" (dated 19.03.2014)

[133] Based on the official exchange rate on December 31, 2021. See https://cbu.uz/en/arkhiv-kursov-valyut/

[134] Presidential Resolution No. PP-5200, dated 28.07.2021 "On Additional Measures for Implementing Cluster System in the Development of Vineyards, State Support in Attractive Modern Technologies to the Sector".

[135] Business Plan of JSC "Uzbekistan Temir Yullari". Available in Russian at: https://railway.uz/upload/iblock/e4f/lpbz5z2g57s16utftve94274c1vtadvr.pdf. p. 45

[136] Business Plan of JSC "Uzbekistan Temir Yullari". Available in Russian at: https://railway.uz/upload/iblock/e4f/lpbz5z2g57s16utftve94274c1vtadvr.pdf. p. 45. External borrowing by corporate entities under State guarantee is classified as souvereign debt in accordance with the Law of the Republic of Uzbekistan "On External Borrowings".

[137] The UFRD lends to four SOBs through credit lines for concessional lending according to government priorities. See *Public Expenditure Review for Uzbekistan. https://www.worldbank.org/en/country/uzbekistan/publication/per*

[138] Meanwhile, most SOB loans to SOEs extended using UFRD's resources were transferred from the SOBs balance sheets back to UFRD. As a result, the share of SOB's outstanding loans to SOEs in total credit decreased from 45 percent in 2018 to 21 percent in 2022.

[139] Presidential Resolution No. PP-3983, dated 25.10.2018 "On Measures for Accelerated Development of the Chemical Industry of the Republic of Uzbekistan". See also, Presidential Resolution No. PP-3253, dated 04.09.2017 "On Preliminary Measures of State Support to the Fundamental Sectors of the Economy in the Period of Currency Markets Liberalization".

[140] *Ibid*, Sections 6 and 7

SOEs and their subsidiaries in the natural gas extraction, machinery, and chemicals manufacturing sectors, with no apparent effort to develop a viable rescheduling option or to compensate lenders.[141]

64. **Ad-hoc financial support to SOEs is facilitated by the lack of a well-developed control framework set out in law or regulation to guide the design of state support measures and limit their competition-distorting effects**. The new Competition law (approved by the Senate in March 2023)[142] defines the scope of "state aid," which can be granted "in the form of tax and customs benefits, subsidies, grants, state guarantees, preferential loans, exclusive rights, sale and lease of state property at preferential prices, granting on preferential terms the rights to use land resources and subsoil and other preferences and benefits." This law asserts that "it is not allowed to provide state aid to individual economic entities on an individual basis, which has a negative impact on a healthy competitive environment." However, what constitutes "a negative impact" is subject to analysis of the CPCPC and will require guidelines for implementation. The new Competition Law also requires all state aid proposals to be shared with the CPCPC for a competition impact assessment, and granting authorities must address all identified problems before authorizing the state aid. In this regard, leveling the playing field will require stricter oversight and controls by the CPCC regarding SOE financing and support as well as support to private firms, increasing transparency and clarity regarding the amounts transferred to SOEs and the private sector and considering phasing out subsidies and other forms of state aid that will be assessed as incompatible with a normal competitive environment.

65. **The March 2021 SOE Ownership Strategy indicates the government's intention to abolish some concessional debt and other typical forms of financing SOEs**. It provides that state guarantees to finance SOE investments and infrastructure projects will be abolished, except only for "social significance and strategic importance" projects.[143] This, combined with stricter procedures on approving large-scale SOE borrowing, will help impose greater financial discipline for SOEs.[144]

[141] Presidential Resolution No. PP-3253, dated 04.09.2017 "On Preliminary Measures of State Support to the Fundamental Sectors of the Economy in the Period of Currency Markets Liberalization".
[142] The new Competition Law entered into force in October 2023, after the completion of the current report.
[143] Paragraph 15.
[144] IMF (2022). Uzbekistan: Staff Concluding Statement of the 2022 Article IV Mission. Available here: https://www.imf.org/en/News/Articles/2022/04/13/mcs041322-uzbekistan-staff-concluding-statement-of-the-2022-article-iv-mission

# Chapter 4. Fiscal Impacts

66. **The objective of this chapter is to provide an assessment of the fiscal costs and risks posed by the SOE sector in Uzbekistan and the potential fiscal benefits of simulated SOE reforms in key sectors**. Because of its large size—operating revenues equivalent to 32 percent of GDP as of 2019,[145] according to the BOS database—the SOE sector has profound fiscal implications in Uzbekistan, which are somehow hidden by the lack of systematic and comprehensive financial SOE data. While the government´s macro fiscal position appears to be relatively sound—the average overall fiscal deficit over 2016-2020 was 2.6 percent of GDP, the present value of public and Publicly Guaranteed Debt was 15.5 percent of GDP at the end of 2021, and the overall risk of debt distress was evaluated as low in the 2022 Debt Sustainability Analysis [146]—a fiscal impact assessment of the SOE sector is relevant for several reasons. First, while on aggregate SOEs make a net positive contribution to the budget, some SOEs—in particular, large utilities operating as natural monopolies—frequently incur significant losses, which are mostly funded off-budget. Second, these utility SOEs have been chronically generating substantial quasi-fiscal deficits[147], which are funded through a combination of borrowing at subsidised interest rates and the lack of expenditure on essential repairs and maintenance, and therefore pose significant fiscal risks. A fiscal impact analysis of these main facts and related trends, following the iSOEF methodology, complemented by projections of the long-term fiscal impact of reforms in the energy sector under two different scenarios, are offered below.[148]

## Fiscal Costs of SOEs

67. **SOE financial transactions with the budget involve numerous channels and a comprehensive evaluation is impeded by a lack of data.** SOEs have a very large presence in economy, and they contribute a large share of budget revenues, but their contribution would be much larger if they did not receive substantial tax benefits. Although SOEs receive only relatively small amounts of explicit regular budget subsidies, they are recipients of substantial indirect budget financial support—through both the national public investment program and the so-called "policy-based funding operations"—and off-budget financial support—including tax and customs preferential treatment and exemptions, and (state regulated) low prices for key inputs such as oil, gas, electricity, and land rent.

68. **Despite benefiting from significant tax and customs exemptions, SOEs nevertheless pay taxes accounting for approximately half of total central government tax revenue during 2019-21**.[149] According to MoF data, tax benefits given to companies in 2021 amounted to UZS 42 trillion.[150] The largest 50 beneficiary companies accounted for two thirds of the total exemptions, UZS 28 trillion, of which SOEs[151]

[145] Considering the 2023 SOEs included for the analysis of this report. This ratio increases to 47 percent of GDP if all SOEs —including minority holdings and subsidiaries—are also considered.
[146] IMF, 2022.
[147] Quasi fiscal deficits are defined as economic losses not directly funded from the Government budget.
[148] The iSOEF methodology for the fiscal analysis of SOEs is set out in the Guidance Note for Module 2 of the iSOEF, Assessing the Fiscal Implications of SOE Reform (World Bank, 2019).
[149] This is based on data from SAMA. The taxes paid by SOEs include not just corporate income tax, which is a tax borne by the SOEs themselves, but also other taxes which are submitted by the SOEs to the tax authority but which, in economic terms, are borne by workers or consumers, such as VAT on SOE's output and payroll taxes on their workers.
[150] This is around 30 percent of the total tax collected in 2021 and equivalent to 5.7 percent of GDP. However, it is not clear whether this figure applies only to tax foregone in 2021.
[151] This includes joint ventures between SOEs and foreign companies.

and SOBs together accounted for almost 80 percent—UZS 16.6 trillion and UZS 5.9 trillion respectively. Meanwhile, SOEs made negligible contributions to government revenue from dividends, which amounted to less than 0.7 percent of total budget revenues in 2021.

69. **SOEs receive on-budget explicit government subsidies, but also benefit from large indirect budget-financial support through the National Investment Program and concessional "policy-based" loans.** SOEs receive some regular subsidies from the budget, mainly for the transport sector, but these are relatively small in magnitude and some irregular one-off subsidies, such as the UZS 1 trillion paid to Uztransgas in 2021 (0.14 percent of GDP), according to official numbers provided by the former MoF for the purpose of this report. In this respect, it is worth highlighting this figure might be an underestimate as the GoU does not yet publish a consolidated table of the revenues and expenditures of all budget funds, broken down into detailed economic categories[152]. However, a larger amount of resources is also channelled to SOEs on a regular basis through: (i) public investment for the benefit of SOEs funded by the state budget under the Public Investment Program (no specific data was available); and (ii) subsidized loans funded from the state budget, classed as "policy-based funding operations" in the budget data, which averaged 2.0 percent of GDP over 2019-2021. Loans from the budget are made at the preferential lending rate of 5 percent (for domestic currency loans) and are mostly channelled through the UFRD or the state-owned banks. SOEs also receive finance, some of it at concessional interest rates, from the SOBs and the UFRD independently of the budget (i.e., the loans are made from funds mobilized from non-budget sources). [153]

**Table 4.Budget transactions with SOEs, 2019-2021: UZS billions (percent of GDP)**

| | 2019 | 2020 | 2021 |
|---|---|---|---|
| **From SOEs to the budget** | | | |
| Tax revenues | 52,286<br>(9.9) | 49,931<br>(8.3) | 54,592<br>(7.4) |
| Dividends | n.a. | n.a. | 1,340<br>(0.2) |
| **From the budget to SOEs** | | | |
| Tax benefits (foregone tax revenue)* | | | 22,500<br>(3.1) |
| On-budget subsidies (direct) | n.a. | n.a. | 1,000<br>(0.1) |
| Public Investment Program (indirect) | n.a. | n.a. | n.a. |
| Policy-based funding operations (indirect) | 18,623<br>(3.7) | 6,792<br>(1.2) | 13,221<br>(1.2) |

Notes: The estimate of tax benefits includes only those received by the larger SOEs and SOBs. On-budget subsidies (direct) are transfer payments from the budget to SOEs. Policy-based lending operations involve loans.

Source: World Bank staff consolidation based on MoEF data.

[152] This official number contrasts with World Bank (2021) estimates of 1 percent of GDP of on-budget subsidies provided to SOEs in 2018.

[153] As already mentioned in Chapter 3 of the current report, the GoU in end-2019, in its first important attempt to detach the banking system from the previous SOE-centric model, implemented a crucial reform which stopped the practice of direct on-lending of the UFRD funds through SOBs to SOEs, while most SOB loans to SOEs extended using UFRD's resources were transferred from the SOB balance sheets back to UFRD. As a result, the share of SOB's outstanding loans to SOEs in total credit decreased from 45 percent in 2018 to 21 percent in 2022. It is worth highlighting that SOBs continue to lend to SOEs, but do not use funds from the UFRD to finance this.

## Fiscal risks

70. **This section highlights the fiscal risks—i.e., the potential future claims on public resources—of the SOE sector**. The approach adopted uses the iSOEF fiscal risk matrix (Table 5), which categorizes fiscal risks into the actual or potential liabilities for the central government budget and which are divided into four categories. Fiscal liabilities are defined as *direct* if they involve events which are certain, or highly likely, to occur, and *contingent* if they are dependent on events which may or may not occur, such as whether an SOE repays its debt. Fiscal risks are further defined as *explicit*, if they involve a clear legal or contractual obligation on the part of the Government—e.g., a government loan guarantee—and *implicit* where there is no contractual or legal obligation but where social, political, or moral pressure is likely to force the Government to provide resources to SOEs, e.g., to ensure that essential services can be supplied to the population.

**Table 5.Fiscal risk matrix (percent of GDP)**

| | **Balance Sheet** | |
|---|---|---|
| | **Direct Liabilities** | **Contingent Liabilities** |
| **Explicit Obligations** | | Government guaranteed loans to SOEs from external lenders (10.5%)<br>Government guarantees of SOB loans to SOEs<br>Loans to SOEs from UFRD and GoU (3.4%)<br>Tax arrears of SOEs |
| **Implicit Obligations** | Capital investment requirements of SOEs<br>Quasi-fiscal deficits arising from SOEs implementing policy objectives | Loans to SOEs from SOBs (10.5%)<br>External loans without GOU guarantee (7.9%)<br>SOE arrears to suppliers<br>Liabilities of SOEs under PPP contracts |

There are no direct Government liabilities in the form of external loans contracted by the Government and on-lent to SOEs
Sources: World Bank staff consolidation based on MoEF and SAMA data.

71. **The main sources of fiscal risk are the debt liabilities of the SOEs and their future capital investment requirements, which are greatly exacerbated by SOE quasi-fiscal deficits**.[154] The estimated quasi-fiscal deficit of the gas industry in 2021 was 5.7 percent of GDP while that of the electricity industry was 2.1 percent of GDP. There are two main causes of SOE-related quasi-fiscal deficits in Uzbekistan. First, SOEs are frequently required by the Government to undertake activities for non-commercial reasons, often termed as Public Service Obligations. In this regard, the most prominent example of these quasi-fiscal deficits is the sale of energy at subsidized prices (tariffs set at below full cost recovery levels). Second, quasi-fiscal deficits also emanate from inefficiencies in the operations of some SOEs, such as excessively high technical losses in energy or water supply, which are partly the result of failure to maintain capital equipment in good working order or replace obsolete equipment because of lack of funds. SOEs which incur quasi-fiscal deficits are unlikely to have sufficient resources to fully service their debt liabilities or to fund their capital investment requirements. Furthermore, their future capital investment requirements are likely to be greater because past quasi-fiscal deficits have led to under-investment, including failure to replace obsolete equipment. The SOEs' quasi-fiscal deficits could be exacerbated by future

[154] Quasi- fiscal deficits are defined as economic losses not directly funded from the government budget.

macroeconomic shocks, notably depreciation of the real exchange rate, given that a large share of SOEs' debts is denominated in foreign currency, increases in in interest rates and volatility in commodity prices.

72. **Total non-financial SOE sector debt liabilities were approximately equivalent to one third of GDP at end-2020**. Table 6 provides estimates of the SOE sector liabilities (excluding SOBs and other public sector financial entities). Almost all the borrowing of SOEs involves an explicit or implicit contingent liability of the state. Explicit liabilities are the government guaranteed external loans or loans where the creditor is the state itself, including the UFRD. Loans from external lenders with sovereign guarantees amounted to almost 11 percent of GDP and loans from the UFRD 3.4 percent of GDP at end-2020. Loans from SOBs to SOEs (10.5 percent of GDP) and non-guaranteed external loans (7.9 percent of GDP) are implicit fiscal liabilities—the Government is not contractually obliged to fund these liabilities if the debtor defaults. However, if SOBs incur losses on their loans which are large enough to deplete their capital below statutory minimum levels, the Government would be obliged, as the owners of the SOEs, to recapitalize them.[155] Also, the Government will face pressure to bail out SOEs which could not service non-guaranteed external debt, not least because default could negatively affect Uzbekistan's sovereign credit rating and thus its access to external capital.

**Table 6.Borrowing by non-financial SOEs, end-2020: UZS trillions (percent of GDP)**

| By Lender | | Total liabilities of SOEs | |
|---|---|---|---|
| | | | |
| External debt with GOU guarantee | 63.2<br>(10.5) | Uztransgas | 29.8 (5.9) |
| | | Railways | 20.6 (3.6) |
| External debt without GOU guarantee | 47.8<br>(7.9) | Uzneftegas | 18.3 (3.2) |
| | | Navoi Mining & Metalurgic | 16.6 (2.9) |
| Domestic commercial Bank loans | 63.0<br>(10.5) | Uzbekistan Airways | 11.2 (1.9) |
| | | Almalyk Mining & Metalugic | 10.3 (1.8) |
| UFRD loans | 20.6<br>(3.4) | NES | 6.6 (1.1) |
| | | Uzbektelecom | 6.2 (1.1) |
| | | | |
| Total | 194.6<br>(32.3) | Total (*) | 193.9 (32.2) |

Sources: World Bank staff consolidation based on IMF (2021) and (2022), and SAMA data.

(*) Note: Although the aggregate numbers on the left- and right-hand sides of the Table are very close, there are two important differences. First, the numbers in the left-hand side column refer to debt liabilities only whereas the right-hand side column includes all types of liabilities reported by SAMA. Second, whereas the left-hand side comprises comprehensive aggregate data, the data, in the right-hand side are limited to the largest SOEs.

[155] This would probably be done using funds from the UFRD, as the UFRD already holds significant equity in many of the SOBs.

73. **The scale of these risks is closely linked to the financial performance of a few large and loss-making SOEs**. Twelve large SOEs—accounting together for 46 percent of the total SOE liabilities in 2020—made aggregate losses in the 2019-21 period, notably Uztransgas, Uzbekiston Temir Yullar (Railways), Uzbekistan Airways, and National Electricity Networks.[156] The risk posed to public funds by unsustainable debts of SOEs was demonstrated in 2020 when UFRD wrote off loans, including capitalized interest, amounting to UZS 16.8 trillion (2.5 percent of GDP) to three SOEs, of which UZS 15.6 trillion were liabilities of Uzbekneftegas.[157] Furthermore, if SOEs continue to incur quasi-fiscal deficits, their liabilities are likely to increase further.

74. **The investment required to close large SOE infrastructure gaps is another significant liability (implicit/direct) for the government in Uzbekistan**. These infrastructure gaps are the consequence of chronic under-investment by SOEs, which has left much of their capital assets beyond their normal service life. This impedes the SOEs' ability to meet demand for energy and other services in a reliable manner with detrimental effects on the economy. For example, in the electricity industry, over 60 percent of the components of the transmission and distribution grids have been in service for over 30 years, which has contributed to average transmission and distribution losses of 2.7 percent and 12.5 percent respectively.[158] There are also large technical losses in the gas industry due to the poor condition of the industry's infrastructure, while the district heating system is obsolete, with very low energy efficiency, and its equipment is in poor condition. In addition, the SOEs in the energy sector need to expand their infrastructure to meet growing demand for energy over the medium to long term.[159] The power utilities need to invest approximately USD 8-9 billion cumulatively over the period 2022-2030 to replace obsolete equipment, expand capacity and to shift generation capacity towards renewable energy (mainly solar and wind) in order to put Uzbekistan on track to achieve net zero carbon emissions by 2060.[160] Another example is given by the country's airports, which require an estimated $867 million of investment—of which $629 million is needed in the next five years—to meet growth in traffic and comply with international standards.[161] In addition, SOEs have explicit contingent liabilities under Public Private Partnership (PPP) contracts with private investors. If these contingent liabilities materialize and the SOEs are unable to honor them, they could be assumed by the Government and as such are implicit contingent fiscal liabilities. Data on their magnitude is not available.

[156] This number draws from SAMA. The 12 SOEs are as follows: Uztransgaz, Uzbek Railways, Uzzbekistan Airways, NES (the national electricity transmission grid), Uzbek Coal, Tashkent Metallurgy, Tashkent Metro, Technopark (electrical engineering), Angren (energy), Toshissiquvvati (energy), Yangi Angren (energy) and Tashkent Issiqlik Markazi (construction and utilities).

[157] UFRD, 2020, p26. The debts of Uzbekneftegas were incurred before it was unbundled.

[158] The Government has developed a concept note for ensuring electricity supply in Uzbekistan, which include as objectives: i) meeting the growing demand for power from domestic generation; ii) improving the energy efficiency of transmission and distribution and; iii) developing the generation of renewable energy and integrate it into the national power system. The estimated total cost for reaching these objectives by 2030 is USD 35 billion (International Energy Agency, 2021)

[159] Domestic demand for electricity is projected to expand by 87 percent by 2030.

[160] Estimates of investment requirements are from the World Bank's forthcoming Uzbekistan Country Climate and Development Report.

[161] Uzbekistan: Building Blocks for Integrated Transports and Logistics Development, WBG Policy Paper Report No: AUS0000970 (2021).

75. **The Government does not currently have a comprehensive strategy in place for either assessing and reporting the fiscal risks posed by the SOEs or for mitigating these risks.** There is no fiscal risk report published with the annual budget documentation, nor are there any consolidated data on budget transactions with the SOEs or any data on the quasi-fiscal deficits of the SOEs published in official sources. There is no strategy yet in place for controlling the quasi-fiscal deficits of the SOEs. However, the Government has initiated measures to exercise greater control over the contracting of external debts by SOEs, through a resolution issued by the Cabinet of Ministers in 2022. SOEs are categorised as low risk, medium risk or high risk based on their financial condition. High risk SOEs will need the permission of the Republican Commission to contract any external debt. The Republican Commission will also set an upper limit on the total external debt servicing costs of the SOEs. SOEs will be required to provide information on the projects to be financed with external debt and on the servicing of the debt. In the reform options proposed in Chapter 8, several specific reforms are intended to mitigate the fiscal risks of the SOE sector, notably; strengthening financial reporting and disclosure by SOEs, the preparation and publication of an annual fiscal risk report on SOEs by the MoEF, properly costing and fully reimbursing SOEs, transparently through the budget process, for implementing public policy obligations (PSOs) and raising utility tariffs to full cost recovery levels.

## Forecasting long-term fiscal implications of SOE reforms (energy sector)

76. **In this section projections of the long-term fiscal impact of the energy sector SOEs under two scenarios (reform/no-reform) are provided**. We focus on the energy sector because the SOEs in this sector have by far the largest quasi-fiscal deficits among all SOEs. Specifically, the impact on the quasi-fiscal deficits of the energy sector (discussed above) of raising energy tariffs to levels that fully cover the cost of supply, and reducing technical and collection losses to benchmark levels, over a 10-year horizon, is modelled and then compared with a no reform scenario. Both scenarios utilize the same projections for domestic demand for electricity and gas.[162] Domestic electricity demand is projected to grow at just under six percent per annum over the forecast horizon from 2021 (base year), whereas demand for gas for electricity generation is projected to grow at three percent per annum.[163] Both scenarios utilize the same projections for the full cost recovery levels per unit of gas and power supplies which are assumed to remain constant in real terms over the forecast horizon from their 2021 levels.[164]

77. **In the no-reform scenario, average domestic power tariffs remain unchanged in real terms from their 2021 levels—around two thirds of the average full cost of supply**. It is also assumed that no improvements are realized to reduce technical and collection losses to their respective benchmark levels.[165] Similarly, that average gas tariffs, which were only 46 percent of the estimated full cost of supply in 2021, is assumed to remain unchanged in real terms over the forecast horizon and that no reductions in technical and collection losses are achieved. Figure 10 depicts the evolution of the quasi-fiscal deficits for gas and electricity under the two scenarios. In the no-reform scenario, the combined quasi-fiscal deficit of the two industries declines slightly as a share of GDP, from around eight percent of GDP in 2021 to just

[162] Taken from Government's Concept Note for ensuring electricity supply in Uzbekistan (2020).

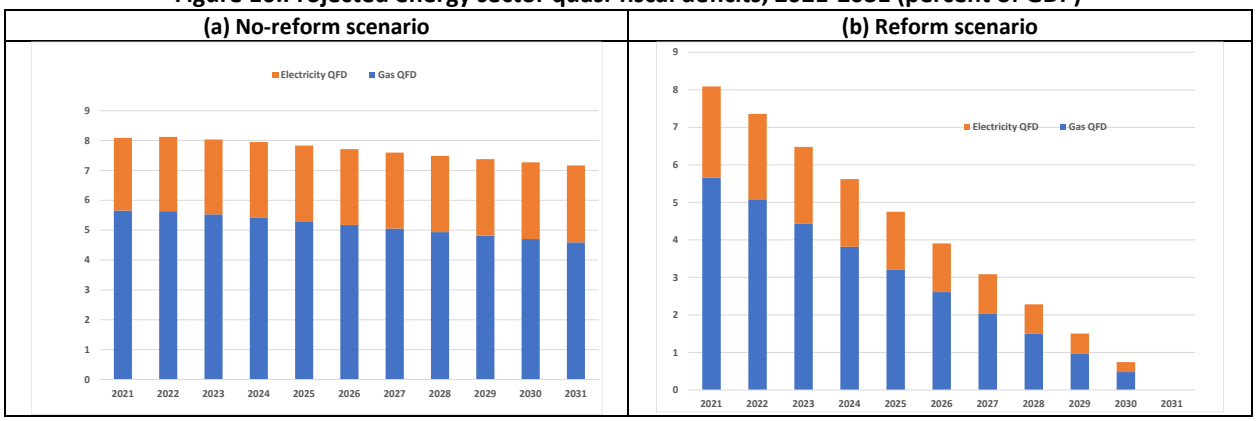
[163] The fact that demand for gas for power generation is projected to grow more slowly than demand for electricity reflects the objective of the Government to diversify sources of electricity generation with renewables accounting for an increasing share of the total power output.

[164] The full cost of gas supply for domestic use is estimated at UZS 1,393 per cubic metre in 2021 and that of electricity is estimated at UZS 621.5 per kWh.

[165] Technical losses in both gas and electricity industries were estimated at 20 percent of domestic consumption in 2021, compared to a benchmark of 10 percent. In both industries, collection losses were three percent compared to a benchmark of one percent.

over seven percent in 2031, a decline which is attributable to the assumed slower rate of growth of domestic gas consumption than real GDP, but its magnitude remains very substantial.

**Figure 10.Projected energy sector quasi-fiscal deficits, 2021-2031 (percent of GDP)**




Source: World Bank staff estimations

78. The reform scenario assumes that average domestic gas and power tariffs will be raised gradually in real terms over the forecast horizon to reach the estimated full cost recovery levels in 2031. It is assumed that investments to rehabilitate and modernize the transmission and distribution infrastructure, together with enhanced metering, will gradually lower the technical and collection losses in both the gas and electricity industries to their respective benchmark levels by 2031. Figure 10 (b) illustrates the impact of these reforms. The combined quasi-fiscal deficits fall sharply to half of their 2021 levels by 2026 and are eliminated completely by 2031, which is what these specific reforms are intended to do. Tariff reform in the two industries contributes around 80 percent of the combined reduction in quasi-fiscal deficits over the forecast horizon.

# Chapter 5. Distributional Impacts

80. **Managing distributional and social risks is essential to increase the chances of success of the government's reform and privatization program, and to boost its integrity.** Privatizations of public assets that are not implemented in a manner consistent with the public interest are hazardous to the government's larger reform agenda. Some of the most pervasive concerns relate to corruption and vested interests, risks to employment in SOEs,[166] and risks of rising consumer and producer prices. Evidence from many countries around the world showing the failure of past privatization programs to achieve equitable and social sustainable outcomes highlights the dangers to reform if procedures are inappropriately applied or lacking in accountability and transparency, which can lead to the loss of public resources on a massive scale and increase both poverty and inequality.

81. **In Uzbekistan the public is highly sensitive to distributional and fairness concerns, and challenges remain in terms of the actual role played by civil society institutions.** Respondents to the Listening to the Citizens of Uzbekistan (L2CU) survey who become dissatisfied with the government's performance dealing with corruption were more than 5 times as likely to take a negative view of the national reform agenda,[167] saying that "the government is not engaged in open dialogue on reform with the public". Besides, the role of civil society institutions such as the media, independent unions, and worker councils is limited by the existence of a complex and ineffective regulatory environment. In fact, the absence of independent organizations representing workers increases the country's exposure to risks of capture by insiders with vested interests. Although freedom of the press has improved since 2016, the media is still highly regulated and faces binding constraints to strengthening public accountability. Removing these constraints as early as possible would play an important role in supporting an effective privatization process.

82. **Strong social protection systems can offset potential risks arising from the ongoing liberalization and privatization process.** Several legal reforms are, at the time of elaboration of this report, setting the stage for SOE governance reform and privatization. In 2022, a new Privatization Law was submitted to the Parliament[168] and a new Law on Insolvency was enacted. In 2023, the Law on State Property Management was promulgated. All these legislative documents explicitly require the government to ensure that social obligations are carefully considered during the reform and privatization process. Formal contracts currently in force include standard severance provisions of up to three months following job termination, and employees are eligible for in-kind unemployment assistance in the event a worker is unable to find work during that time. But potential weaknesses in safety nets could jeopardize the privatization process. Limited progress has been made regarding the introduction of a comprehensive cash unemployment insurance program for eligible workers, allowing displaced workers sufficient time and resources to be adequately reinserted into the economy. Although unemployment support policies exist de jure,[169] they require updating and a strong political commitment to ensure that they provide effective support.

[166] SOE reforms are often associated with employment optimization as excessive employment is a widespread SOE phenomenon.

[167] Referring to the National Development Strategy 2017-2021, available here: https://president.uz/en/pages/view/strategy?menu_id=144

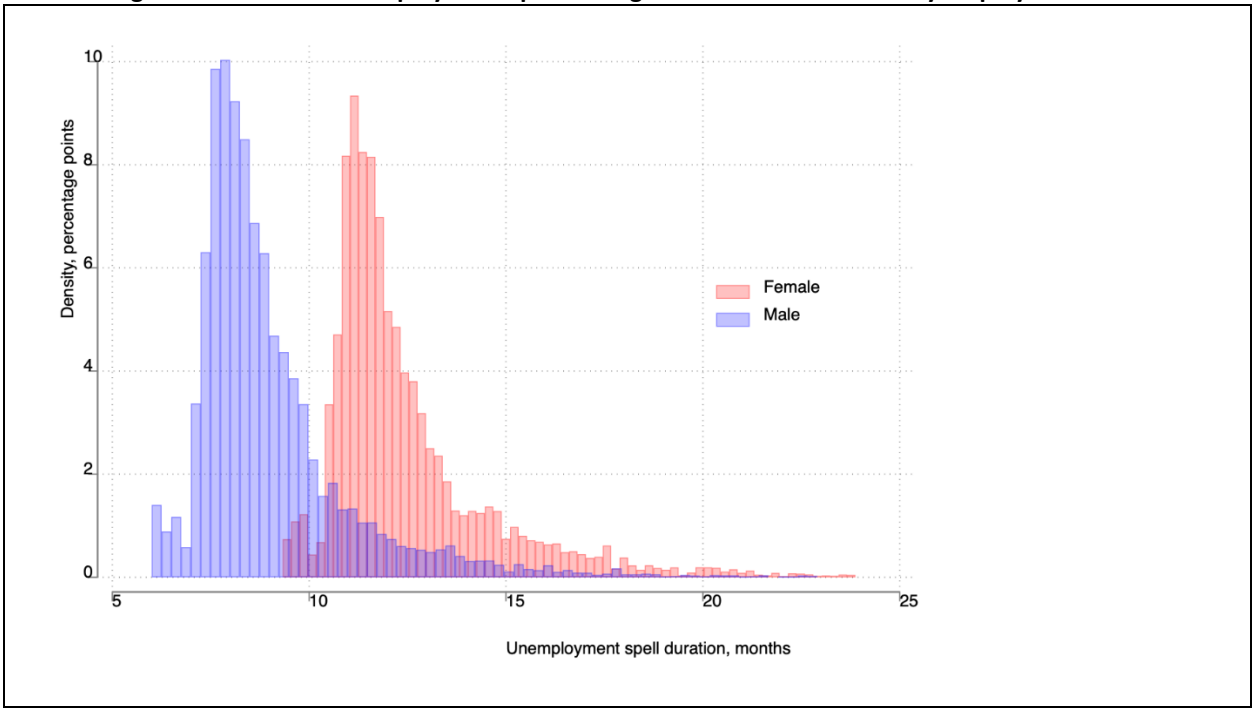
[168] During the current report's preparation, the Law was in the second reading stage in Parliament. After the completion of this report, the new Privatization Law received approval in the Senate in November 2023 and is currently awaiting ratification by the President's Office.

[169] The new labor code of Uzbekistan, adopted in 2022, is available here: https://lex.uz/ru/docs/6257291

## Measuring potential impacts

83. **Poverty and unemployment from job loss is less common among workers formerly employed by SOEs than other comparable groups, but women and older workers are at higher risk**. According to findings derived from the official Household Budget (HBS) and the L2CU surveys, among those who leave SOE employment, the duration of job search is about 10.6 months, 15 percent less than non-SOE employment. SOE employees are five times as likely to have completed tertiary education as non-SOE employees, and typically have both higher incomes during employment as well as stronger employment prospects following job loss. However, the duration of non-employment following the loss of an SOE job is gender-imbalanced, at 12.1 months for women compared to 8.9 months for men. Also, as expected, older age is also associated with longer unemployment spells; those aged 25-34 typically find a new job within 9.6 months (on average), while those aged 55-64 take 12 months (Figure 11).

**Figure 11.Predicted unemployment spell among men and women formerly employed in SOEs**

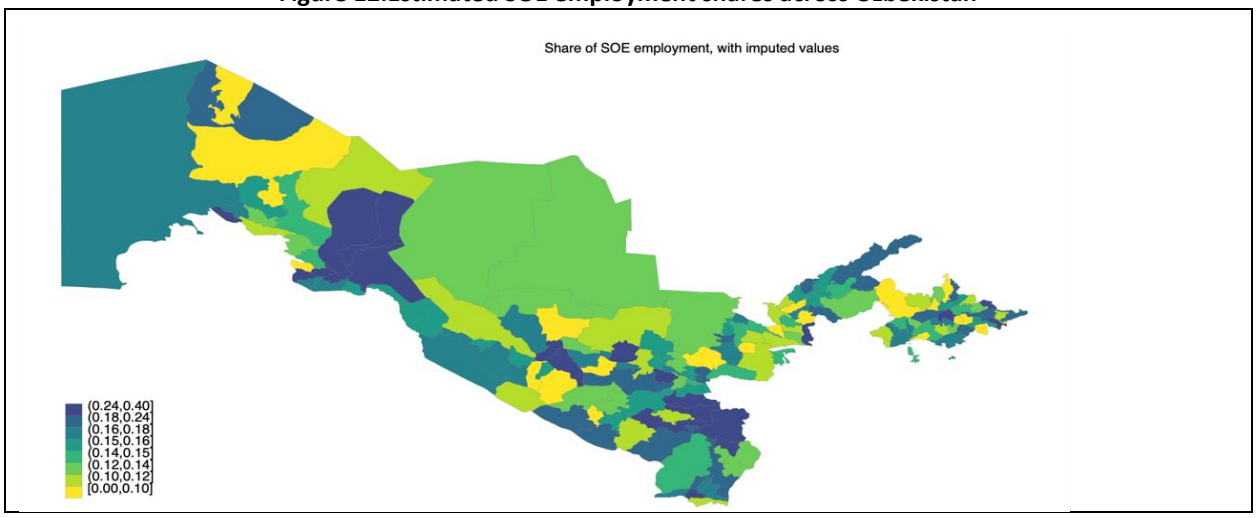



Source: World Bank staff elaboration using HBS and L2CU-derived projections.

84. **Largest SOEs shape the spatial distribution of both SOE employment and long-term unemployment risks**. Although spatial concentration may play a significant role in the duration of unemployment spells and may also lead to other spillovers in local communities, local SOE employment share is also strongly correlated with higher average income. Figure 12 provides estimates of the SOE employment share by district. Zones with the highest shares of SOE employment are concentrated around the capital city of Tashkent, as well as in the southeast and center of the country. The spatial distribution is shaped by the location of the country's largest SOEs and by the availability of other employment opportunities. For example, the Navoi Mining and Metallurgy Company mining sites generate higher SOE employment shares in the central parts of the country; Uzbekneftegaz oil fields, Kumir coal extraction and Almalyk mining generate SOE-intensive districts in the East; and many of infrastructure SOEs concentrate their management in Tashkent. Potential differences in unemployment duration are driven by the workforce composition within the region and region-specific factors. For example, a higher share of highly

educated SOE employees is specific to Tashkent city, but at the same time the labor market is most diverse there, which mitigates unemployment risks.

**Figure 12.Estimated SOE employment shares across Uzbekistan**




Source: World Bank staff estimations based on L2CU and Mahalla administrative data, aggregated to rayon (district).

85. **SOE employment is more stable than other types of employment.** Table 7 depicts the transition matrix between four categories: non-employment, employment in SOE, other employment in Uzbekistan, or migrant work. SOE employment is the most stable category (after non-employment, which partially captures retirees). Most newly acquired jobs – exits to employment from non-employment – were in the non-SOE sector, indicating that most of the recent job creation reported in surveys has happened in the private sector.

86. **New jobs are mainly created outside of the SOE sector but are not easily accessible to women and people aged 45 and older.** Finding employment in the non-SOE sector is 2.5 times more frequent than in the SOE sector. However, finding a new job in the non-SOE sector is more difficult for women who have similar rates of transitioning from non-employment to employment in SOE- or non-SOE sectors. Women also have a higher probability of losing a job in the non-SOE sector, suggesting less employment security. Finding a new job is more difficult for people over 45 years old, as longer unemployment spells attest. People with higher education are over four times more likely to find a job in the SOE sector than people without higher education.

**Table 7. Transitions in employment type from 2018-2022**

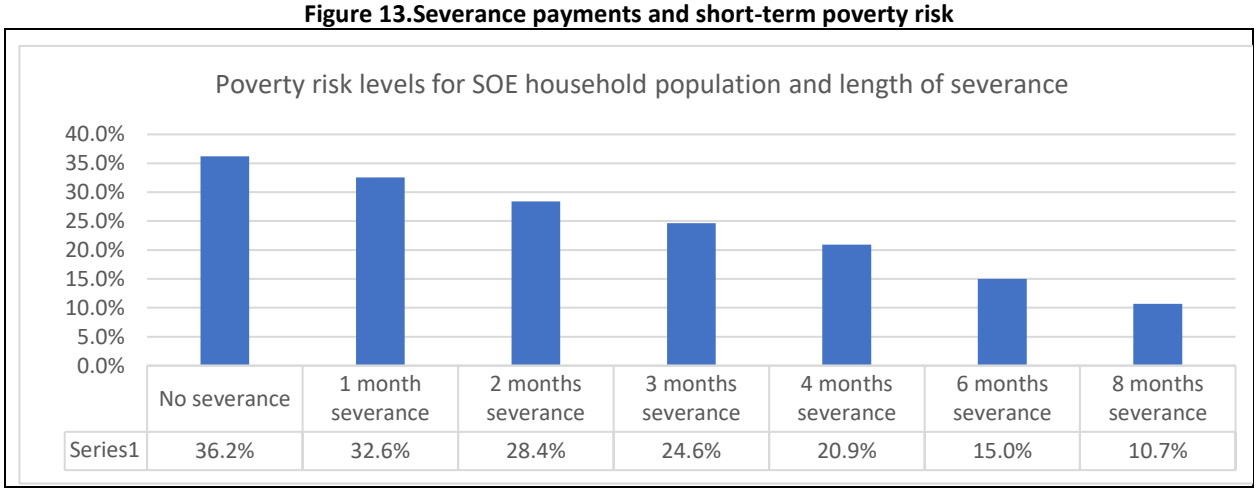
| All working-age (15-65) | | | | | | 45 to 65 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Non-emp. | SOE | non-SOE | Migrant | | | Non-emp. | SOE | non-SOE | Migrant |
| Non-emp. | 92.23 | 1.98 | 4.97 | 0.82 | | Non-emp. | 93.88 | 2 | 3.7 | 0.41 |
| SOE | 9.64 | 84.21 | 5.96 | 0.19 | | SOE | 9.2 | 86.48 | 4.24 | 0.08 |
| non-SOE | 20.28 | 5.01 | 73.69 | 1.02 | | non-SOE | 23.65 | 5.61 | 70.17 | 0.57 |
| Migrant | 14.09 | 0.37 | 2.65 | 82.88 | | Migrant | 14.55 | 0.34 | 1.97 | 83.14 |
| | | | | | | | | | | |
| **Female** | | | | | | **Male** | | | | |
| | Non-emp. | SOE | non-SOE | Migrant | | | Non-. | SOE | non-SOE | Migrant |
| Non-emp. | 96.19 | 1.7 | 1.88 | 0.23 | | Non-emp. | 85.58 | 2.46 | 10.16 | 1.8 |
| SOE | 11.99 | 85.44 | 2.46 | 0.11 | | SOE | 7.83 | 83.25 | 8.66 | 0.26 |
| non-SOE | 30.41 | 5.17 | 64.33 | 0.09 | | non-SOE | 18.17 | 4.98 | 75.63 | 1.21 |
| Migrant | 16.64 | 1.06 | 0.32 | 81.98 | | Migrant | 13.72 | 0.27 | 2.99 | 83.02 |
| | | | | | | | | | | |
| **Higher education** | | | | | | **No Higher education** | | | | |
| | Non-emp. | SOE | non-SOE | Migrant | | | Non-emp. | SOE | non-SOE | Migrant |
| Non-emp. | 88.61 | 7.89 | 3.02 | 0.47 | | Non-emp. | 92.47 | 1.58 | 5.11 | 0.84 |
| SOE | 8.47 | 88.41 | 3.03 | 0.08 | | SOE | 10.12 | 82.5 | 7.14 | 0.24 |
| non-SOE | 14.93 | 12.74 | 71.99 | 0.34 | | non-SOE | 20.59 | 4.56 | 73.79 | 1.06 |
| Migrant | 12.43 | 1.69 | 1.41 | 84.46 | | Migrant | 14.16 | 0.32 | 2.7 | 82.82 |

87. Source: World Bank staff estimations using L2CU Survey.

88. **The relationship between unemployment duration and education is complex.** Unemployment spells after SOE employment are slightly shorter for individuals without higher education: 10 and 10.1 months on average for secondary and vocational eductation, compared to 11.7 months for highly educated. Longer spells for higher-education individuals might reflect difficulties in skills matching, and could also be driven by higher-income individuals sustaining more extended search for better job matches due to their higher savings—this hypothesis is partially supported by a higher average unemployment spell for the highest income decile.

89. **While Uzbekistan's severance payments scheme significantly reduces the negative effects of job loss, it does not eliminate short-term poverty risks.** A minority of those formerly employed by SOEs may face short-term poverty risks in the event of delays in finding other work and/or in the absence of financial support. According to HBS data, 41 percent of the population resides in households with SOE employees, i.e., households that might be potentially affected by SOE reform. These households obtain 53 percent of their disposable income from SOE wages. Simulating a total loss of SOE employment and SOE earnings, the average poverty risk in the potentially affected household would increase from 10 percent—the de-facto poverty rate across individuals in SOE households in 2021—to 36 percent, provided that no compensatory severance payments were made (see Figure 13). Alternatively, if full statutory 3-month severance were paid, the poverty risk estimate for SOE workers would fall to 25 percent, and this estimate would drop further to only 10 percent if full severance payments were paid up to 8 months.

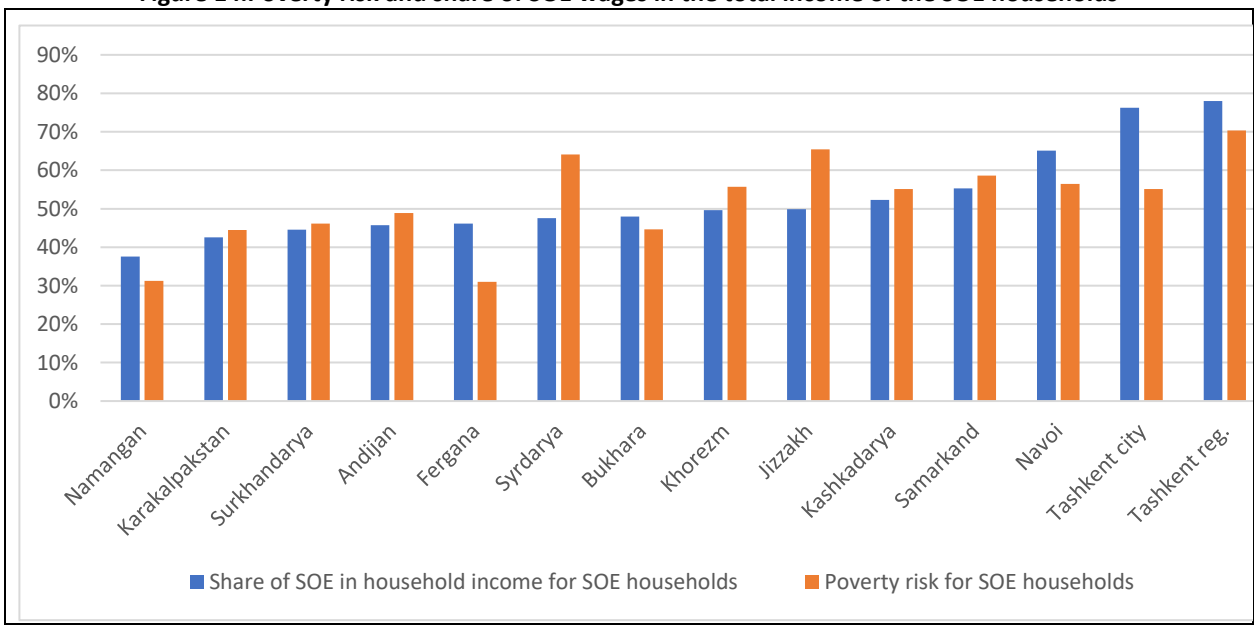
**Figure 13.Severance payments and short-term poverty risk**




Source: World Bank staff elaboration using HBS and L2CU-derived projections

90. **Poverty risks are unevenly distributed by region.** Regional distribution of poverty risks depends not only on the share of SOE employment—and hence the share of individuals residing in potentially affected households—but also on the share of income in the households SOE employment generates. Figure 14 shows how the estimated poverty risk (caused by complete loss of SOE employment, and not considering severance payments) varies across regions, ranged by the share of SOE earnings in total household income. Tashkent city and the Tashkent region have the highest percentage of SOE earnings in household income, but only the Tashkent region has the highest poverty risk of 70 percent. The lowest poverty risks at around 31 percent are observed in the cities of Namangan and Fergana.

**Figure 14.Poverty risk and share of SOE wages in the total income of the SOE households**




Source: World Bank staff elaboration based on HBS data.

91. **Unemployed workers may also be eligible for targeted social assistance and unemployment benefits that complement severance payments.** As social assistance is more efficiently targeted, it is a more cost-efficient means of reducing poverty risk than extension of severance payments. Analysis of simulated poverty gaps after losing SOE employment and obtaining three-month severance payments

suggests the median annual per capita poverty gap would amount to around UZS 1.9 million in January 2022 terms, equivalent to 30 percent of the statutory three-months' severance payment.

92. **Retraining and other active labor market policies mitigate risk for vulnerable workers, but their implementation remains challenging**. As most new jobs are created in the non-SOE sector, it is likely that some former SOE employees will face a skill mismatch with available private sector jobs. In 2021, coverage of unemployment benefits reached only from 1 to 5 percent of the registered unemployed, and there was no unemployment insurance system applying for workers in the event of job loss. Women stand out as a peculiar at-risk category due to longer projected unemployment spells and fewer private sector jobs available for them. Besides, SOE employment is skewed to older age groups.[170] After losing employment, people of pre-retirement age (5 years or less before actual retirement) face longer unemployment spells and fewer chances to find a job. They are also usually less mobile and less likely to acquire new skills. On average, about 7 percent of total SOE employees have five or fewer years before the retirement age, but this percentage increases to 11 percent in both Fergana and Samarkand regions, and peaks at 13 percent in the Namangan region.

[170] The retirement age in Uzbekistan is currently 60 years for men and 55 for women.

# Chapter 6. Corporate Governance and Accountability Mechanisms

93. **Good corporate governance is the foundation for stable, financially healthy SOEs.** Compared with private sector companies, SOEs face distinct governance challenges that directly affect their performance. These challenges include multiple stakeholders, competing goals and objectives, excessive protection from competition, undue political interference, and low levels of transparency and accountability. Facing such challenges and considering their strategic role in providing key infrastructure and public services, it is vital to ensure that SOEs follow good corporate governance practices.

94. **Following the iSOEF methodology, this chapter assesses six dimensions of corporate governance for the SOE sector of Uzbekistan**: (i) legal and regulatory framework; (ii) ownership and oversight function; (iii) performance monitoring; (iv) boards of directors; (v) transparency and disclosure; and (vi) procurement.

## Legal and Regulatory Framework

95. **Uzbek legislation related to SOEs is fragmented and regulated by numerous legal instruments, sometimes conflicting with each other.** The current legal system in Uzbekistan is an evolution of Soviet civil law. The primary sources of corporate governance legislation range from the Law on Joint Stock Companies and Protection of Minority Shareholder, the Law on Securities Market to the Law on Accounting to the Law on Auditing Activity.[171] The above-mentioned laws set formal mechanisms governing all companies—private and state owned—specify the channels of interaction between governing bodies, and establish financial accountability mechanisms, thus constituting a fragmented legal framework for SOE corporate governance. In addition, there are many normative acts of secondary legislation, presidential resolutions, government regulations, strategies, roadmaps, etc., which regulate specific issues related to SOEs' operations.

96. **In addition, the Law on State Property Management was approved by the Senate in June 2022 and was promulgated in March 2023**. This Law[172] marks an important step in institutionalizing the ongoing SOE reform. It is expected that this new Law will largely solve the SOE legislative fragmentation issue, clearly define the responsibilities of the SOE ownership agencies and assign board appointment function to the respective agencies. The Law could be improved in several ways, though; for example, by (i) prioritizing the most significant SOEs; (ii) setting tiered timelines for implementation of the corporatization process, boards establishment and other requirements; and (iii) mentioning explicitly the two current SOE ownership entities—SAMA and ASR[173]—to ensure proper segregation of duties and avoid ambiguity with respect to the role of other ministries and agencies in overseeing and governing the SOEs. According to good corporate governance practices, the CEO appointment function should be assigned to the supervisory board and not to SAMA, as it is envisaged by the law.

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[171] Law on JSCs and Protection of Shareholders' Rights, #223-I, April 26, 1996
*Law on Securities Market (№3РУ-163 of 22.07.2008)*
*Law on Accounting (№3РУ-404 of 13.04.2016)*
*Law on Auditing Activity (№3РУ-677 of 05.02.2021)*

[172] The WB team reviewed the version of draft Law on State Property Management dated August 2021. The final draft submitted to the Parliament —and then approved by the Senate in June 2022—wasn't accessible to the WB team.

[173] In August 2023, the shares of strategic SOEs were transferred back to the Ministry of Economy and Finance, as per Presidential Decree # 283.

97. **The largest SOEs in Uzbekistan have been corporatized and basic elements of the corporate governance structure are in place.** SOEs are incorporated in one of the following two legal forms: (i) a joint-stock company (JSC); and (ii) a limited liability company (LLC). Non corporatized SOEs remain as state unitary enterprises (SUEs). [174] JSCs are the primary form used to incorporate major SOEs, while their subsidiaries are commonly incorporated either as JSCs, LLCs, or remain as SUEs. With JSCs as the primary legal form used to incorporate large SOEs, this section will focus primarily on the governance practices concerning state-owned JSCs. All JSCs, private or state-owned, fall under the requirements of the Law on JSCs and Protection of Shareholder Rights.

**Table 8.Main Legislation applicable to SOEs in Uzbekistan**

| Law/Regulation | Date of Approval | Key Provisions |
|---|---|---|
| Law on JSCs and Protection of Shareholders' Rights, #223-I | April 26, 1996 | The Law stipulates basic corporate governance framework for all JSCs. |
| Corporate Governance Code | 2016 | The Code introduces many important aspects of good corporate governance practices on a "comply or explain basis". |
| Decree of Cabinet of Ministers #207, Annex on the Criteria for Evaluating the Effectiveness of Activities of JSCs and other Business Entities with a State share | July 28, 2015 | The Act mandates all SOEs to follow and report on a set of key performance indicators (KPIs). |
| President Resolution # 2635 On measures for further improvement of the corporate governance in entities with state ownership. | October 17, 2016 | The resolution sets the strategic SOEs with 100 percent state ownership, and prescribes key corporate governance principles requirements (i.e., corporate governance code, transparency and accountability requirements, financial statements audit and disclosure, etc.) for those SOEs. |
| President's Decree on Procurement, #PP-3487 | January 22, 2018 | The Decree sets a special procedure for procurement of goods (works and services). |
| Rules on Corporate Governance for SOEs, #24/I-989 | April 20, 2018 | The Rules provides additional requirements for corporate governance of SOEs. |
| President's Resolution #3946 on Measures for the Further Development of Audit Activities | September 19, 2018 | The Resolution requires all company audits to be conducted in accordance with ISA, translated into the Uzbek language, and published on the website of the MOF (effective 2020). |
| Decree of Cabinet of Ministers #356 On Measures of further Improvement of the System of Governance of State Assets | April 26, 2019 | The Decree introduces of Appointment System of Board Members of SOEs with at least 50% of State Shareholding. |
| Presidential Decree #4611 on Additional Measures of Transition to IFRS | February 24, 2020 | The Decree mandates that "largest companies"—both private and state-owned—adopt IFRS. |

[174] Legacy legal form, remnant of the Soviet legal system referring to an unincorporated state enterprise. This unique form implies that the assets—and the liabilities—of such entities do not belong to them, but rather to the state directly. Although some countries limit their governments' liability through regulations, they would still bear the secondary liability on the obligations of such entities, if the entities' property were insufficient to clear their debts. Therefore, potential bankruptcy or an interruption of the operations of any such enterprise represents potential risks and contingent liabilities for the government.

| | | |
|---|---|---|
| Presidential decree #6096 on measures to Accelerate Reform of Enterprises with State Participation and Privatization of State Assets | October 27, 2020 | The Decree sets an SOE reform action plan based on the government's comprehensive stock take of centrally owned SOEs. |
| Resolution of The Cabinet of Ministers #674 on Measures to Improve the System for Disclosure of Information on State Owned JSCs and Unitary Enterprises. | October 30, 2020 | The Resolution requires all SOEs to establish their websites before 2021 and publish quarterly reports and various financial information on their websites. [175] |
| Decree of Cabinet of Ministers #775 on Measures to Further Improve the System of Performance Evaluation of the Executive Body of Enterprises | December 9, 2020 | The Decree regulates performance evaluation and incentives of management of SOEs. |
| Resolution #166 of the Cabinet of Ministers on Approval of the Strategy for Management and Reform of Enterprises with State Participation in 2021-2025 | March 29, 2021 | The Strategy outlines the government's objectives for SOE reforms. |
| Presidential Decree #-101 on the Next Reforms to Create Conditions for Stable Economic Growth by Improving the Business Environment and Developing the Private Sector | April 8, 2022 | The Decree contains various corporate governance policies affecting incorporated SOEs, including the establishment of board committees headed by independent members, introduction of a remuneration policy and evaluation of the activities of board members, and setting incentives for CEOs; it creates a special position of "Deputy CEO" for a selected group of SOEs. |

Source: World Bank staff compilation, based on the current Uzbek legal framework.

98. **The Corporate Governance Code (the Code) of Uzbekistan, based on the German model, was adopted in 2016 by the *Commission for Enhancement of Performance of JSCs and Improvement of Corporate Governance System*, laying out recommendations that JSCs can voluntarily follow.** The Code sets independence requirements for at least one supervisory board member, introduces a position of a corporate secretary (consultant) and calls for preparation and disclosure of financial statements based on the IFRS, but it fails to address some of the good international corporate governance practices like the establishment of board committees[176] and board evaluations. The Code follows the "comply or explain" principle, and envisages an annual independent evaluation based on compliance. This evaluation is carried out by entities that are authorized to such effect by the Code and selected on a competitive basis by the

[175] SAMA is publishing financial as well as some corporate information about the entities with state ownership on its website (kpi.davaktiv.uz). The web-portal discloses information for about 313 SOEs and includes both the general information (entity name, address, Tax ID number, contact details) and specific information, such as Supervisory Board/Board of Directors, Management/Executive staff and Revision (Audit) committee composition. The web-portal also discloses quarterly and annual financial information, such as financial position and performance.

[176] Board committees are recommended by G20/OECD Principles of Corporate Governance. Audit committees are important for all SOEs, whereas risk committees should be considered for financial institutions. Remuneration and nomination committees are also recommended in line with good international practices. The overall approach to establishing board level committees should be based on the size and complexity of the SOE.

SOEs' supervisory boards. The results of the evaluation are published on the corporate websites of the respective JSCs and on the Corporate Information Portal of the 'old' MoF.

99. **The Corporate Governance Rules for SOEs (the Rules) entered into force in 2018 and are meant to supplement the Code.** The Rules stipulate some specific aspects of SOE corporate governance such as additional independence and qualification requirements for supervisory board members, as well as complementary disclosures of information including grants, subsidies and guarantees received from the state. They are based on the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The Rules are also not mandatory but are recommended to be applied by SOEs with 50 percent or more of state shareholding. The decision to implement the Rules is made by governing bodies of each individual SOE. While the Rules were designed to supplement the Code, they fall short of duly addressing some of issues also overlooked by the latter, such as the creation of board committees.

100. **Since 2018, the government has adopted various legal acts of secondary legislation to accelerate the SOE reform, addressing financial reporting, auditing, and board appointments.** The Decree on *Additional Measures of Transition to International Financial Reporting Standards (IFRS)*[177] requires all SOEs to start gradually adopting IFRS based accounting and financial reporting from 2020. Some SOEs have been taking measures and efforts on establishing internal IFRS reporting units and have started submitting financial statements per IFRS. This progress, though, is affected by the lack of qualified resources (certified accountants and financial specialists) on the local market. The President's Resolution on *Measures for the Further Development of Audit Activities*[178] requires all audits to be conducted in accordance with the International Standards on Auditing (ISA) also starting from 2020. Currently, some of the largest SOEs (manufacturing, financial services, banking, and other sectors) have their financial statements audited per ISA. In 2019, a basic appointment system for board members was introduced for SOEs with at least 50 percent of state shareholding, requiring the approval of the Prime Minister (or his deputies).[179] Following a comprehensive inventory of SOEs, the President of Uzbekistan approved a set of measures to privatize a substantial number of small SOEs and strengthen the corporate governance of largest ones.[180]

101. **In March 2021, the government approved the SOE Ownership Strategy (the Strategy)[181] and a detailed roadmap for its implementation in 2021-2025.** The Strategy constitutes an important first step on the road to bring the country to better corporate governance practices for SOEs. It takes stock on previous SOE reforms, and it is based on the OECD Guidelines on Corporate Governance of SOEs and the World Bank Corporate Governance of SOEs Toolkit. The Strategy stipulates a commitment to undertake various reforms, including: (i) provide a rationale for SOE ownership; (ii) segregate regulatory and ownership functions; (iii) introduce specific corporate governance policies; and (iv) set out SOE financial accountability mechanisms. The Strategy addresses some key corporate governance issues, such as selection of board members, fiduciary duties of supervisory board members, and (increasing) percentage of independent members on the board.

[177] Decree of the President of Uzbekistan #4611 of 24.02.2020.

[178] President's Resolution on Measures for the Further Development of Audit Activities in the Republic of Uzbekistan No. 3946, September 19, 2018.

[179] Decree of Cabinet of Ministers On Measures of further Improvement of the System of Governance of State Assets #356 of 26.04.2019.

[180] Presidential Decree N0.UP-6096 from 27.10.2020.

[181] Resolution of the Cabinet of Ministers of the Republic of Uzbekistan on Approval of the Strategy for Management and Reform of Enterprises with State Participation in 2021-2025 #166 of 29 March, 2021.

102. **Lastly, in April 2022, a new Presidential Decree was adopted introducing special measures for privatization and transformation of corporate governance of 17 large and strategic SOEs.**[182] The Decree establishes some corporate governance policies to complement existing legal acts, such as: establishment of board committees headed by independent members; introduction of a remuneration policy; evaluation of the activities of board members; and empowering boards to set incentives for CEOs in line with good international practices. To foster the reform process in SOEs, a special position of "Deputy CEO", with its supporting office, has also been created by this Decree.

## Ownership and Oversight Function

103. **In recent years, Uzbekistan has transitioned from a decentralized ownership model to a more centralized one.** Uzbekistan has taken several important steps in reforming SOEs, including the implementation of an explicit policy towards the centralization of SOE ownership and oversight. Until recently, line ministries were responsible for SOE ownership, and the Centre for Management of State Assets (CMSA)—a unit within the former State Committee for Assistance to Privatized Enterprises and Support of Competition (also referred to as the State Committee on Competition)—has been responsible for SOE oversight. The CMSA, created by Decree #-337 of 1992, operated as an autonomous authorized single state agency responsible for policy actions and administration in overseeing, coordinating, monitoring, and managing state assets. In subsequent years, there were several government resolutions authorizing it for capital market development and regulation, anti-trust and competition policy making and administration, and entrepreneurship and privatization policy development.

104. **To centralize SOE the ownership and oversight functions, in 2019 the government established and empowered the State Assets Management Agency (SAMA) to exercise an ownership and oversight role over SOEs owned by the central government (with the exception of a number of largest and strategic SOEs).** In 2019 the President issued a Resolution (PR#-5630) establishing SAMA as a single state agency responsible for policy issuance and administration in the areas of state assets management, SOEs' privatization and transformation, corporate governance implementation, financial and economic performance monitoring. SAMA is accountable to both the President and the Prime Minister of the Republic and is currently working on building a sound corporate governance architecture and introducing a system of centralized financial oversight of SOEs' performance. All SOEs must report to SAMA, which, by gradually taking over functions formerly exercised by line ministries, is mandated to act as SOEs' shareholder, implement good corporate governance practices, appoint SOE board members, monitor financial performance, and develop and enforce key performance indicators. SAMA currently oversees 426 SOEs from all sectors of the economy, and in this respect it coordinates key policy actions with the MoEF, the Central Bank and line ministries. Though SAMA is adequately resourced and has representation in all regions of the country, challenges over efficient and effective oversight of the SOEs remain.

**105. Until recently, the MoF carried out shareholders' main functions with respect to 23 large and strategic SOEs, which effectively created a second center of ownership.** From October 2020, the MoF has established two specialized departments (Departments for transformation of the largest SOEs and SOBs) which are responsible for strategic oversight and management of the transformation and privatization of strategic SOEs and SOBs, in close coordination with the SAMA (including line ministries). This approach is considered by the Government to be adequate and aligned with the government reform agenda, because the MoF has been the main and key shareholder of the largest SOEs for years, and it is

[182] Presidential Decree on the Next Reforms to Create Conditions for Stable Economic Growth by Improving the Business Environment and Developing the Private Sector, April 8, 2022, #101

aware of the SOEs' financial and operational positions, economic value and political impact. Yet, this function was transferred to ASR recently and the number of SOEs under ASR authority is currently 32[183].

## Performance Management

**106. Performance management and monitoring is a key function to ensure an SOE has clear and relevant strategic goals and to track whether it is meeting them.** This requires each SOE to: (i) formulate a business strategy, reflecting any mandate assign to it by the State, and updating it at regular intervals; and (ii) develop a set of KPIs on economic, service-delivery, technical, human resources, social, environmental and governance aspects.

107. **The SOE performance measurement system has significantly improved in recent years and is currently monitored by SAMA.** The SOE performance monitoring system evolved significantly in 2016 with the introduction of a detailed and elaborate set of KPIs.[184] Since then, all SOEs have had to follow and report on a set of KPIs. The new system of monitoring covers a wide range of KPIs, including a mix of financial and a few non-financial indicators. There are currently 13 mandatory performance indicators and 18 supplementary ones, as amended in 2020.[185] As per regulation, SOEs are encouraged to further develop additional KPIs based on the SOE industry/sector nature, market conditions, and strategic goals. The performance of an enterprise is measured using the so-called "integrated efficiency indicator (IEI)"—each of the main key 13 KPIs is assigned a weighted value, and the combination of the weighted values provides an IEI. The regulation further sets the gradual measurement system of the annual IEI, based on which the executive body of an enterprise is either additionally rewarded (for successful or outstanding performance) or could be sanctioned. A set of key underlying documents (entity's business plan, financial statements, annual reports, and other corporate information) lays out the performance targets of SOEs and provides a framework for further monitoring of SOEs by the government. SAMA monitors performance of SOEs and regularly publishes KPIs and associated targets for each SOE on its website.[186]

**Table 9.SOE Performance monitoring system**

| # | Financial KPIs | |
|---|---|---|
| 1 | Fulfillment of the forecast of net sales proceeds | Measures whether the entity has met the net sales forecast |
| 2 | Fulfillment of the forecast of net profit (loss) | Measures whether the entity has met the net profit forecast |
| 3 | Return on assets (%) | Measures the overall profitability of the entity with regard to assets employed in production |
| 4 | Reducing the cost of production (in% of the set target) | Measures the efficiency of the production via reduction of the costs |
| 5 | Capacity utilization rate | Measures how efficiently the production capacities were utilized |
| 6 | Coverage (solvency) ratio | Measures the solvency/liquidity ability of an Entity |

[183] In August 2023, the ownership of strategic 32 SOEs was transferred back to the MoEF, as per Presidential Decree #283.
[184] Decree of Cabinet of Ministers #207.
[185] Decree of Cabinet of Ministers #775.
[186] https://davaktiv.uz/en/menu/datagovuz and https://kpi.davaktiv.uz/site/uz/sama

| | | |
|---|---|---|
| 7 | Calculation of dividends | Measures whether the Entity met the amount of dividends to be paid as stated in the business plan |
| 8 | Export parameters completion rate (in % of the set task) | Measures whether the Entity met the export forecasts |
| 9 | Foreign currency independence ratio | Measures the coverage of import needs by the export proceeds |
| 10 | Return on investment of shareholders (TSR - Total Shareholders Return) | Measures the total return on investments during the year |
| # | Non-Financial KPIs | |
| 11 | Implementation of investment programs (%) | Measures how well the entity utilized the investment funds |
| 12 | Financial Independence Ratio | Measures the sufficiency and availability of own financial resources |
| 13 | Localization Indicator Completion (%) | Measures whether the entity achieved the forecast localization of production |

Source: https://lex.uz/ru/docs/2712349 (Cabinet of Minister Resolution # 207, 2015) and https://lex.uz/ru/docs/5149408 (Cabinet of Ministers Resolution # 775, 2020).

108. **Decree #-775 of 2020 included a special provision allowing to link SOE performance results directly to management.** According to this decree, low performance of an SOE for two consecutive quarters or nondisclosure of its performance results may lead to dismissal of the CEO. At the same time, bonuses up to 5 percent of the net profit may be paid to management in cases of high SOE performance. If this is the case, paid bonuses are to be disclosed on respective SOE websites.

## Boards of Directors and Management

109. **SOEs in Uzbekistan are generally organized under a two-tier board system,[187] although not all SOEs have supervisory boards.** All SOEs organized as JSCs have SBs, whereas a significant number of SOEs organized as LLCs do not have one. At the same time, in JSCs with less than thirty shareholders, the functions of the SB may be assigned to the General Shareholders Meeting (GSM).[188] The number of SB members is not specified by the law and is rather determined by the charter of each SOE.

110. **The board nomination process can be strengthened to improve the selection of professional, qualified board members.** It is advisable to establish a formal, merit-based, and transparent process for the nomination of board members with specific skills. Currently for SOEs with 50 or more percent of shares owned by the state, board members are nominated by SAMA and the MoEF, respectively, with the approval of the Prime Minister or his respective Deputies and advisors. For SOEs with minority ownership by the state, Cabinet of Ministers' secretariat approves such nominations. A new regulation on board appointment procedures has been drafted and it is expected to be approved soon.

111. **Supervisory board members´ qualifications and background may vary, as these boards are in practice still dominated by civil servants.** Although, the Rules on Corporate Governance of SOEs provide

[187] A typical state-owned JSC is governed by the general meeting of shareholders, the supervisory board, and the management. The latter can either be a single individual or a management board consisting of multiple executive directors.

[188] Law on JSCs and Protection of Shareholders' Rights, #223-I, April 26, 1996, Article 74.

for certain qualification requirements for supervisory board members including a qualification certificate of a corporate manager issued by the Scientific-Educational Center of Corporate Governance, it is unclear whether these requirements concern ex-officio supervisory boards members. Presidential Decree #-6096 on "Measures to Accelerate Reform of Enterprises with State Participation" calls for introducing at least 30 percent of qualified international cadre to the supervisory boards and at least three senior positions to the management of SOEs subject to corporate governance reform by July 1, 2021, and the SOE Strategy also describes key qualifications of board members mentioning reputation and absence of conflict of interest with competitors. The above-mentioned deadline does not seem to have been met.

**112. Having independent members on supervisory boards is still a rare practice for Uzbek SOEs.** The concept of an independent board member was introduced by the Corporate Governance Code in 2016. SOEs following the Code are required to have at least one independent member in the SB, or 15 percent of its total members. Furthermore, large and strategic SOEs are obliged to have at least 30 percent of independent members on their SBs before the end of 2022.[189] So far, however, only 7 independent SB members were appointed at large and strategic SOE under the oversight of the MoF, and SBs are still predominantly staffed with high-profile civil servants representing various key ministries and agencies, such as the (former) MEDPR, the MoF, and SAMA. In the case of large and strategic SOEs, ministers and deputy ministers frequently sit on the SBs. In general, civil servants excel at ensuring that the SOE is attentive to political or policy goals, but they may pursue those goals to the detriment of the economic and financial health of the SOE. The legislation explicitly indicates that a member of the SB cannot at the same time be employed by the SOE.

113. **Most SBs currently do not play their expected strategic role and have little autonomy. Supervisory** Boards should play a central role in providing strategic guidance while ensuring that managements discharge their responsibility in the best interest of the state as the owner. However, the degree of autonomy of Uzbek SOEs and their supervisory boards in determining strategic and operational decisions is frequently constrained. supervisory boards have little influence in decision-making processes, with most important decisions made frequently at the shareholder-level and handed down to the supervisory boards for signature and endorsement. Furthermore, in the case of large and strategic SOEs, ministers chairing board meetings generally create an environment that is not conductive to critical discussions and participation of minority independent members.

114. **Supervisory boards of large and strategic SOEs do not appear to have full legal autonomy in appointing members of the management board and the company CEO.** Members of the management board, excluding the CEO, are appointed by the supervisory board. The CEO is appointed by the shareholders' meeting unless this right for appointment and dismissal of the CEO by the SB is explicitly granted to it in the SOE's charter.[190] Regulation related to large and strategic SOEs commonly indicates further that the SB appoints the CEO following the approval of the candidate by the Cabinet of Ministers and, in some cases, also by the President's Office.

**115. The establishment of committees for SBs is an ongoing process.** The concept of supervisory board committees was first introduced by the Corporate Governance Rules for SOEs. However, the Rules allowed participation of executives and employees on those committees, which is not considered as a good practice, because committees represent an integral part of the board. Later, the Strategy introduced the establishment of "audit" and "appointments and remunerations" committees within SBs, starting by July 1, 2021, and even limiting board membership for each candidate to five boards. Lastly, according to

[189] Resolution #166 of the Cabinet of Ministers on Approval of the Strategy for Management and Reform of Enterprises with State Participation in 2021-2025, March 29, 2021.
[190] Law on JSCs and Protection of Shareholders' Rights, #223-I, April 26, 1996*, Article 75*

Presidential Decree #-101 (2022), committees for "strategy and investment", "audit", and "appointments and remuneration" are to be formed from among the members of the supervisory boards of 17 selected SOEs starting from May 1, 2022.

116. **Supervisory boards members´ remuneration policy and board evaluation and training practices are still being developed.** Remuneration of supervisory board members that are civil servants was capped in 2019[191] by 50 times the amount of the minimum salary in Uzbekistan. The Strategy calls for setting remuneration of SOE board members in line with their private sector peers, based on the assessment of corporate governance results. Presidential Decree #-101 aimed at further improving the system of remuneration for members of supervisory boards and called for the development of a unified policy on payment of monthly wages and lump sum bonuses until June 1, 2022. However, final arrangements are not yet in place. Regarding to supervisory boards members´ evaluation and training practices, they were introduced by the CG Rules for SOEs, and updated also by Presidential Decree #-101 of 2022. It envisages the development of a curriculum and the organization of training courses for independent supervisory boards members of government-selected 17 SOEs, at the same time it introduces evaluation of board members´ activities.

## Transparency and Disclosure

117. **A first basic aggregate report on the Uzbek SOE portfolio was recently published by SAMA.** The report recently published by SAMA provides an analysis of the financial statements of enterprises showcased in the form of infographics of 20 companies with the largest net profit, 20 companies with the largest losses and 10 companies with the largest paid dividends. To further enhance the level of transparency around the SOE sector, SAMA should prepare a more detailed aggregate report covering the overall SOE portfolio size and sectoral distribution, a general statement on the ownership policy and its implementation, as well as non-financial information bearing on environmental, social and governance practices. Changes in SOEs' boards with emphasis on independent members should also be included in the aggregate reporting.

118. **Reporting and disclosure requirements for Uzbek SOEs are specified in the provisions of the Accounting Law (1996, amended in 2016).** All companies—private and state owned—are subject to this law and must submit their annual financial statements to the shareholder(s). JSCs are required to publish their annual financial statements accompanied by auditor's opinions no later than two weeks before the company´s Annual General Shareholder's Meeting. The Accounting Law prescribes all companies to use National Accounting Standards and allows for the use of IFRS. JSCs are legally required to use IFRS according to the Law of JSCs and Rights of Shareholders.[192]

119. **Starting in 2021, the government mandated many SOEs, regardless of their legal status, to gradually adopt IFRS**. [193] Starting from 2020, SAMA is legally required to annually approve and publish by June 1 a schedule of the transition of SOEs to IFRS accounting and financial reporting. While some SOEs are already applying IFRS, many others are in transition to apply them, and the rest still apply National Accounting Standards. The Government aims to migrate all SOEs to IFRS accounting standards to achieve comparability before the end of year 2025. However, experience registered so far indicates that

[191] Decree of Cabinet of Ministers #356 On Measures of further Improvement of the System of Governance of State Assets.
[192] Law on JSCs and Protection of Shareholders' Rights, #223-I, April 26, 1996. Article 102.
[193] Decree of the President of Uzbekistan #4611, February 24, 2020.

substantial capacity building activities and strengthening of internal accounting systems are needed to achieve this goal.

120. **All SOEs are required to report and disclose key financial and non-financial information**. In addition to the above legislation, there are several government regulations, specifying requirements related to financial and non-financial reporting. A key update was provided by the Strategy, presenting transparency and disclosure of information in SOEs as a key priority. The Strategy requires SOEs to establish their own corporate websites and disclose important nonfinancial information such as information on supervisory board members and their remuneration, auditor's opinions on annual financial statements, risk factors, and information on major transactions. Furthermore, starting from 2021, SOEs incorporated as JSCs and SUEs are both required to disclose important information, including board and management composition, quarterly and annual financial information, and KPIs on their websites.[194] Failure to disclose required information on SOE websites may result in administrative fines vis-à-vis SOEs executives.[195] SOEs are also required to report to SAMA on corporate governance measures, their financial results, achievement of business plan targets, strategy implementation and other important information. Starting by 2022, SAMA is also required to report to the Parliament, the Cabinet of Ministers, and the President of Uzbekistan on the effectiveness of SOEs and implementation of the Strategy and publish on its website a report on SOEs´ financial results.

121. **External Audits of SOEs´ financial statements are conducted in accordance with International Standards on Auditing (ISA).** External audits are regulated under the Law on Auditing Activity that entered into force in 2021. There is no independent audit oversight system in Uzbekistan. However, the Cabinet of Ministers recently adopted a resolution[196] (effective from January 2023) on external quality control of audit firms by the MoEF. As per resolution, the MoEF, with engagement with professional audit unions (e.g., Chamber of Auditors) will conduct quality reviews and assessments of the performance of the audit firms on a regular basis. External auditors are appointed by the annual GSM and selected via public tendering, although the Strategy envisages the involvement of audit committees in determining the terms of selection of external auditors. Large SOEs can afford external audits to be conducted by international audit companies (Big 4s), the service of which is quite expensive, while smaller/less profitable SOEs use the service of local audit firms for the audit of financial statements per IAS. The Supreme Audit Institution (SAI) is also involved in the audit of SOEs, but its scope is targeted, specific (related to budget funds utilization), and mostly linked to the efficiency and/or performance audits, as well as validation of expenses. Follow-ups on the audit findings depend on the nature of the audit: SAI-conducted audit findings could be of a restricted use/disclosure and respectively the follow-up over those audit recommendations is conducted by the SAI itself. Follow-up on financial statements audits findings is carried out by the executive bodies of the SOEs, but the resulting management letters are usually restricted in use and are not disclosed to the public. Financial statements' audit findings, though, are to be validated by the external auditor during the subsequent, next year's financial audit.

122. **The internal audit system of SOEs has been strengthened since 2021.** The Uzbek Law on JSCs and Rights of Shareholders sets out the establishment of internal audit by SBs reporting to the audit committee (if existing), in SOEs with total assets over UZS 1 billion (approximately USD 89,000).[197] The

[194] Resolution of The Cabinet of Ministers #674 on Measures to Improve the System for Disclosure of Information on State Owned Joint Stock Companies and State Owned Unitary Enterprises.
[195] Presidential Decree #УП-6247 on Additional Measures to Ensure Transparent Activities of State Bodies and Organizations, as Well as Effective Implementation of Public Control, June 16, 2021.
[196] Decree of the Cabinet of Ministers #538, September 28, 2022, on Approval of the Regulation on the external quality control of audit organization.
[197] Law on JSCs and Protection of Shareholders' Rights, #223-I, April 26, 1996

Strategy further envisaged the establishment of an internal audit function in all SOEs starting July 1, 2021, which is still under process.

## Procurement

123. **Public Procurement in Uzbekistan is covered by Uzbekistan's Public Procurement Law, which was adopted in April 2021 (and enacted in July 2021).** All organizations financed from the state budget and non-budgetary state funds must follow the Public Procurement Law. This includes legal entities with a state ownership share of 50 percent or more of their authorized capital, as well as their majority owned subsidiaries. The Public Procurement Law allows for different procedures to be applied to projects funded by international financial institutions. In general, the new national regulatory and legislative framework of Uzbekistan promulgates a robust and modern procurement policy, in line with current international practices. The Law has also introduced a unified institutional and operational framework for the national Public Procurement system in Uzbekistan.

124. **Besides the Public Procurement Law, SOEs in Uzbekistan follow the appropriate Government Regulations and, at least on paper, should not have any privileges over private firms under the public tenders**[198]**.** Originally, there was list of around 21 SOEs of strategic importance which had some different procurement approaches concerning the direct contracting, applicable procurement procedures thresholds, etc., but this has been abolished by the 2021 revision of the Public Procurement Law. Overall, while no privileges exist from a legal perspective, in practice there may still be some specific cases of preferential treatment to SOEs.[199]

125. **The Public Procurement Law may not be applied to procurement in some cases.** This is the case, for example, of goods, works, services in cases of emergency situations, for state defense, security, and maintenance of internal order in the country. The Public Procurement Law is also not applied for foreign loans with Government guarantee, and for foreign grants if the procedures of donor countries, international, foreign governmental and non-governmental organizations do determine different procurement procedures.

126. **The Government aims to conduct all the public procurement electronically.** SOEs may already conduct certain procurement through the currently available electronic government procurement (e-GP) platforms. All procurement opportunities shall be mandatorily published in the Single Information Portal which is governed by the Public Procurement Department of the MoEF, which is the authorized body for the Public Procurement as indicated in the Public Procurement Law.

127. **To secure fairness and transparency, the government is paying attention to procurement complaints and has issued regulations establishing a complaint handling mechanism, as well as defining the Complaints Review Commission composition and its functions.** Moreover, the e-Complaint module, which shall be an integral part of the entire e-GP system, has been developed and shall be launched soon, thus allowing to accept complaints in any forms, as well as addressing and resolving them in a timely and transparent manner.

128. **The professionalization of procurement remains a challenge.** The requirement that only duly qualified persons can conduct procurement is one of challenges which the MoEF has yet to address. Also,

[198] While no privileges seem to exist from a legal perspective, the law may still allow for some cases of preferential treatment advantages. The Competitive Neutrality chapter discusses this topic further.
[199] See Chapter 3, Box 4.

while SOEs, particularly the largest ones, usually have their asset or procurement departments to address their needs, their procurement staff may often not have the required skills and educational background.

129. **Sustainable, green procurement is in the Government's agenda already and several regulatory documents have been issued so far to consider such innovations in procurement.** For example, the recent Cabinet of Minister's Resolution #-518 suggests using the decisions for green alternatives, specifically in the energy sphere. Also, the recently issued Presidential Resolution #PP-390 (October 2022) introduces quotas for goods produced by disabled persons. Finally, the MoEF´s Public Procurement Department is working under the Procurement Strategy for the next five years to address the current challenges and to systematically introduce new approaches in Public Procurement.

# Chapter 7. Strategic Communication for SOEs Reform

130. **This chapter overviews some key dimensions of the GoU's communications practices around economic reforms, including SOEs**. For such purpose, the chapter analyzes first the main facts and peculiarities of these communication practices and then it tries to identify some challenges to implementing an effective communications strategy.

131. **Since 2016, the Uzbek government has dedicated significant efforts to communicate both its political and economic reform agendas to the domestic and international audiences.** The political agenda has included promoting the commitment of the new Administration of President Shavkat Mirziyoyev, who was elected in December 2016, to ensure human rights, religious freedom, freedom of speech, eradication of child and forced labor, the transparency of state bodies and agencies, and combating corruption. The economic agenda has included measures taken to promote the government's effort to liberalize the economy, accelerate the country's transition to a competitive market economy, improve the business and investment climate, ensure the protection of private property and foreign investment, and stimulate entrepreneurship.

132. **The government has focused its communications on international audiences.** This might be explained by the fact that it has prioritized the promotion overseas of Uzbekistan's favorable image and positive changes after the years of economic stagnation and isolation. These efforts have aimed at improving the Uzbekistan's perception and rankings in various international indexes as well as attracting foreign investment and boosting international economic cooperation.

133. **SOEs reform is one of the central parts of government's economic reform agenda.** A large-scale process of privatization and reform of SOEs was launched early on. President Mirziyoyev p blicly criticized SOEs and state monopolies, highlighting their inefficient practices and how they hindered the economic development of the country and impeded foreign investment. However, in 2023, SOEs and state monopolies remain dominant in Uzbekistan's economy, , even if selected senior government officials continue to criticize SOEs and reiterate its commitment to reform.

## Communications practices since 2016

### *Communications objectives*

134. **Communications practices of the government have had several objectives, targeting both international and domestic audiences**. The overarching objective was to show the image of a new Uzbekistan, to get credibility on the international arena, and ensure that the reform agenda enjoys society's support.

135. **The government has focused on promoting its democratic and economic liberalization agendas, especially the measures taken to combat issues that had drawn harsh criticism from the international community during the previous Administration of President Islam Karimov**. The political and economic reforms implemented by the government since 2017 have been essential for reducing international pressure, opening Uzbekistan to the global economy, re-launching cooperation with international financial institutions (IFIs), international organizations and non-governmental organizations (NGOs), attracting foreign investment, as well as for positioning the country more favorably vis-à-vis international public opinion.

136. **As for domestic objectives, the government has undertaken measures to demonstrate its readiness to engage with civil society, and to provide it with more space to operate and oversee activities of the central and regional governments.** This has been essential for the Administration of President Mirziyoyev to develop trust, strengthen its legitimacy and prevent social tensions, thus buying time and generating the goodwill necessary to implement a significant transformation of the country.

### *Target audiences and key messages*

137. **Target audiences may be divided into international and domestic stakeholders.** International stakeholders are represented by key foreign governments, international organizations, IFIs, international NGOs and the global business community. The domestic ones are the general public across the country, civil society and local business community. The key messages communicated by the government are specific to each group, situations as well as to its political and economic objectives.

138. **Promoting the government's economic and political agendas vis-à-vis international organizations and NGOs was justified by the necessity to improve the reputation of Uzbekistan as an isolated country notorious for its violations of human rights and economic stagnation, which was inherited from the Administration of President Karimov**. The main goal was to indicate that the Administration of President Mirziyoyev was genuine in its commitment to open the country and introduce meaningful changes in the political, social, and economic spheres. Therefore, the government started actively communicating with its key former critics, including international NGOs, such as Amnesty International, Human Rights Watch and the Cotton Campaign. It undertook several measures to prove its commitment to liberate political prisoners, ensure freedom of speech and religion, as well as to eradicate forced and child labor, all actions largely encouraged by international actors. Many of these measures and their adequate implementation brought significant positive results. For example, in 2019, The Economist named Uzbekistan the "Country of the Year", recognizing the progress in the affairs of democracy; and, in March 2022, the Cotton Campaign ended its call for a global boycott of cotton from Uzbekistan, that since 2009 had been supported by over 330 international brands and retailers.

139. **IFIs and international donors were considered crucial international audiences as well**. The government intensified relationships with those IFIs that had operations in Uzbekistan, as well as re-launched its dialogue with those of them that left the country during the Administration of President Karimov, like the EBRD in 2007. The government's firm commitment to the reform agenda persuaded international donors to support changes in Uzbekistan. The access to financial resources of IFIs was important to implement social and economic reforms. As a result, the portfolios of IFIs in Uzbekistan have significantly increased since 2017. One of the most notable signs of the improvement of political and business climate in the country was the return of the EBRD that reopened it office in Tashkent in 2017

140. **The reduced international pressure and large support of the policy direction by IFIs and donors has allowed the government to send a message to key economic partners and foreign investors**. Uzbekistan's embassies abroad have been specifically tasked with promoting the investment potential of

the country and attracting foreign investments. In the meantime, the government has focused on addressing issues that for a long time hindered the development of the economy, including solving the currency conversion issue, liberalizing foreign economic activity, customs and tariff regulation, and reforming the tax system. Particular attention was paid to the promotion of the reform and privatization of SOEs, as the large footprint of the state in the economy was considered both by international experts, local economists, and the public alike as a key obstacle for economic development.

141. **The government has repeatedly claimed that it is opening to society and is refocusing its activities on solving citizens' issues**. To stress this commitment, 2017 was officially declared the "*Year of Dialogue with the People*". All state officials were instructed to prioritize citizens' needs and communicate through media all key decisions made by the authorities. In addition, the government set up special offices in all state bodies tasked with receiving comments and complaints from citizens. The press services of the central and local governments got restructured and significantly strengthened, getting the necessary institutional, financial, and human support to engage with the media and citizens more effectively.

142. **A key domestic audience of the government's communications efforts was the local business community**. From 2016, President Mirziyoyev talked about entrepreneurs bearing the heaviest burden of the previous development model. He repeatedly confirmed his commitment to creating a conducive business climate in Uzbekistan. 2018 was declared the Year of Entrepreneurship, Innovation and Technology. In 2017, the Business Ombudsman position was created. In 2021, the government established the Prime Minister's office for the entrepreneurs' issues and the President held the first open dialogue with the business community, where he reiterated his commitment to safeguarding the interests of the local business community.

### *Communications mechanisms and style*

143. The government has used several channels to promote its reform agenda, including official statements and comments communicated trough state and private media outlets, institutional response, media relations, social media presence and promotional events.

#### *a) Official statements and comments*

144. **The main platform for conveying the government policies and decisions has been the policy statements by President Mirziyoyev as well as summaries of important government meetings**. Such activities are widely covered by the Press Service of the President's Office, the communications teams of various relevant state bodies and agencies, as well as by state and private media. In those statements, the President focuses on different areas of political, economic, and social life, highlights sectoral issues, announces the broad measures to be taken as well as specific next steps.

145. **To ensure that citizens are made aware of key political and economic initiatives, the government overhauled its communications apparatus**. In 2019, it established the Agency for Information and Mass Communications, tasked with coordinating communications policy and strengthening the capacity of communications officials across ministries and government agencies. It also elevated the position of Press Secretary in ministries, equating it to the position of Ministerial Advisor. Also, all state bodies, agencies and SOEs were tasked to open accounts on social media platforms to increase the coverage of their activities. The usual communication products they produce include press statements covering the activities of their respective state bodies and explaining certain actions and decisions made by the country's leadership and sectoral and regional authorities.

#### *b) Institutional response*

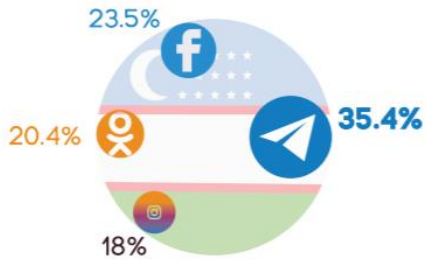
146. **The government is providing space through the so-called "virtual offices" to harness the power of citizens' voices.** Through these virtual offices, citizens can ask questions, raise issues, or voice their concerns on a variety of topics to all levels of government, with the expectation that the relevant officials will promptly respond. Since the establishment of these feedback mechanisms in 2017, the Government has been addressing thousands of citizens' concerns on a regular basis. While these mechanisms have been widely used, there is still insufficient qualitative evidence as to the impact they are having and whether they have achieved the goal of building public trust in the authorities and ensuring that citizens feel heard.

*c) Media coverage*

147. **From 2016 onwards, the government reconsidered its engagement with the media, both domestically and internationally**. In the past, independent journalists were perceived as a threat to the state's security and stability. Hence, the interaction between the government and private media had been limited. President Mirziyoyev has criticized officials for being too closed and not engaging enough with media. At the same time, a newly gained freedom by the media, albeit limited, has increased the coverage of government's actions at the local level. In its outreach to media, the government prioritizes state TV channels and printed media. Meanwhile, private online media outlets play an important role in providing the public with a more nuanced view on ongoing events, although officials are still learning how to live with the increased level of scrutiny.

*d) Social media (Telegram)*

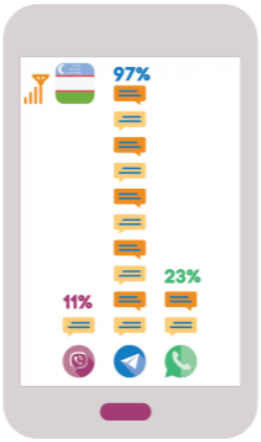
148. **Social media and especially Telegram have become an important communication channel for the government.** Telegram is highly popular with internet users and the platform has become the key source of information in Uzbekistan. Amid these developments, the government prioritizes social media as the instrument for regular interaction with the public. The press services of state bodies publish press-releases in Telegram sometimes even before posting them in official web pages. They also launch special channels and bots allowing people to communicate their issues and ask for help.




Share of News Agencies' Subscribers by Platform.

Source: IWPR CA (2019)

Social media users also see Telegram as the main news source:




Messengers as News Sources, Percentage of Respondents Who Answered "Always" and "Often"

Source: IWPR CA (2019)

*e) Promo events*

149. **Both the political and economic reform agendas are promoted through the organization of various events**, including press conferences, round tables, expert meetings, international forums involving government officials, representatives of foreign diplomatic missions, international organizations and donors, representatives of civil society, expert community, and the private sector. These events aim at demonstrating vis-à-vis international and domestic stakeholders the Government's readiness to organize discussions on various issues, take into consideration alternative views and confirm its commitment to the reform agenda. Such events may be both domestic, like the dialogue between President Mirziyoyev and local entrepreneurs, or geared towards an international audience, like Uzbekistan Economic Forums in Tashkent and Samarkand in 2021 and 2022, respectively.

## Communications practices around SOEs reform

150. **Uzbek society has for a long time been dissatisfied with the performance of SOEs and the dominance of monopolies, for instance, in automotive, civil aviation, and railways sectors**. The government understood this to be some sort of bottom-up demand for SOE reform and built on it to demonstrate its willingness to break from the previous economic development model. President Mirziyoyev frequently criticized SOEs and state monopolies, claiming that they were one of the main barriers having prevented economic development in the previous decades.

151. **The authorities have tried to focus on sending a message towards divesting and improving the corporate governance of SOES operating in sectors of main public concern.** These include the automotive, civil aviation, utilities, food, and banking sectors. Also, the government has targeted key sources of public discontent, criticizing SOEs for being ineffective and unprofitable, benefiting from preferences, and impeding the development of a well-functioning market economy. The general message conveyed to the public in Uzbekistan is that reform of SOEs, including privatization, will foster economic development and translate into tangible improvements in the well-being of citizens.

152. **In terms of communicating vis-à-vis international audiences, the government has used its intention to pursue SOE reform as an indicator to showcase its commitment to reform, but implementation challenges remain**. As an indicator of this commitment, the government established in 2019 the State Assets Management Agency (SAMA), designed to become the driver of the reform of SOEs. One of the key challenges of communicating SOE reform is what many observers perceive as a gap between the ambitious declarations and the limited results on the ground. If the speeches of key public officials from 2017 and 2022 are compared, the goals they declare have not changed over time, yet the

reforms related to certain SOEs, including monopolies, is still progressing slowly. For example, the goal to abolish the monopoly in the automotive industry and to reform UzAuto Motors was declared long time ago. That message was very much welcomed by the public, but so far progress in this area has been slow.

## Key challenges for an efficient communications practice

153. **Despite the increased communications activity of the government, results have been uneven and not always commensurate with the efforts deployed**. In terms of outreach to international audiences, the government has proven highly successful at positioning Uzbekistan as a nation diligently undertaking important reforms to open its economy and political system and attract foreign investment. As far as domestic audiences are concerned, the government does not feel the same level of pressure. This could be explained by the fact that many in Uzbekistan trust that the country is moving in the right direction and seem willing to give the authorities the benefit of the doubt. In this context, while public sentiment has been in favor of reforming SOEs, the slow pace of reform in this area does not appear to be eroding the government's political capital.

154. **Another challenge to communications practices in Uzbekistan is the lack of professional communications specialists**. During the Administration of President Karimov, the government wasn't interested in engagement with citizens. and hence, there was a very limited number of public and media relations professionals in the central and local governments. Establishing a modern mechanism for communications and citizen engagement can be done relatively quickly but staffing it with a cadre of well-trained communications professionals and bringing about the necessary culture change across the government, at the central and local levels, is a much harder endeavor that will require several years to succeed.

155. **Another issue affecting the government's communications capacity is that it remains highly centralized**. There are not enough reform champions in all relevant state bodies who can promote the reform process in their respective sectors. The most visible reform champion is the President, and nearly all communications activities of the various state bodies and SOEs revolve around promoting the President's statements and actions in this area. While it is important for the success of the government's communications to count with the strong leadership of the President, many reforms including in the SOE sectors would benefit from having sectoral champions who engage with stakeholders and the public on a regular basis.

# Chapter 8. Reform Options

156. **This iSOEF proposes a series of recommendations to improve SOEs governance and performance, while limiting their fiscal costs and risks and promoting competitive neutrality principles**. SOE reforms are multidimensional and require a holistic and integrated approach. As such, this iSOEF focuses on four main intertwined main options for reform, which were chosen from many possible reforms for the Uzbek case, by considering both their strategic relevance and feasibility. Other important reform options are also explored in this chapter.

## Main Options for SOE Reform

- **Institutional arrangements for SOE oversight.** Clarify the roles and responsibilities of government agencies in charge of SOEs to ensure proper segregation of duties and avoid ambiguity with respect to the role of various ministries and agencies (SAMA, MoEF, line ministries, etc.) in overseeing and governing SOEs. Strengthen the capacity and authority of SAMA to oversee the entire SOE portfolio, and enable it to fully propose, lead and engage in strategic policy actions and decision making with respect to SOEs under its oversight. For strategic and prioritized SOEs, set tiered timelines for duly implementation of the State Property Management Law, of the SOE Strategy requirements and other related decrees. A periodic review and update of SOE strategy should also be considered.
- **SOE transparency, reporting and disclosure.** Enhance SOE aggregate reporting (by SAMA) covering and defining the overall SOE portfolio, and including SOE legal status, share of state ownership, economic size (by assets/revenues) and sectoral distribution. For strategic and prioritized SOEs, also include a general statement on the ownership policy and its implementation, as well as non-financial information bearing on environmental, social and governance practices. Enforce SOE publication requirements, ensuring audited financial statements are publicly disclosed by SOEs. Follow the current plan to migrate most SOEs to IFRS and to promote that SOE financial statements are audited under ISA. For strategic and prioritized SOEs, enforce ISA standards and strengthen scrutiny of financial reporting by requiring independent audits provided by reputable firms. Request the MoEF, with the assistance of / in coordination with SAMA, to elaborate and make public an annual fiscal risk report on SOEs —with a focus on debt liabilities, quasi-fiscal deficits, and received subsidies.

- **SOE portfolio size, divestiture, and the role of market institutions**. Continue to reduce state ownership, especially for the case of SOEs operating in competitive sectors - - i.e., sectors with low entry barriers (based on cost structure and technology), which are not characterized by sub-additivity costs, and which are not related to negative or positive externalities. Adopt a new privatization law[200], refine the methodology ("rule of 5") regarding SOE creation to consider potential market effects, and leverage the CPCPC –former AMC - role in the creation of SOEs to minimize potential market distortions. Develop criteria for identifying subjects of natural monopolies based on economic rationale (including implications for price regulation).

[200] During the current report's preparation, the Law was in the second reading stage in Parliament. After the completion of this report, the new Privatization Law received approval in the Senate in November 2023 and is currently awaiting ratification by the President's Office.

- **Public service obligations (PSOs) and transparency of subsidies targeting SOE.** Ensure PSOs are properly costed and implementation decisions using public resources are made transparently through the budget process. This will provide SOEs with stronger cash flows and thereby enable them to undertake timelier investment and maintenance of capital assets. In turn, this would allow more optimal capital asset spending. Transparent compensation of SOEs´ PSOs through the budget should be separated from the revenues derived by SOEs from commercial activities to avoid risks of cross-subsidization and to avoid distorting prices of goods and services provided in competitive segments. Finally, increasing overall transparency on subsidies granted to SOEs as well as the private sector will contribute to a level playing field.
- Use protection measures included in the newly approved labor code to ensure adequate coverage for downsized workers. Those workers with formal contracts currently in force include standard severance provisions of up to three months following job termination, in addition to in-kind unemployment assistance in the event a worker is unable to find work during that time.
- Remove constraints on discussion of privatization and reform in media.
- Identify differences in long-term unemployment risk driven by the spatial density and workforce composition within affected districts, and other district-specific factors. Use discretionary tools outlined in the labor code to supplement support in cases where communities or individuals are disproportionately affected by reform.

## Other Reform Options

- **SOE performance management**. Ensure that performance monitoring units at SAMA and at the MoEF have sufficient capabilities. Link KPIs (both financial and non-financial) and associated targets to the SOE strategy and objectives to facilitate effective monitoring and evaluation (M&E). Enhance web-portal functionality to enable more sophisticated analysis and reviews of financial and non-financial SOE performance. This should be disaggregated by sectors, business development (such as exports, market destination, product line, and innovations), assets, and human resources, for example. Implement a ranking of SOEs based on KPI performance and classified by economic sector. For strategic and prioritized SOEs, extend the set of KPIs to cover financial, service delivery, human resources, social, and environmental aspects.
- **SOE boards.** Introduce a transparent and comprehensive system for selection of SOE board members aiming to attract independent parties into the selection process and establish a pool of potential board candidates. Empower supervisory boards to properly exercise their functions in terms of strategic SOE oversight and management supervision and act as effective governance bodies. For strategic and prioritized SOEs: (i) revise the role of the civil/public servant board participation, targeting a gradual reduction to bring corporate governance structures in line with best practices; (ii) set professional requirements for board members; (iii) comply with recently adopted regulations to establish supervisory board committees to support SOE supervisory boards in taking well-informed decisions. Such committees could concern audit or remuneration, depending on specific SOE needs, and should comprise members possessing appropriate skills and experience and be headed by independent board members; (iv) comply with the SOE Strategy requirement of independent supervisory board representing at least one-third of total board members; (v) introduce independent board members with the skills matching each SOE's long-term strategy and need; (vi) consider engaging out-of-country expertise; and (vii) implement

adequate training programs, peer exchanges, and learning opportunities for potential candidates and existing SOE board members.

- **Competitive neutrality principles.** Make the competitive neutrality principles binding, e.g., requiring SOEs to earn a profit on commercial activities and implement cost allocation systems to separate commercial from non-commercial activities in accounts, as outlined in the 2021 SOE Ownership Strategy, the 2020 Competition Policy Strategy, and the 2023 Law on State Assets Management.

- **Separation of State functions.** Separate ownership and oversight activities of SOEs from line ministries and regulators to minimize conflict of interest and market distortions. Gradually transfer all SOE ownership responsibilities to SAMA/MoEF.

- **Management of government subsidies.** Create and maintain a public registry of all central government subsidies and corresponding recipients, in particular for SOEs. Require all government agencies involved in central government subsidy design/granting to share information with AMC. Develop a fully-fledged subsidy control framework (ex-ante, ex-post control) for all granting agencies; and ensure AMC plays a central role in reviewing subsidy notification and analysis from a competition point of view.

- **Utility Tariffs**. Gradually raise utility tariffs to full cost recovery levels to mitigate SOE fiscal risks. Wholesale tariffs for gas and electricity should be raised to levels that cover the full supply cost, plus a competitive return on capital. End-user tariffs for consumers and businesses should be set at levels that cover the costs of supply of the transmission and distribution utilities unless the government decides to explicitly subsidize the energy consumption of specific groups of customers, in which case the full cost of the subsidy (PSO) should be paid for from the budget and transferred to the relevant utility.

- **Communications and change management:** As the authorities consider the various policy options outlined above, they would benefit from articulating a compelling narrative for the reform of the economic sectors dominated by SOEs and explain, in a clear and consistent manner, the unsustainability of the current system, the changes being contemplated and the necessary trade-offs. Equally important, the reforms of SOEs would need to be contextualized within the evolving role the state and the shift to the private sector as the engine of growth and source of employment. Within the individual SOEs undergoing reform, a change management plan would help leaders proactively engage with employees, reduce resistance from middle management, address concerns and generate an environment conducive for a smoother transition.
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# ANNEX 1: Railway services: corporatization, structural separation, and new efforts to private investment

The 2001 Presidential Decree "On measures for demonopolization and corporatization of railway transport" provided for the transformation of UTY holdings in transportation, repair of passenger and freight cars, refrigerator and container facilities into open joint-stock companies.[201] Subsidiaries/holdings engaged in activities unrelated to rail freight and passenger transport, including social facilities, auxiliary and service enterprises were to be structurally separated and/or sold by UTY.[202] The law also provides that these entities could be subject to divestiture by the government and privatized.[203] In subsequent years, the GoU corporatized the subsidiaries Uzjeldorpass (passenger transport services), Uzjeldorconteiner (transportation of goods in containers) and Yulreftrans (refrigerated wagons), as well as several other the enterprises involved in the repair of passenger and freight wagons.[204] Some holdings engaged in activities unrelated to the rail transport sector have been fully sold to private investors. In 2004, the GoU noted that privatization of those entities remaining in rail transport activities was slow and competition was still absent.[205]

New plans were underway in 2022 to privatize UTY and transform the sector. Presidential Decree #-101 of March 2022 requires the development of a strategy for SOE transformation, development, and privatization, as well as efforts to promote private operators for privately owned passenger and cargo services, as well as engagement of the private sector through PPP or franchise contracts for the same (domestic and international).[206] The Decree also calls for the development of competition in the sector more broadly and efforts to improve the business operations of UTY subsidiaries.

Source: World Bank staff consolidation.

[201] Section 3, the Decree of the President of the Republic of Uzbekistan dated 02.03.2001 N UP-2815, referring to "[enterprises and organizations] engaged in the transportation of goods and passengers [through railways], producing consumer goods, as well as providing freight forwarding services to shippers and passengers".
[202] Ibid.
[203] Section 3, the Decree of the President of the Republic of Uzbekistan dated 02.03.2001 N UP-2815 "On measures for the demonopolization and corporatization of railway transport".
[204] Decree of the Cabinet of Ministers of the Republic of Uzbekistan of August 3, 2004 N 366 "On further improvement of the organization of management of the State Joint-Stock Railway Company" Uzbekistan Temir Yollari.
[205] Ibid.
[206] See para. 12 in particular regarding the plans for UTY, Presidential Decree No. UP-101 dated April 08, 2022 "On the next reforms to create conditions for stable economic growth by improving the business environment and developing the private sector", paras. 12 and 13.

# ANNEX 2: Transforming the fertilizer sector and improving competition[207]

**Uzbekistan is currently pursuing various reforms aimed at liberalizing the mineral fertilizers sector and reducing state ownership.[208]** Historically, the GoU dominated the production of mineral fertilizers through Uzkimyosanoat (UKS), an SOE owned 100 percent by the State and managed through SAMA, which in turn holds majority shares in 8 fertilizer producers. In addition to fertilizer production, UKS bundles three other key functions under one entity – a government agency, shareholder of fertilizer plants and subsidiaries, and research and development (R&D) functions for the sector. In the distribution sector, the State is present through Uzagrokimyohimoya (UKH), an SOE owned 100 percent by the State and managed through the Ministry of Finance, which in turn holds majority shares in 13 fertilizer distributors. Alongside UKH's commercial distributor functions, it was responsible for plant quarantine and protection activities, including combating locusts and mulberry fires, R&D, and agrochemical analysis (laboratory testing), and related border control.

**In 2021, the GoU began the process of unbundling commercial and non-commercial activities within the remit of UKH—**by liquidating UKH and its regional distribution joint-stock companies,[209] and assigning all non-commercial functions to a new Agency for Plant Quarantine and Protection (APQP). Furthermore, the assets held by the 13 main enterprises/territorial branches of UKH (JSCs "Agrokimyohimoya"), which supplied mineral fertilizers and provided related services to farmers, are to be sold to the private sector. These moves will speed up the growing role of the private sector in mineral fertilizer distribution in recent years—between 2018 and 2020, the UKH's share of total sales at exchange auctions dropped by almost 20 percent. Vertically integrated and privately owned agribusinesses involved in production, processing and sales of cotton and wheat have been increasing their activities in distribution. In addition, two fertilizer production plants have been privatized,[210] two are currently undergoing privatization (JSC "Ferganaazot" and of JSC "Dehkanabad Potash Plant")[211] and transformation (involving management and financial reforms, including obtaining an international credit rating) as well as technology improvement—the Navoiyazot complex )[212] while two other plants have minority foreign ownership. Moreover, no new SOEs having been established in the past five years mineral fertilizer sector overall.

[207] After the finalization of this report, the GoU issued a Presidential Resolution #169 ( in October 2023), which changed the chemical sector's organizational structure. Among other things, the Resolution unbundled Uzkimyosanoat (UKS) and transferred the regulatory and SOE shareholding functions of UKS to responsible government bodies. These measures will allow UKS to focus on its core function of operating and managing existing assets prior to their privatization. The UKS shares of companies in the chemicals sector will be transferred to the State Assets Management Agency (SAMA) and UFRD. SAMA and UKS will do inventory of remaining UKS shares in companies and joint ventures and develop recommendations on transferring these shares from the UKS. UKS will relinquish the authority to perform policy and regulatory functions.[207] The function on development of new investment projects and their implementation will remain with the UKS until full privatization of assets in the sector.

[208] The IFC is heavily involved in these efforts, see https://disclosures.ifc.org/project-detail/AS/605537/uzbekistan-fertilizers.

[209] Presidential Decree No. PP-6262 "On Measures to Radically Improve the Quarantine and Plant Protection System in the Republic"6262 from July 15, 2021

[210] Formerly known as the Kukon Superphosphate Factory, this SOE was acquired in 2019 by Indorama Holdings, a wholly-owned subsidiary of Indorama Corporation, Singapore. See https://www.indorama.com/news/49. The second, Kungrad Soda Plant, was subject to a sale of 51% of the government's holding in 2019 to unknown buyers, see https://www.jdsupra.com/legalnews/privatization-in-uzbekistan-new-69000/.

[211] IFC (February, 2022). *IFC to Help Government of Uzbekistan Privatize One of the Key Chemicals Companies.* https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=26807

[212] The IFC is supporting the GoU in the transformation of the Navoiyazot complex, one of the largest chemicals and fertilizer SOEs in the country, with the aim to attract private sector solutions and investments for modernizing and developing it. https://disclosures.ifc.org/project-detail/AS/605537/uzbekistan-fertilizers

**Much more remains to be reformed in the sector, however, if private investment is to be further fostered and a dynamic competitive market emerge.** First, it is difficult to justify the continued presence of UKS and its subsidiaries in various market segments. From an economic perspective, per a recent taxonomy of sectors (Dall'Olio et al., forthcoming), none of the segments of the mineral fertilizers value chain justify exclusive state ownership on the basis of market failures involving cost structure or sub-additivity.[213] Nevertheless, contestable segments are still classified as legal monopolies. For instance, export of fertilizers is also subject to a legal monopoly attributed to Uzkimyoimpex, an SOE owned by UKS. Furthermore, Uzkimyoimpex is the single importer of equipment, spare parts, components, raw materials and materials for the production needs of UKS subsidiaries.

**Second, the SOEs that remain in the sector—even though JSCs are subject to IFRS and certain financial disclosure requirements—operate subject to little market discipline.** The absence of a clear definition in the law of what constitutes commercial activity continues to create risks of cross-subsidization and market distortions whenever UKS is subject to PSOs. In addition, without any obligation to earn a commercial rate of return, SOEs will continue to operate within soft budget constraints and potentially undercut private competitors on prices.

**Third, the GoU also continues to create competition risks through sectoral regulation and non-separation of commercial and non-commercial functions.** For example, the UKS negotiates on behalf of SOEs and private firms with the Ministry of Economic Development and Poverty Reduction (MEDPR), which prepares and approves the balance of production and resources needed for the sector on an annual basis. As part of this process, private firms are required to share commercially sensitive information through UKS and ultimately with other competitors—the absence of a direct intermediary-free mechanism for private sector players to share their data can lead to anticompetitive outcomes. In addition, mineral fertilizer prices are regulated under a 'cost+' approach, i.e., margin over cost, which removes incentives to reduce production costs in the absence of competitive pressures from private sector competition.

Source: Adapted from IFC (2022). Competitive Neutrality of the Fertilizer Sector in Uzbekistan.

[213] According to a forthcoming taxonomy of sectors, all segments of the fertilizer value chain would be either partially contestable, or competitive. See Dall'Olio et al. (forthcoming).