

An impact of tax reforms on the economic development in Uzbekistan

Maksudov Sherzod Ravshanbayevich
Mustaqil Izlanuvchi +998977004488

Annotation: As an independent state, Uzbekistan appeared on the world map in 1991. The country launched reforms that were supposed to create a base for running a market economy. In 1996, however the course of the economy was radically shifted towards intensification of state intervention in the economy and the implementation of an import substitution policy. To accelerate industrial development, the state redistributed huge flows of material, financial, monetary and labour resources through:

Direct allocation of resources, administrative regulation of commodity prices, interest rates and exchange rates;

High taxes and government expenditures;

Restricted access to the official exchange rate which is beneficial for currency buyers (usually two to three times different from the market rate);

Establishment of artificial monopolies by limiting the access to markets for new players and provision of tax, credit and other benefits to certain enterprises or groups of enterprises;

Direct ('manual') business management; and Limitation of imports by tariff and non-tariff barriers.

Key words: Tax, reforms, economic, economy, development, Uzbekistan, Independence, state.

The result was the extremely low level of economic efficiency and economic growth rates, high unemployment and external labour migration, and rampant corruption.

Due to the policies pursued, market reforms were curtailed and market mechanisms were partially replaced by command and administrative regulation. Limited competition, high business costs, and insecurity of property rights and deals hampered the creation of competitive manufacturing and other businesses. The incredibly large benefits and high level of monopolism stimulated corruption, rapid unearned incomes and the export of monetary capital. The artificial cheapening of capital (conversions at the lucrative official exchange rate, cheap loans, and tax exemptions) and expensive labour (due to high payroll taxes) led to utilisation of capital-intensive industries instead of labour-intensive ones, which, amongst other factors, contributed to extremely low employment in the formal sector. As the results of a sociological survey conducted in the summer of 2018 showed (no earlier data is available), with about 18.8 million people employed, employment in the official sector of the economy amounted to 5.3 million people (less than 30 per cent of the workforce), while in the informal sector – also about 5.3 million people (including 1.6 million employed in temporary one-off and seasonal jobs), the number of external labour migrants exceeded 2.6 million people. A very high level of direct government intervention in the economy has been established. The vast majority of large-scale enterprises and financial institutions are state-owned. Many enterprises are controlled by the state through controlling stakes or so-called 'golden shares'. The scale of state ownership is impossible to estimate due to the lack of respective statistics, but according to some estimates it exceeds 50 per cent of the country's total production assets. The state also owns more than 80 per cent of all the assets in the banking sector.[4] At the end of 2018, the expenditures of the consolidated budget of Uzbekistan amounted to 35.2 per cent of GDP in 2018, and considering quasi-fiscal expenditures of state enterprises, the volume of state expenditures amounted to no less than 41.2 per cent of GDP. These two figures are one and half to two times higher than similar figures of successfully developing countries with comparable GDP per capita and even higher than analogous figures of some advanced countries in the world. Uzbekistan's economy needs fundamental, systemic and consistent reforms and the replacement of the entire system of public institutions. The key task is to create environment for normal operation of effective market mechanisms. Uzbekistan's economic reforms began after the assumption of power by the new president. The following reforms are most important ones from an economic perspective:

Unification of exchange rates, liberalisation of the foreign exchange market and introduction of conversion for current operations (summer – autumn 2017);

Removal of various administrative barriers to cross border flow of goods and people (primarily with the neighbours of Uzbekistan) and reduction of customs charges (2017-18);

Reforms of banking sector and money circulation (2017-18);

Radical tax reform (2019); and Reduction of various administrative costs of doing business.

Several other important areas have already been outlined for reforms to be launched in 2020: administrative reform, agrarian reform, the restructuring and privatisation of state enterprises, a new stage of banking reform, and more. However, due to the COVID-19 pandemic, the timeframe and scope of these reforms became uncertain. Some of the reforms, both in progress and pending, are described below in more detail. Liberalisation of foreign economic activity. Up to 2017, the government of Uzbekistan had been implementing the policy of active protectionism, by limiting imports through the absence of free conversion of the national currency, high customs charges and non-tariff barriers. In addition, there were significant formal and informal barriers to the free movement of people and capital across borders. All of this deprived Uzbekistan of opportunities to fully participate in the international division of labour and to establish competitive industries. As already mentioned, in 2017-18 the government introduced free currency conversion for current transactions, removed a number of administrative barriers to the movement of goods and people and reduced customs charges, which constitute the most important achievements of reforms in Uzbekistan. However, starting from December 2018, under pressure from industry lobbyists, the government started to restore to some extent the import substitution and protectionism policy: earlier reduced customs charges for a certain range of FEACN codes were increased and new non-tariff barriers to import were introduced.[5] However, zero and low customs tariffs for some categories of goods are combined with rather high tariffs for other categories, which allows to keep the average customs tariff approximately at the level comparable to the average tariffs of the Eurasian Economic Union (EAEU) countries. As a result, in industries with high tariffs and non-tariff barriers, conditions are created for monopolisation of markets by particular companies. In connection with the COVID-19 pandemic in the spring of 2020, customs charges on a range of essential goods were abolished, the government plans to reduce customs charges on goods for business as well. There is hope that once the pandemic is over, the tendency of liberalisation of foreign economic activity will continue. The government has announced its desire to join the World Trade Organisation (WTO) as soon as possible. Joining the WTO will inevitably lead to the reduction of many tariff and non-tariff barriers to imports. Up to 2017, the bank-credit sector used to be one of the most regulated sectors of the Uzbek economy. Banks had no commercial independence, their activities, including the establishment of interest rates, were strictly regulated by the Central Bank and alternative credit institutions had very limited presence. The monetary system was fragmented and tight restrictions on cash circulation were in place, generating different values for different types of money. The deregulation and commercialisation of Uzbekistan's banking sector have taken place over the recent years. The Central Bank has significantly reorganised its activities in terms of control and regulation of commercial banks, regulation of money circulation and currency market. The banks have become more client-oriented, the cost of the banking services significantly reduced, the quality improved and the range of services expanded. The administrative restrictions on the purchase of currency and cash turnover have been removed. Nevertheless, more than 80 per cent of bank assets are still owned by the state, and the government is actively providing 'soft' and 'bad' loans (imposed by government agencies) through banks primarily to state enterprises. The credit sector competition is still underdeveloped, new players (both domestic and international) have limited access, and the non-banking sector is represented by only a small number of microfinance institutions and pawnshops. However, the government declares its intention to denationalise the sector, to privatise some part of the assets of state banks, to cease the practice of concessional lending, to increase access of foreign banks to the sector. Several important reforms were planned to be carried out in 2020. However, the coronavirus pandemic is undermining these plans. Preservation of the practice of concessional lending, administrative interference in the issuance and prolongation of loans (which is often almost inevitable in the conditions of an acute economic crisis) is especially dangerous for the planned reforms.

The key problems of the tax system of Uzbekistan, formed in the previous two decades, were as follows:

The overall high tax burden on the economy (mentioned above), especially high payroll taxes, which is burdensome for business;

Very complicated taxation rules which increase the costs of tax administration and create unequal game rules for business (a large number of taxes, different taxation regimes, separate rules for calculating the same taxes for different categories of taxpayers, great deviation from international practice in determining the tax base, a huge number of exceptions, additional rules, benefits, including individual ones, when paying taxes); Highly uneven distribution of the tax burden between the simplified and general taxation regimes (transition of an enterprise from the simplified to the general taxation regime increased the tax burden several times), as well as between different sectors of the economy; and Broad application of taxes on gross revenues (turnover), which negatively affect the public division of labour and the formation of long value chains (as the goods move along the chain, the same value was taxed many times, and the longer the chain, the higher the tax burden). These problems became the key reasons for the low level of registered employment of the population, did not allow to carry out deep processing of raw materials and to create competitive manufacturing by utilising the advantages of economies of scale and narrow specialisation, forced the business to go into the 'shadow economy', to split into parts, and destroyed the competitive environment. On January 1st 2019, Uzbekistan launched a tax reform process, during which many of the above-mentioned problems were already addressed (partly or completely).[10] The following achievements were particularly important:

Drastic reduction of taxation on labour (by one and half to two times);

Significant reduction of the tax burden on enterprises under the general taxation regime (the most important ones are the reduction of the VAT rate from 20 to 15 per cent, elimination of contributions to the State Targeted Funds from revenues – 3.2 per cent); Significant reduction in the sphere of influence of turnover taxes (before the reform these taxes were paid by almost all enterprises, now medium and large enterprises do not pay them at all, and small enterprises can choose between turnover tax and VAT); and Work has begun on eliminating a huge number of tax privileges and exemptions, equalising tax conditions for all parts of the economy. Several mistakes in the preparation and initial phase of the reform were corrected by subsequent adjustments in the second half of 2019. In particular, VAT was reduced from 20 to 15 per cent, the refusal to provide tax benefits and exceptions began, and some mechanisms for paying VAT were improved. Nevertheless, relatively high tax administration costs and overall high level of redistribution of revenues through the budget and quasi-budget funds remain. Due to the coronavirus pandemic, some businesses have been given tax holidays and several inefficient budget and quasi-budget expenditures are being reduced. It is hoped that after the pandemic it will be possible to maintain some positive steps towards reducing state participation in the economy.

In conclusion, the author would like to note that there is an acute objective need for expert and organisational support for reforms in Uzbekistan by international organisations, governments of foreign countries and the international expert community. Without it, it will be quite difficult for the country to build and implement an effective strategy of reforms, which will make it possible to shape a fundamentally new socio-economic system.

Reference:

1. The currency was distributed at the official exchange rate not on the free market and between 'selected' buyers in accordance with decisions of officials who were guided by: a) the development priorities of certain industries defined by state programs, b) corruption interests.
2. Source: Databank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators#>
3. Kun.uz, 7.9 million Uzbeks work in informal sector, October 2018, <https://kun.uz/ru/69289201>; The figure for external migrants seems to be substantially underreported.
4. Nuz.uz, Banking sector transformation: strategic challenges for Uzbekistan, January 2020, <https://nuz.uz/ekonomika-i-finansy/45851-transformaciya-bankovskogo-sektora-strategicheskie-vyzovy-dlya-uzbekistana.html>

-
5. Foreign Economic Activity Commodity Nomenclature, the customs codes used in the post-Soviet Space Additional requirements for properties of imported goods and conditions for their sale, different from the requirements for local goods, or difficult to achieve for importers.
 6. Julius Yusupov, What will result in growth of customs payments, ced.uz, October 2019, <http://ced.uz/publitsistika/chem-obernetsya-rost-tamozhennyh-platezhej/>