State-owned enterprises in Uzbekistan: Taking stock and options for the future

Umidjon Abdullaev*

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Abstract

The state is a major owner of industrial and commercial enterprises in Uzbekistan. State-owned enterprises (SOEs) dominate and have significant influence on the performance of most sectors in the economy including natural resources, energy, manufacturing, telecommunications, transport and agriculture. The purpose of this paper is to review the economic weight and degree of presence of SOEs in the economy of Uzbekistan, analyze in detail governance mechanisms currently employed by the Uzbek government to manage its portfolio of commercial enterprises and discuss the scope of Uzbekistan's past and ongoing privatization initiatives. A number of recommendations for addressing key issues identified in the paper are outlined.

*Principal Economist, Department of Economics, Policy and Governance (EPG), European Bank for Reconstruction and Development (EBRD). I would like to thank Maxim Dogonkin, Nail Hassanov, Sergei Guriev, Rika Ishii, Kahramon Juraboev and Martin Pospisil for useful comments and suggestions. Helpful comments received at the EBRD EPG brown bag seminar and the meeting of the EBRD Community of Practice on Privatization are gratefully acknowledged. The views expressed in this paper are those of the author and do not necessarily represent those of the EBRD or EBRD policy.

Executive Summary

State-owned enterprises (SOEs) in Uzbekistan dominate and have significant influence on the performance of most sectors in the economy including natural resources, energy, manufacturing, telecommunications, transport and agriculture. The SOE sector has been the key driver of Uzbekistan's industrial development during the past decades and will likely remain so in the coming years. In this respect, understanding better the SOE sector and identifying some of its critical issues and bottlenecks should help design effective reform initiatives in the future.

The study demonstrates that the state continues to be a major owner of industrial and commercial enterprises in Uzbekistan. Despite difficulties related to lack of data on economic weight of SOEs, available evidence suggests that SOEs are present in most sectors of the economy and many SOEs are dominant producers of goods and services in their markets. Moreover, some major enterprises continue to play sector supervision and, in some cases, regulatory role they inherited from their predecessor institutions. Significant role of SOEs extends not only to industrial sectors, but also to the banking sector and a number of financial service markets. Lack of data does not permit adequate analysis of the financial and operational performance of SOEs but a number of recent government decrees enacting a wide range of restructuring and support measures to major SOEs point to their suboptimal performance.

Uzbek government has on numerous occasions stated its willingness to reduce the degree of state presence in the economy, particularly by using privatization as one of the main tools for achieving this objective. Analysis of decrees initiating large privatization programs in late 1990s and 2000s indicates that the government did consider partial divestment of its shares in strategic SOEs in mining, oil and gas, energy, transport, telecommunications and manufacturing but those attempts largely did not succeed. Data on the progress of privatization during the past decade indicates that the government continues to sell its assets but current efforts focus on small or non-core enterprises and, often, on unused real estate property. The scope of recent privatization programs remains largely limited and existing legislation clearly rules out the privatization of major enterprises in energy, natural resources, chemicals, vehicle manufacturing, transport, telecommunications and agriculture. Two major state-owned banks are also indicated to be not subject to privatization.

With few exceptions, major SOEs have been corporatized and key elements of formal governance structure of SOEs appear to be in place. Building blocks of governance structure of large SOEs including the law on joint-stock companies, the corporate governance code, disclosure requirements exist and basic formal accountability lines between enterprise management, supervisory board and shareholders appear to be sufficiently determined. Despite these improvements, further work on improving the efficiency of the formal governance structure is necessary, particularly in terms of increasing the degree of board autonomy in SOEs, strengthening board professionalism (e.g., by introducing independent board directors) and ensuring full degree of compliance with standards and practices prescribed by the legislation.

At the same time, the government continues to use a range of additional governance mech-

anisms that influence the performance and day-to-day operations of SOEs. These range from existence of additional accountability lines of CEOs of large SOEs directly to the Cabinet of Ministers to a set of policies and instruments affecting enterprise decisions concerning capital investments, production, pricing, purchase of inputs, and exports. Direct governance mechanisms employed by the government provide effective tools for channeling SOE operations towards achieving its industrial policy objectives but likely at the expense of efficiency of SOEs and their ability to respond to market signals. Moreover, these measures weaken the role of recently introduced formal corporate governance mechanisms (dual board structure following corporatization, disclosure requirements, use of performance KPIs), which, in essence, prioritize clear accountability lines and enterprise efficiency.

There appear to be a number of overarching issues related to economic weight and governance of SOEs in Uzbekistan. These include (i) determining the optimal degree of presence of SOEs in the economy and reducing the degree of interference of the government in their day-to-day operations; (ii) improving overall governance structure of the SOE sector by separating regulatory and supervision from ownership and management functions currently concentrated in major SOEs overseeing sectors; (iii) strengthening the corporate governance mechanisms to create clear accountability lines of SOE management to the board and improve board autonomy and effectiveness; and (iv) exposing SOEs to competitive pressure from domestic and foreign private sector players and creating a level-playing field between SOEs and private sector enterprises. Nevertheless, due to Uzbek government's view of SOEs as key tools for implementing its industrial policy objectives, it will likely resort to gradual and cautious approach to reforming the SOE sector.

1 Introduction

State-owned enterprises (SOEs) in Uzbekistan dominate and have significant influence on the performance of many sectors in the economy including natural resources, energy, manufacturing, telecommunications, transport and agriculture. Given that Uzbekistan is currently reinvigorating its reform efforts, particularly in terms of increasing the role of the private sector, strengthening economy's export potential and increasing its efficiency, detailed analysis of its SOE sector is of utmost importance. The SOE sector in Uzbekistan has been the key driver of its industrial development during the past decades and will likely remain so in the coming years. In this respect, understanding better the SOE sector and identifying some of its critical issues and bottlenecks should help design effective reform initiatives in the future.

The purpose of this paper is to review the economic weight and degree of presence of SOEs in the economy of Uzbekistan, discuss the evolution of the scope of its privatization initiatives and analyze in detail the governance mechanisms currently used by the Uzbek government to manage its portfolio of commercial enterprises. The study is based on publicly available information on Uzbekistan's SOE sector including data available from the State Committee for Statistics, the Centre for Management of State Assets (CMSA) and a public repository of Uzbek legislation. In this respect, major limitation of the study is lack of analysis of operational performance of SOEs due to limited availability of consolidated and complete data on their financial and operational performance.[1]

The paper complements a number of earlier related studies carried out primarily by international financial institutions (IFIs) by identifying the scope of the SOE sector in the economy using latest available data, providing detailed analysis of a number of issues concerning the governance structure of SOEs and by evaluating government's past privatization initiatives.[2] The paper is structured as follows. Section 2 provides information on the economic role and weight of SOEs in the economy of Uzbekistan. Section 3 evaluates the scope of current and past privatization initiatives. Section 4.1 looks into formal corporate governance structure of SOEs in Uzbekistan, while section 4.2 discusses a number of further governance mechanisms that the state uses to exert control over SOEs. Section 5 concludes with a set of recommendations.

[1]Necessity for the analysis of financial performance of SOEs in Uzbekistan and its difficulty due to lack of relevant data were pointed out also in the recent Systematic Country Diagnostic for Uzbekistan prepared by the World Bank (World Bank, 2016).

[2]For earlier studies see Broadman (2000), Conrad and Lin (2005) and Conrad (2008)

2 Economic weight and role of SOEs in the economy

SOEs in Uzbekistan have traditionally been viewed as a key tool for achieving country's industrial policy objectives. Uzbekistan has during the past two decades implemented various activist industrial policies aimed at supporting existing and developing new industrial capacities in the country. SOEs have been an integral part of this strategy and state's production, export and import substitution objectives over a wide range of goods have commonly translated into specific targets for major SOEs. SOEs in a number of sectors are also explicitly indicated to be of strategic importance for economic development of the country (see Box 1).

Major SOEs overseeing sectors of the economy trace their history to sector ministries. Historically, management of enterprises in Soviet-type economies had been carried through sector-specific ministries (also referred to as "line ministries"), which was the common method of organizing the work of enterprises around state development plans and policies. Following the breakup of the Soviet Union, such ministries in many former Soviet economies were dismantled. In Uzbekistan, sector ministries were in many cases converted to holding companies, associations or so-called concerns, which largely retained the functions of original sector ministries in terms management of sector enterprises, their supervision and overall implementation of industrial development policies.

During the past two decades, sector associations and concerns have been corporatized and transformed into sector-specific joint-stock or holding companies but many major SOEs retained their original multiple mandates and responsibilities. This largely translated into the current structure of industrial sectors in Uzbekistan, which are commonly characterized by a major sector-specific holding or joint-stock SOE with a mandate of managing the portfolio of SOEs operating in the sector, monitoring or supervising the performance of private

Table 1: Examples of major state-owned enterprises in Uzbekistan

Sector	Enterprise	Key products/services
Agriculture	Uzpakhtasanoateksport Holding Company	Purchase, storage, processing and export of cotton
	Uzdonmahsulot JSC	Grain storage, production of flour, bread products
Mining, metals	Almalyk Mining and Metallurgy Complex JSC	Mining, metals (copper, silver, gold and others)
	Navoi Mining and Metallurgy State Company	Mining, metals (gold, uranium and others)
	Uzmetkombinat JSC	Ferrous metals
Oil and gas	Uzbekneftegas Holding Company	Oil and gas exploration and production
Electricity supply	Uzbekenergo JSC	Production, distribution and sale of electricity
	Uzbekhydroenergo JSC	Operation and management of hydro power plans
Manufacturing	Uzagrotehsanoatholding Holding Company	Production, servicing of agricultural machinery
	Uzavtosanoat JSC	Production of automobiles, trucks and buses
	Uzbekengilsanoat JSC	Production of textile products
	Uzeltekhsanoat JSC	Consumer and industrial electronic products
	Uzbekoziqovqatholding Holding Company	Production and export of food products
	Uzkimyosanoat JSC	Production of chemical products, fertilizers
	Uzstroymaterialy JSC	Production of construction materials
	Uzsharobsanoat JSC	Production of alcoholic and other beverages
Transport	Uzbekiston Havo Yollari National Air Company	Air transportation, management of airports
	Uzbekrailways JSC	Rail transportation

Note: Most of listed enterprises also carry the official designation of "economic management bodies", which commonly implies that an enterprise has not only operational but also sector supervision and related functions.

Table 2: Sectoral distribution of enterprises monitored by the Center for Management of State Assets (CMSA)

Sector	Share (%)	Count
Professional, scientific and technical activities	25.4	356
Construction	18.1	254
Real estate activities	7.9	111
Information and communication	7.8	109
Manufacturing	6.1	85
Transportation and storage	5.9	83
Wholesale and retail trade	5.4	76
Administrative and support service activities	5.1	71
Agriculture, forestry and fishing	3.9	54
Electricity, gas, steam and air conditioning supply	2.6	37
Water supply; sewerage, waste management	2.1	29
Human health and social work activities	2	28
Other	7.7	108
Total	**100**	**1401**

Source: List of enterprises monitored by the CMSA in 2016 and the State Registry of Companies.

enterprises and implementing state's sector development policies.

State's portfolio of industrial and commercial enterprises is large and spans most economic sectors. Complete and up-to-date data on the number and sectoral distribution of enterprises owned or controlled by the state is not publicly available. Despite constraints related to availability of such data, existing evidence suggests that SOEs are present in most sectors of the economy including in energy, mining, oil and gas, light and heavy manufacturing, telecommunications and transport (Table 1).[3]

The government agency responsible for the management and monitoring of state's portfolio of industrial and commercial enterprises is the Centre for the Management of State Assets (CMSA), a unit within with the State Committee for Assistance of Privatized Enterprises and Support of Competition (also referred to as the State Committee on Competition (SCC)).[4] CMSA lists little over 1400 enterprises in its 2016 report on the performance of enterprises it monitors, which likely includes core commercial and revenue generating SOEs operating in Uzbekistan. Sector affiliation of enterprises the CMSA monitors shows that SOEs are present in most sectors of the economy including provision of various professional and technical services (engineering, standardization, testing, veterinary services), construction, information and communication (telecommunications and newspaper publishing), real estate (including

[3]The term "state-owned enterprise" is used to refer to enterprises with different degrees of state ownership. Complete and up-to-date data on the size of state ownership in each SOE is not publicly available. Major SOEs including those listed in Table 1 are commonly fully or majority owned by the state.

[4]The State Committee for Assistance of Privatized Enterprises and Support of Competition was formed by merging former State Committee for Management of State Property and former Antimonopoly Committee into a single agency.

Table 3: Share of the state sector according to official state sector classification (%)

	2000	2005	2010	2016
GDP	24.7	23.6	20.4	18.7
Industry	36.1	13.8	8.2	6.2
Services	-	-	12.0	9.2
Fixed capital investments	63.9	30.9	21.8	16.6
Exports	35.3	29.3	26.9	30.7
Imports	23.2	15.7	10.9	9.8
Employment	24.1	22.8	20.7	17.5

Note: According to the State Committee for Statistics the "state sector" classification only accounts for activities of enterprises fully owned by the state.
Source: State Committee for Statistics of the Republic of Uzbekistan.

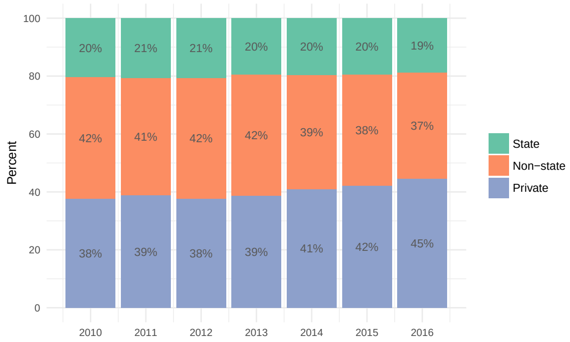
ownership and management of markets) and various manufacturing activities (metals and metal products, fertilizers, food products, chemicals and various machinery) (Table 2).

Official data on state sector performance underestimates contribution of SOEs to GDP, employment and other economic indicators. Comprehensive and reliable data on the share of SOEs in GDP, sectoral and regional value-added, employment and exports is not available. Official sources provide information on the contribution to economy of a group of enterprises that are classified to be in the "state sector". However, this classification includes only enterprises that are fully owned by the state making it too restrictive. Definition of a "state enterprise" defined in the legislation includes only so-called "state unitary enterprises" and, thus, excludes companies of other legal forms with state ownership share (e.g., joint-stock or limited liability companies) (Government of the Republic of Uzbekistan, 2006c). Acknowledging potential limitations of this classification, according to official estimates, share of the state sector in economy is relatively modest and it has been gradually declining during the past decade. In particular, in 2016 the state sector accounted for about 18% of GDP, 6% of industrial output, 20% of external trade and 17% of total employment (Table 3).

Official data also indicates that the state sector has minimal presence in construction, transport and communication sectors and plays no role in agricultural output. As many subsidiaries of major SOEs have mixed ownership (mixture of direct state ownership, ownership by other SOEs and sometimes also by employees, management or foreign investors), reported share of the state sector likely understates the actual footprint of SOEs in the economy due to activities of many of them being classified as contribution to the so-called non-state sector of the economy. Non-state sector group of enterprises accounted for 37% of GDP in 2016. Enterprises in the private sector, category used by official sources to account for activities of fully privately owned enterprises and individual entrepreneurs, contributed to about 45% of GDP (Figure 1).

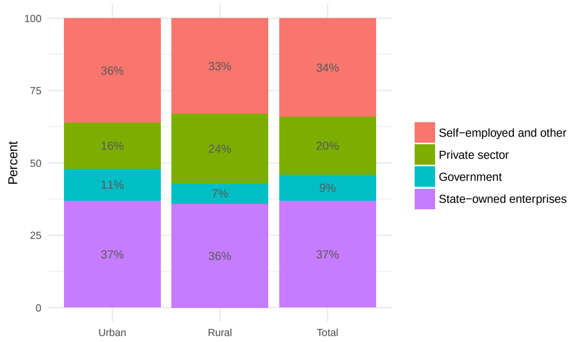
SOEs account for a significant share of industrial output. Despite lack of reliable estimates of contribution of SOEs to GDP, authorities report information on contribution of enterprises with majority state ownership to industrial output. In particular, enterprises with majority state ownership accounted for 47% of total industrial output in 2017. Contribution of such

Figure 1: Contribution of state, non-state and private sectors to GDP (%)



Source: State Committee for Statistics of the Republic of Uzbekistan.

Figure 2: Employment in state-owned enterprises, survey evidence



Source: Ajwad M. et al. (2014). The Skills Road: Skills for Employability in Uzbekistan.

enterprises to industrial output varies considerably across regions ranging from 26% in Namangan region (Ferghana valley) to up 80% in Navoi and Karakalpakstan (State Committee for Statistics, 2018).

Large enterprises, which are primarily SOEs, are dominant contributors to industrial production and foreign trade. Additional evidence of significant share of state-owned enterprises in economy is data on contribution to industrial production and foreign trade of enterprises by size. According to available data, large enterprises accounted for about 60% of industrial production and over 60% of foreign trade in 2016 (Table 4). Within specific industrial sectors, large enterprises dominate mining, energy, water supply and waste management sectors (around 90% of total output in sectors). The role of small and micro enterprises is consistently increasing only in manufacturing, where their contribution to total manufacturing output reached 50% in 2016. Large enterprises dominate both export and import as well, though the role of small business has been gradually increasing. Given that majority of large enterprises that operate in most industrial sectors are either state-owned or state-controlled, data on contribution of enterprises to industrial production and trade by size likely better reflects the true footprint of SOEs in the economy, particularly in key sectors determining its growth and pace of development.

Alternative sources of data on economic weight and contribution of SOEs to economy are lacking. Lack of household or nationally representative firm survey data in Uzbekistan also limits other indirect sources of information, which could facilitate better assessment of the role of SOEs in the economy.[5] Little available survey data provides evidence of more important role of SOEs and state sector employment than suggested by official estimates. For example, according to the Uzbekistan Jobs, Skills and Migration Survey undertaken by the World Bank in 2013, 37% of the employed worked in SOEs. Survey also indicated that about 34% of the employed were self-employed, which suggests that employment in SOEs accounted for more than half of wage employment (Figure 2) (Ajwad et al., 2014).

[5]There is no recent publicly available and nationally representative labor force or household survey data for Uzbekistan. Business Environment and Enterprise Performance Survey (BEEPS) undertaken on regular basis by the World Bank and EBRD has very limited coverage of SOEs.

Table 4: Share of large enterprises in industrial production and foreign trade (%)

	2010	2013	2016
Industrial production	73.4	67.5	59.4
Mining and quarrying	80.7	95.4	96.0
Manufacturing	68.6	59.6	49.6
Electricity, gas, steam supply	95.4	97.2	96.3
Water supply; sewerage, waste management	95.6	93.7	89.6
Foreign trade	77.2	65.8	64.3
Export	86.3	73.8	73.0
Import	64.2	57.6	55.5

Source: State Committee for Statistics of the Republic of Uzbekistan.

Many SOEs are monopolies or dominant producers of goods and services in their sectors. Information on market position of many SOEs in a number of markets also points to their importance and significant market power. This is evident from the registry of companies with dominant position in different product and service markets, which is regularly published by the State Committee on Competition (SCC).[6] Recent version of the registry lists over 120 goods and services along with 500 enterprises that provide them at either country level or within regional markets (the registry includes a large number of regional subsidiaries of major SOEs). Analysis of the list suggests that more than 90% of enterprises included in the registry are either state-owned or state has some degree of control in them (e.g., joint-ventures). SOEs hold dominant market position in vehicle manufacturing, chemicals, supply of seeds, fertilizers and fodder to the agricultural sector, supply of coal and gas, production of construction material (e.g., cement, asphalt and others), provision of access to international data networks, various certification and engineering services, processing of cotton and others.[7]

SOEs are incorporated in different legal forms and they are prominent among joint-stock companies. SOEs are commonly incorporated using different legal forms including joint-stock companies (JSCs), state unitary enterprises and limited liability companies. State ownership appears to be specifically prominent among joint-stock companies. In particular, as of end-2016, out of 659 existing JSCs state had direct ownership share in 158 enterprises (24% of all JSCs), while shares of further 329 JSCs were owned indirectly through other state-owned SOEs (49% of all JSCs). In other words, 73% of existing JSCs in Uzbekistan are either majority state-owned or state has some degree of control and ownership in them. In terms of volume of JSC share capital owned by the state, as of end-2016 84% of existing share capital of JSCs is directly or indirectly owned by the state (State Committee for Support of Privatised Enterprises, 2017).

State's portfolio of commercial enterprises includes both large and small enterprises. In particular, according to the state registry of enterprises, over 65% of enterprises monitored

[6] Another related registry that the SCC maintains is the official registry of natural monopolies.

[7] An enterprise is classified as a dominant one in a given good or service market if its market share exceeds 50% of total market size (including imports). Under certain conditions a 35% market share or above is already sufficient to classify the enterprise as the one with a dominant position (Government of the Republic of Uzbekistan, 2012a).

by the CMSA are classified as small businesses.[8] Overall, data from the state registry of enterprises indicates that there were over 38 thousand state-owned legal entities in 2016 (accounting for 13% of all non-farm entities). However, this figure is not a reliable estimate of commercial SOEs in the economy as it commonly includes inactive enterprises and real estate property fully owned by the state but registered as a separate legal entity.

State presence is significant not only in industrial sectors but also in financial services. Sizable state ownership is a prominent feature also of banking and financial services sectors. In particular, ten banks with state ownership share (out of total 27) account for over 80% of total bank loans and over 75% of banking sector assets. Leasing sector is also dominated by the state-owned companies. Four out of five largest leasing companies are either state-owned or state-controlled and they accounted for over 45% of total volume of new leasing transactions in 2016.[9] Insurance market is heavily dominated by state-owned and state-controlled companies as well. Four top insurance companies are all directly or indirectly state-owned and their total market share exceeds 50% (out of 26 insurance companies operating in 2016).[10]

Major SOEs continue to perform sector supervision and, in some cases, regulatory functions, which conflicts with their simultaneous role of enterprise owners and managers. In addition to being key economic players in different sectors of economy, major SOEs carry out various supervisory and regulatory functions over companies operating in a sector, both private and state-owned, which expands their economic weight beyond their actual market share. As noted earlier, role of major SOEs in sector supervision and, in some cases, regulation is the outcome of them being successors of old sector ministries. In addition, this role continued to be reinforced during the past decades due to SOEs being viewed by the government as a key tool for achieving its industrial policy objectives.[11]

Supervisory and regulatory functions range from development, monitoring and implementation of sector development programs to very specific control functions like issuance of permissions to other companies in a sector, participation in the decision to issue licenses to new sector entrants, implementation of systems of quality control, development and approval of sector-specific regulation and enforcement of technical and other standards (see Table A.1 in Annex for examples of supervisory and regulatory functions carried out by major SOEs). This arrangement creates significant conflict between responsibilities of some major SOEs related to developing and enforcing sector regulation, ensuring efficient performance of its operational subsidiaries, supervision of existing private sector competitors, if any, and regulation of entry of new players.

Another key aspect of SOE operations in Uzbekistan that significantly influences the rest of the economy is their instrumental role in allocation of goods indicated to be of strate-

[8]Depending on a sector, enterprises employing up to 270 people can be classified as small. Specific threshold level of employment varies across sectors and ranges from 6 to 270 employees (Government of the Republic of Uzbekistan, 2016b).

[9]Uzbekistan Leasing Sector Overview for 2016: `http://ula.uz/files/1487650553.pdf`.

[10]Report of the Ministry of Finance of on the insurance market in Uzbekistan for 2016: `https://www.mf.uz/deyatelnost/deyatelnost1/strakhovanie.html`.

[11]See also Conrad and Lin (2005) for detailed discussion of mechanisms of implementation of industrial policy in Uzbekistan used by the government in 1990s and early 2000s.

gic importance to the country. Allocation of a number of key goods have for many years remained under close government control and SOEs have been the key tool in implementing this policy. Goods produced by major SOEs that have been subject to state allocation requirements include natural gas, oil and other fuels, electricity, coal, metals and certain metal products, fertilizers, wheat, cotton and others (Government of the Republic of Uzbekistan, 2004d, 2006b). A decree approved in late 2017 suggests that the government intends to dismantle this system starting from 2018, in particular by starting the process of selling some of these goods through the commodity exchange only (Government of the Republic of Uzbekistan, 2017b). Economic impact of this recent initiative is currently not fully clear, but the ultimate extent of this reform initiative and success of its implementation will better define the future role of SOEs in the supply of these goods across the economy.

Fiscal implications of soft-budget constraints many SOEs face are likely non-negligible. In addition to government facilitated access to key resources discussed above, implementation of state development policies in Uzbekistan has traditionally been characterized by the provision of a wide range of enterprise and project support mechanisms. These commonly include tax breaks, provisions for non-payment of customs duties on imported equipment and inputs, low-interest local and foreign currency financing, sovereign guarantees and others.[12] There are no reliable estimates of the size of benefits and subsidy measures provided by the government to SOEs. At the same time, making this estimate will also be difficult given that most benefits are provided in targeted manner to specific SOEs or to their investment projects and a central repository of all support measures does not exist.

Comprehensive publicly available data on financial and operational performance of SOEs is also lacking. Nevertheless, several recent government decrees suggest that enterprises in a number of sectors have been underperforming. For example, a series of government decrees approved in 2014 indicated a suboptimal performance of multiple SOEs in chemicals, oil and gas, energy, construction and manufacturing sectors and legislated a number of turnaround and support measures to revive their performance (Government of the Republic of Uzbekistan, 2014a,b,c). An extensive set of enterprise support and restructuring measures with respect to major SOEs have also been enacted following the unification of the exchange rate and introduction of mechanisms for market-based allocation of foreign exchange resources in 2017 (Government of the Republic of Uzbekistan, 2017c).

In addition, many SOEs have for several years been mandated to improve their efficiency and cut their operational costs. Following the onset of the financial crisis in 2008 a government decree mandated over 30 large SOEs and industry associations to reduce costs in 2009 by an average of about 20% (Government of the Republic of Uzbekistan, 2009). Similar in nature and scope decrees with specific cost reduction targets across key types of cost categories (e.g., energy use, inputs and others) were further issued annually between 2012 and 2016. Cost reduction targets averaged between 10% and 15% across SOEs (Government of the Republic

[12]Other measures with no immediate fiscal implications include ability to bypass existing legislation or provisions for exemptions. These, for example, can be the approval of construction works for specific investment projects before design documentation is completed, ability to receive government-facilitated financing before approval of the final business plan or sector-specific exemptions to banking prudential regulation (e.g., provision to exceed sector concentration limits for banks to facilitate sector-specific financing).

of Uzbekistan, 2012c,b, 2014d, 2015c,b). These targets involved all major SOEs in agriculture, energy, mining, chemicals, heavy and light manufacturing, transport and other sectors.

Despite lack of data permitting more adequate analysis of economic weight of SOEs in Uzbekistan, available evidence suggests that SOEs continue to play important role in country's economic performance. As discussed above, evidence suggests that SOEs are present in most sectors of the economy, many SOEs are dominant producers of goods and services in their markets and major SOEs continue to play sector supervision and, in some cases, regulatory role they inherited from their predecessor institutions. Significant role of SOEs extends not only to industrial sectors, but also to the banking sector and a number of financial service markets.

Box 1: Strategic sectors, enterprises and goods in Uzbekistan

Terms "strategic sectors" or "strategic enterprises" are frequently used in legislation, various economic reports and media in Uzbekistan, though specific definition and criteria for what qualifies a sector or enterprise to be "strategic" are not available. Despite ambiguity over the criteria, implications of a sector or enterprise being classified as strategic are more evident. Such sectors and enterprises are more likely to be characterized by high degree of state intervention and direction, restrictions on scope of privatization and private sector participation and, in some cases, presence of various price control and output allocation mechanisms.

A presidential decree on improvement of performance of SOEs approved in 2016 lists eight enterprises that are indicated to be of strategic importance for economic development of Uzbekistan. These include key SOEs in the oil an gas sector (Uzbekneftegas Holding Company), energy (Uzbekenergo JSC), transport (Uzbekistan Railways JSC, Uzbekistan Airways), telecommunications (Uzbektelecom JSC), mining and metals (Navoi and Almalyk Mining and Metallurgy Complexes) and banking (Halq Bank). Initial version of the decree also included the National Bank for Foreign Economic Activities and Uzbekavtoyol JSC but both were removed from it in 2017 (the latter enterprise responsible for construction and maintenance of roads in Uzbekistan was transformed into a state committee in 2017). Except for the Halq Bank, all companies in the list are either monopolies or dominant producers of goods and services in their sectors.

In a recent presidential decree approved in 2017, the term "strategic" was further applied to an extended list of over 50 SOEs. The purpose of the list was to indicate important SOEs that are not subject to privatization. In addition to eight enterprises mentioned above, the list covers further enterprises in agriculture (cotton and wheat processing), chemicals and various manufacturing (agricultural machinery, vehicle production, construction materials and food processing).

The term "strategic" is also applied in legislation to a number of goods, which subsequently makes them subject to price controls and regulation on their allocation across different types of consumers (government, SOEs, export, private sector). The list of goods of strategic importance includes electricity, natural gas, petrol and other fuels, coal, fertilizers, cotton, metals and certain construction materials (e.g., roof slate). Allocation of some of these goods across consumers is commonly controlled through the annual exercise of preparing so-called "material balances" (supply-and-use balances), which prescribe the amount of goods made available to different types of consumers at government approved prices (see Section 4.2 for further details). The government has indicated in late 2017 that starting from January 2018 some of the goods classified as strategic will be offered through the commodity exchange only, presumably at market determined prices.

Source: Government of the Republic of Uzbekistan (2016e, 2017f, 2004d, 2017b).

3 Scope and progress of privatization programs

Privatization has traditionally been indicated as one of the main tools for reducing the role of state in the economy. Uzbek government has on numerous occasions stated its willingness to reduce the degree of state presence in the economy, particularly by using privatization as one of the main tools for achieving this objective. Privatization in Uzbekistan has had two distinct stages. The first stage started in 1992 and involved large scale divestment of state shares in small enterprises in agriculture, construction, transport, communications and various retail and other service sectors. This stage was also characterized by a large-scale privatization of state-owned housing stock. Unlike early stage privatization efforts, programs initiated from late 1990s and onwards were carried out already on a case-by-case basis and focused not only on small to medium-size SOEs but also on partial privatization of large SOEs (Lieberman et al., 1997; Conrad and Lin, 2005).

Key privatization programs of late 1990s and 2000s had wide scope and ambition, though efforts to privatize large SOEs were not successful. Analysis of decrees initiating large privatization programs in late 1990s and 2000s indicates that the government did consider partial divestment of its shares in strategic SOEs in mining, oil and gas, energy, transport and manufacturing but those attempts largely did not succeed. Data on the number of privatized entities does indicate that the government has continued to sell its assets during the past years but efforts focused on small and auxiliary enterprises and, often, on unused real estate property (Table 5).[13]

Table 5: Privatisation in Uzbekistan, selected years

	2005	2009	2010	2011	2015	2016	2017
Privatised entities	980	135	96	95	848	609	542
Privatisation proceeds, mln USD*	68.2	23.6	14.0	21.8	36.7	51.0	28.1

*At end-of-the-year official exchange rate.
Source: State Committee for Statistics of the Republic of Uzbekistan.

Major SOEs are currently indicated to be not subject to privatization. Overall scope of privatization programs of Uzbekistan is defined in the "Law on denationalization and privatization" approved shortly following the breakup of the Soviet Union in November 1991 (Government of the Republic of Uzbekistan, 1991). The law indicates that SOEs in a wide range of sectors including in mining, oil and gas, chemicals, cotton processing, energy, manufacturing, information technologies, transportation, postal services and others may potentially be offered for privatization. However, one specific clause in the law specifies that SOEs included in a dedicated government approved list will remain in state ownership and not be offered for privatization.

The latest version of the list includes over 50 SOEs that are explicitly excluded from future privatization efforts (Government of the Republic of Uzbekistan, 2017f). These include major SOEs in mining (Navoi and Almaly Mining and Metallurgy Complexes), telecommunications (Uzbektelecom JSC), oil and gas (core enterprises withing Uzbekneftegas Holding Company), energy (Uzbekenergo JSC, Uzbekgidroenergo JSC), agriculture (Uzpakhtasanoateksport JSC,

[13]See also Box 2 for details of several past major privatization initiatives.

Uzdonmahsulot JSC), transport (Uzbekistan Airways, Uzbekistan Railways, airports), manufacturing (major SOEs in vehicle manufacturing, textiles, light manufacturing, construction materials and food processing) and two commercial banks (the Halq Bank and the National Bank of Uzbekistan).

A range of auxiliary SOEs are offered for privatization but the willingness of the state to retain the controlling stake in many of them is evident. Current privatization efforts of the government are largely defined by a 2015 presidential decree, which offered a large set of SOEs for privatization (Government of the Republic of Uzbekistan, 2015f). The decree in particular lists 68 SOEs offered to strategic investors and 342 SOEs that are to be privatized through public auctions. SOEs offered for privatization operate in different sectors including chemicals, oil and gas, textile, construction, food and other manufacturing and real estate. The decree further lists over 800 real estate assets of the government to be offered to the private sector (either through auctions or at zero cost).

Despite its seemingly wide scope both in terms of number of SOEs and sector coverage, the decree does not envisage the privatization of major SOEs currently responsible for overseeing sectors of the economy and those that account for the bulk of their output. Many enterprises in the decree are auxiliary or small companies operating in a sector and those providing very specific technical and related services to other key enterprises (e.g., construction, transport or repair and maintenance services). More importantly, the decree clearly suggests that for many enterprises effective transfer from state to private ownership is not envisaged. In particular, state intends to retain controlling 51% stake in 40 out of 68 SOEs offered to strategic investors (either through direct state ownership or ownership through a different SOE). The same applies to 95 out of 342 SOEs offered to privatization through public auctions. Majority state ownership is intended to be retained particularly in enterprises in the chemicals sector, grain processing, cotton processing and in ownership of city markets.

Recent initiative to mandate the sale of a minority stake in SOEs to foreign investors did not succeed. Another notable effort to attract foreign investors was made in late 2015, when selected joint-stock companies with state share were mandated to sell at least 15% of ownership share to foreign investors by July 2016 (Government of the Republic of Uzbekistan, 2015g, 2016c). Despite seemingly drastic and transformational in nature, the requirement was actually limited in scope and it was not imposed on SOEs engaged in the production and processing of strategic natural resources, natural monopolies and enterprises that are classified as suppliers of socially important goods and services (in total, over 270 SOEs were explicitly excluded from this requirement). The decree offered over 60 SOEs to partial privatization by foreign investors, though with a number of exceptions it similarly focused on non-core SOEs (e.g., sector-specific construction or equipment repair and maintenance companies) or on regional subsidiaries of major SOEs.

Overall, potentially transformational impact of this requirement was already very limited by design. The success of this particular effort to attract foreign investors is difficult to assess due to lack information on the progress of the initiative. A follow-up decree of the Cabinet of Ministers approved in August 2016 acknowledged that targeted SOEs did not manage to attract foreign investors by the initial deadline and it was further extended to December 31, 2017 (Government of the Republic of Uzbekistan, 2016a).[14]

The government appears to be reviving its privatization efforts, though proposed initiatives focus primarily on simplification of the privatization process itself. The government further proposed simplifications to the process of privatization itself. In particular, in January 2017 a presidential decree allowed the approval of privatization of small non-strategic SOEs and sale of state-owned real estate property at zero cost by local authorities (Government of the Republic of Uzbekistan, 2017g). The decree also allowed for the privatization process to proceed in case of a single bidder and deferral of payment of privatization proceeds for up to three years (Government of the Republic of Uzbekistan, 2017f). While introducing simplification to the privatization process is laudatory, potential economic impact of this initiative will likely remain limited. For instance, little over 340 out of 1400 SOEs monitored by the Center for Monitoring of State Assets (CMSA) are directly subordinate to local authorities and these primarily constitute local city markets, regional newspapers, publishing houses as well as enterprises in transportation, retail trade, construction, municipal and various other technical services.

Scope of an effort to revive already privatized but underperforming enterprises appears limited as well. There is limited information available on the performance of already privatized enterprises. Recent presidential decree indicated that the production capacity of a significant number of privatized enterprises and property has not been sufficiently utilized and overall performance of these enterprises has been worse than expected (Government of the Republic of Uzbekistan, 2017e). The decree further singled out more than 2000 enterprises, whose performance the government intends to revive through various support measures. Envisioned measures include facilitating access to financing and infrastructure and training the owners on modern business practices. Market potential of specifically singled out privatized enterprises and property is not readily clear as the large share of them appears to be buildings that are currently empty or underutilized.[15]

Overall, available information suggests that the scope of recent privatization programs remains largely limited and this constrains their ability to significantly promote the expansion of the private sector in key sectors of the economy. As noted above, existing legislation clearly rules out the privatization of major enterprises in such sectors as energy, natural resources, chemicals, vehicle manufacturing, transportation, agriculture, two dominant state-owned banks and others. Many such enterprises are either monopolies or dominant players in their sectors. This suggests that significant presence of SOEs in key sectors of the economy is likely to continue in the near future. Existing privatization programs focus on non-core and relatively small regional enterprises, which limits the potential of these programs to spur the development of a vibrant private sector through particularly privatization of state assets.

[14]The requirement for a 15% foreign ownership share in selected JSCs may be canceled in the near future. As of April 2018, draft of a presidential decree canceling this requirement was undergoing a mandatory public consultation (see https://regulation.gov.uz/ru/documents/2146).

[15]See the relevant list of already privatized enterprises at https://gkk.uz/ru/deyatelnost/direction/perechen-ranee-privatiziruemykh-i-neispolzuemykh-ob-ektov.

Box 2: Major privatization initiatives of the Government of Uzbekistan

Following privatization of small enterprises of early 1990s, the basis for further potential privatization of medium to large SOEs was laid in the state program on denationalization and privatization approved in 1994. The program outlined high-level priorities of future privatization programs, described methods of privatization of large enterprises and, more specifically, initiated the opening of some key elements of market infrastructure to facilitate the privatization process. These included the stock exchange, central securities depository, specialized real estate exchange and a dedicated "privatization bank" Uzprivatbank aimed at providing financing to privatized enterprises (the bank was later merged with larger Uzpromstroybank).

Unlike a number of former Soviet countries that resorted to voucher or similar mass privatization programs, Uzbek government followed a different route. With extensive support of the World Bank and other donors the following two key methods of privatization were initially pursued: (i) sale of minority stakes in a large number of medium-size SOEs to Privatization Investment Funds (PIFs) through dedicated auctions and sale of stakes in the PIFs to individuals; (ii) use of the case-by-case privatization process and international tenders for privatizing large strategic enterprises. Initially, the work on PIFs-led privatization showed good progress with 59 privatization funds operating by the end of 1998. Despite early progress of the PIF program, the government withdrew its support of the program by early 2000s (e.g., through dilution of shareholdings of PIFs in enterprises and limiting the supply of good quality enterprises to PIFs).

One of the first ambitious privatization programs, as part of the overall privatization strategy described above, was launched in 1998. Along with over 200 small and medium enterprises the program initiated the process of privatizing around 30 large enterprises in telecommunications, mining (Uzmetkombinat JSC, Almalyk Mining and Metallurgy Complex), transport (Tashkent Airport), oil and gas (Fergana Oil Refinery), banking (National Bank for Foreign Economic Activity) and other sectors. Interest from investors was modest as it was also attested by a 1999 presidential decree. A decree issued in 2000 also indicated government's willingness to partially privatize a number of key state-owned banks including the National Bank for Foreign Economic Activity and the Asaka Bank.

Another major privatization program was initiated in 2001, when the government offered over 1200 SOEs for privatization, including large ones. Further 750 enterprises were offered to the private sector in 2002. The program in particular offered non-controlling (up to 49%) stake in a number of power stations, electricity distribution companies and the government expressed its interest in privatizing Uzbekneftegas Holding Company, major oil an gas company, and its key subsidiaries. Despite high ambition, little progress was made in these important initiatives. As part of the follow-up 2003-2005 privatization program, the government also indicated its willingness to dispose its direct minority share (less than 25%) in over 1300 already privatized enterprises through public share offerings. The government also made an attempt to privatize key operational units of Uzbekistan Railways including those responsible for passenger and cargo transportation. Request for bids announced in 2004 did not result in significant investor interest. The government only managed to privatize non-controlling 47% stake in an enterprise providing refrigerated cargo transportation services in 2008.

One of major highlights of privatization initiatives of early 2000s was an attempt to privatize Uzbektelecom JSC, main telecommunications company. Unlike common position of retaining majority control in large SOEs, the government's initial plan was to retain only 30% state ownership share and offer a strategic foreign investor at least 51% stake in the company. Preparation for privatization started in 2001 and media reports indicated that Russian, Korean, Israeli and Chinese investors expressed interest. But in 2004 the government announced that it intends to retain a higher ownership share of 45% in the company and 49% stake will be offered to a foreign investor (with the remaining 6% allocated to other investors in Uzbekistan). Ultimately, the attempt to privatize Uzbektelecom JSC did not succeed and as of 2017 the company is included in the list of SOEs that are not subject to privatization.

Privatization programs approved in 2005, 2006 and 2007 remained equally ambitious and they commonly included both small and large SOEs. At the same time, willingness of the government to retain controlling stake in major SOEs and their key subsidiaries was more evident. Some large SOEs included in privatization programs in early 2000s were already not part of the later ones. Other notable programs were approved in 2012 and 2015. The latter one defines the scope of government's current privatization efforts, though it appears significantly less ambitious than programs initiated in early 2000s. Many large SOEs are currently indicated to be of strategic importance and, thus, are not subject to privatization.

Source: Conrad and Lin (2005); IMF (1998, 2000); World Bank (2005); Government of the Republic of Uzbekistan (1994, 1998a,b, 1999, 2000, 2001a,b, 2003b, 2004a, 2001c, 2004c, 2005, 2006e, 2007b, 2012d, 2015f).

4 Governance and management of SOEs

4.1 Formal corporate governance structure

Most large SOEs have been corporatized and basic elements of governance structure of joint-stock companies are in place.[16] SOEs are commonly incorporated in the following three forms: (i) a joint-stock company (JSC), (ii) a limited liability company (LLC), or (iii) a state unitary enterprise. JSC is a primary form used to incorporate major SOEs overseeing sectors of the economy, while their subsidiaries are commonly incorporated as JSCs, LLCs or unitary enterprises.[17] Therefore, the discussion in this section will focus on governance practices of state-owned JSCs as the primary legal form used to incorporate large SOEs.[18]

Operation of joint-stock companies, including state-owned, is governed by the "Law on joint-stock companies and protection of shareholder rights" approved in 1996 and amended further on numerous occasions afterwards (Government of the Republic of Uzbekistan, 1996b). A typical state-owned JSC is governed by the general meeting of shareholders, supervisory board and the management. The latter can either be a single individual or a management board consisting of multiple directors (see Annex B for a typical governance structure of a JSC). The law allows for the delegation of operational management of an enterprise (at the management level) to a third-party management company or to an individual.

Disclosure standards and requirements have improved. Law on the securities market imposes a set of disclosure and transparency requirements on listed JSCs (Government of the Republic of Uzbekistan, 2015d). Separate government resolution imposes further disclosure requirements on official websites of JSCs (Government of the Republic of Uzbekistan, 2014e). Corporate governance code applicable to all JSCs was approved in early 2016 and its application is voluntary.[19] The code covers such issues as disclosure of information and transparency, internal audit, protection of shareholder rights, monitoring of compliance with code recommendations and others. The code specifies that assessment of compliance with its recommendations should be carried out by a third-party organization on annual basis. Joint-stock companies, including SOEs, are expected to publish the result of these assessments on their

[16]The objective of this section is to provide overview of key elements of existing governance arrangements and highlight several immediate issues of concern. Comprehensive analysis of issues related to the governance of joint-stock companies in Uzbekistan (either private or state-owned) is beyond the scope of this work. See, for example, OECD (2013) for more comprehensive analysis of regulatory environment related to the governance of JSCs.

[17]As discussed in Section 2, over 70% of existing JSCs in Uzbekistan are either majority state-owned or state has some degree of ownership in them

[18]Some important SOEs continue to be incorporated using other legal forms. For example, Uzbekistan Airways is incorporated as a "National Air Company", Navoi Mining and Metallurgy Complex is a state unitary enterprise, while the National Bank for Economic Activities is incorporated as a unitary enterprise. Overall, out of over 1400 enterprises monitored by the CMSA in 2016, about 12% are incorporated as JSC, 9% as LLCs and over 78% as unitary enterprises. State unitary enterprises do appear as the most frequently used organizational form of state-owned assets in Uzbekistan but it is commonly used to incorporate small and auxiliary enterprises. Primary purpose of this organizational form is the creation of an entity for management and operation of state-owned property. Unitary enterprises use the state-owned property in their operations but they are not entitled with ownership rights (Government of the Republic of Uzbekistan, 2006c).

[19]Source: https://gkk.uz/ru/deyatelnost/direction/corporativ/kodeks-korporativnogo-upravleniya.

websites. Analysis of these assessments conducted by the CMSA suggests that the degree of compliance with the code and corporate governance standards is not complete and uniform and further improvements in implementing recommended practices and standards is necessary.[20]

Supervisory boards of major SOEs commonly include high-level government officials and representatives of relevant ministries. For instance, according to a government resolution Prime Minister chairs the supervisory board of Uzbekistan Railways JSC, while various deputy ministers are its members. Deputy prime ministers chair supervisory boards of Uzbekenergo JSC, Uzavtosanoat JSC, Uzbekneftegas Holding Company, while a number of ministers, deputy prime ministers or heads of government agencies are members of their supervisory boards (Government of the Republic of Uzbekistan, 2006g). The legislation explicitly indicates that members of the supervisory board cannot at the same time be employed by the enterprise. No requirement or possibility for board committees except for the audit committee are specified (for instance, on renumeration, nomination, strategic planning or other issues). Audit committee reporting directly to the supervisory board is mandated to review the performance of an enterprises an annual basis.

The concept of an independent board director was recently introduced but compliance with a recommendation to introduce independent board directors is voluntary. The law on joint-stock companies does not introduce or mention the concept of an independent director within the supervisory board. On the other hand, the corporate governance code does mention the possibility of introducing an independent director to the supervisory board. Specifically, the code prescribes at least 15% of the supervisory board to consist of independent directors. At the same time, compliance with the code is not mandatory and selective and it is not readily clear to what extent enterprises follow this specific recommendation.

Supervisory boards of major 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 its chairman are appointed by the supervisory board (after this right is explicitly granted to the supervisory board by the meeting of the shareholders). Chairman of the management board (i.e., CEO) is appointed by the shareholder's meeting, though legislation allows for appointment and dismissal of the CEO by the supervisory board if this right is explicitly granted to it in the enterprise statute.

Regulation related to specific large SOEs commonly indicates further that the supervisory board appoints the CEO following the approval of the candidate by the Cabinet of Ministers and, in some cases, also by the President's Office. For example, candidates for the position of a CEO of Uzavtosanoat JSC, Uzbekenergo JSC and Uzagroteksanoatholding JSC are additionally approved by the President's Office (Government of the Republic of Uzbekistan, 2004b, 2001d, 2016f). Management contract with a CEO is signed for a year and the shareholder's meeting (or the supervisory board in case it is explicitly granted the right) decides whether to extend the management contract with the appointed CEO on annual basis.

[20] Source: http://www.csam.uz/Default.aspx?id=643.

State ownership rights are formally exercised by delegating the management of state's share in an enterprise to an individual or legal entity. Formally, management of state JSCs is carried out through delegation of management of state shares in an enterprise to either (i) an individual, (ii) other SOE or (iii) an asset management company. For the purpose of management of state assets, state trustees and SOEs are appointed directly, while asset management companies are indicated to be selected on competitive basis (Government of the Republic of Uzbekistan, 2006a, 2013). Individuals and legal entities delegated to manage state's share in enterprises are selected and appointed by a dedicated commission after the candidates for these roles are proposed by the CMSA and approved by the Cabinet of Ministers (Government of the Republic of Uzbekistan, 2003a, 2007a).

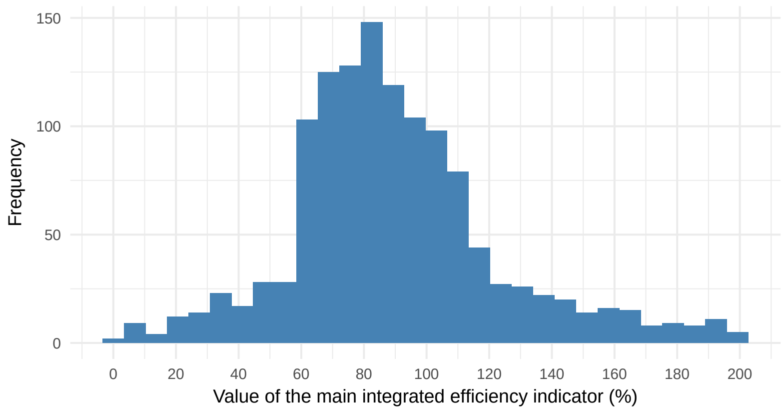
Individuals entrusted with management of state assets may carry two different legal titles – state trustee or state representative. State trustees are appointed in enterprises, where the direct state ownership share exceeds 25% and they are indicated to have voting and other management rights commensurate to the size of state's shareholding (Government of the Republic of Uzbekistan, 2003a). On the other hand, in enterprises, where the state share is below or equal to 25% (including cases when state share is non-existent), state has the right to appoint a state representative through exercising its right for a "golden share". Legislation indicates that state trustees or representatives can be selected from the rank of government officials as well.

State representative and trustees formally hold the position of a member of the supervisory board. Unlike state trustees, state representatives appointed in enterprises with minority or no state ownership share are explicitly entitled special rights that are not proportional to the size of state's shareholding. For instance, they must be present in the shareholder's meetings and meetings of the supervisory board, decisions made by the shareholder's meeting or the supervisory board without their presence are invalidated and they have the right to veto a number of decisions of both the shareholder's meeting or the supervisory board (Government of the Republic of Uzbekistan, 1996b). State trustees report on their work and operations of an SOE to the CMSA and the Cabinet of Ministers on quarterly basis.

State trustees are given extensive set of duties but their degree of independence in making decisions may be constrained. In particular, duties of a state trustee are identified as (i) protection of state's interest as a shareholder, (ii) assistance to enterprises in implementation of economic reforms, (iii) monitoring of work aimed at product and process modernization, and (iv) ensuring that (retained) dividends earned on state shares are indeed used by the enterprise for production upgrading and improvements (Government of the Republic of Uzbekistan, 2003a). At the same time, state trustees are mandated to coordinate and align their voting policy with the CMSA and, given lack of any qualifiers in the legislation, the requirement appears to apply to all questions discussed by the supervisory board (and not, for instance, only to questions related to major transactions or significant changes in the structure of an SOE or its operations).

SOE performance measurement system has substantially improved during the past several years. The system of monitoring the performance of SOEs evolved significantly in 2015, when detailed and elaborate set of key performance indicators (KPIs) were introduced with an obli-

Figure 3: Distribution of the integrated efficiency indicator for SOEs monitored by the Center for Management of State Assets (CMSA)



Source: 2016 performance report of the Centre for Management of State Assets.

gation for SOEs to start implementing the new set of KPIs from January 2016 (Government of the Republic of Uzbekistan, 2015a). The new system of monitoring covers a wide range of KPIs including indicators related to earnings, costs, rate of return, liquidity, indebtedness, ability to service debt and others. In total, the set includes thirteen mandatory performance indicators and additional thirteen of supplementary ones (see Annex C for the full list). The performance of an enterprise is measured using so-called "integrated efficiency indicator", which is computed as a weighted average aggregate of primary performance data.

One of the main uses of this recently introduced measure appears to be its application in the computation of final remuneration of SOE's management. In particular, the variable part of the management compensation is indicated to be adjusted for the performance of an SOE as measured by the integrated efficiency indicator. Moreover, weak performance of an SOE (as confirmed by low values of the efficiency indicator) for two quarters in a row may initiate the process of dismissal of a CEO (Government of the Republic of Uzbekistan, 2015a).

Business plan is another key document that lays out the performance targets of an enterprise and provides a framework for further monitoring of SOEs by the government. In terms of key performance metrics, according to legislation the business plan of a JSC is expected to include targets related to production, profitability and dividend payouts and the document is approved by the shareholder's meeting. CEOs report on the performance of an enterprise against business plan targets to the supervisory board on quarterly basis (Government of the Republic of Uzbekistan, 2003c). In addition, on annual basis CEOs of large SOEs and chairmans of their supervisory boards report to the Cabinet of Ministers on the performance of their SOEs (Government of the Republic of Uzbekistan, 2006d).

Despite progress on the SOE performance measurement system, disclosure practices of key performance metrics need to improve further. CMSA publishes the value of the integrated efficiency indicator for all SOEs it monitors on its website but neither each component of this indicator nor further details (like weights employed by each SOE in the computation) are available. According to legislation, value of the efficiency indicator below 60% is considered to be low, between 60% and 80% as insufficient, between 80% and 90% as medium and above 90% as sufficient and high. Using this assessment scale, performance of over third of SOEs monitored by the CMSA can be be classified as insufficient or low (Figure 3). At the same time, lack of details of this measure and absence of comparable measure for private sector companies prevents providing more comprehensive and meaningful analysis.

To summarize, key elements of formal governance structure of SOEs appear to be in place, though more work on their further improvement is needed. Building blocks of governance structure of SOEs including law on joint-stock companies, corporate governance code, disclosure requirements exist and basic formal accountability lines between enterprise management, supervisory board and shareholders appear to be sufficiently determined. With few exceptions, major SOEs have already been incorporated as JSCs. Despite these improvements, further work on improving the efficiency of formal governance structure is necessary, particularly in terms of increasing the degree of board autonomy, strengthening its professionalism (e.g., by introducing independent board directors) and ensuring full degree of compliance with standards and practices prescribed by the legislation.

4.2 Further governance mechanisms and policies

Despite significant progress in introducing formal SOE governance structure, there exist multiple further governance mechanisms and policies that significantly influence the performance and day-to-day operations of SOEs. Beyond the formal governance structure prescribed by the legislation on joint-stock companies (including state-owned JSCs), there appear to be multiple other mechanisms that allow the government to exert significant direct control of day-to-day operations of SOEs. These mechanisms influence production and pricing decisions of SOEs as well as the incentive structure SOE management faces weakening the role of formal corporate governance mechanisms.

Bureaucratic rank of CEOs of major SOEs point to high political weight of these positions and blurred accountability and reporting lines to the supervisory board. Despite the law on joint-stock companies suggesting the status of CEOs or directors as executive managers of an enterprise, actual role and position of CEOs of particularly large SOEs appear to be more extensive. For instance, position of a CEO in a number of major SOEs, including Uzavtosanoat JSC, Uzbekneftegas JSC (and its major subsidiaries), Uzbekenergo JSC, Uzagroteksanoatholding JSC, Uzbekoziqovqatholding Holding Company, is formally indicated to be equivalent to the rank of either a minister or first deputy minister. Position of a deputy CEO in these enterprises has the rank of a deputy minister (Government of the Republic of Uzbekistan, 2004b, 2006f, 2001d, 2016f,d). This suggests that many large SOEs, despite corporatization and introduction of modern corporate governance mechanisms and structures, continue to play the role equivalent to that of sector ministries or associations. Assignment of the rank of a minister or a deputy minister to executive management and resulting blurring of accountability and reporting lines also undermines the role of supervisory boards in these enterprises.

Degree of autonomy of SOEs and their supervisory boards, especially in large SOEs, in de-

termining strategic and operational decisions appears to be constrained. This is primarily due to the fact that key aspects of SOE operations including capital investments, production, pricing, purchase of inputs and exporting appear to be significantly shaped by government decrees and resolutions. One of the documents that strongly influences operations of major SOEs is a state investment program. State investment programs are important planning documents that are used to coordinate the work of ministries, state agencies and SOEs around major capital investments projects, specify sources of their financing, indicate specific targets set for each agency or organization carrying out the project and provide framework for monitoring the delivery and performance.[21]

When it comes to large SOEs, investment programs include investment projects SOEs are expected to carry out (including projects that are financed using internal funds), sources of their financing and target outcomes. Related bylaws commonly specify additional targeted benefits, tax breaks and other support measures provided specifically to an investment project to facilitate its implementation. Investment programs are approved on annual basis and commonly cover projects intended to be implemented during the following three years. Implementation of projects included in the investment program is closely monitored on quarterly basis by the State Committee on Investments, while annual report on program implementation is submitted to the President's Office.[22]

Many SOEs are strongly affected by the degree of government intervention into pricing decisions of goods they produce. The list of enterprises that are subject to some form of price regulation is significant. For instance, the recent list of enterprises that are subject to price regulation (either due to being involved in the production of strategic goods and services or due to having a dominant position in a market) includes 280 joint-stock companies and other enterprises including those that are subsidiaries of over 15 major industrial SOEs (Government of the Republic of Uzbekistan, 2016c). A number of goods themselves are separately indicated to be of strategic importance, which subsequently makes them subject to price control regulation. In addition to goods that have traditionally been subject to some form of government control, like electricity, the list of goods of strategic importance includes natural gas, petrol and other fuels, coal, fertilizers, cotton, metals, construction materials (roof slate) and possibly others. Ministry of Finance is a key authority responsible for setting or approval of prices, though legislation explicitly allows for the possibility that prices can also be regulated and set by other government agencies and regional authorities (Government of the Republic of Uzbekistan, 2004d, 2017b).

[21]The volume of investment projects coordinated, monitored and overseen through state investment programs is large. For instance, total volume of the state investment program in 2016 was equivalent to 25% of GDP. So-called targeted investments component of the program accounted for 40% of the total program volume (or 10% of GDP). Targeted investments component of the program commonly includes investment projects carried out or overseen by major SOEs.

[22]The institution of state investment programs has undergone a revision in December 2017 but, despite a number of changes, the new system remains similar to the existing one with the following three key modifications: (i) projects included in state investment programs (referred to as "state development programs" following the revision) should be aligned with long-term sector development strategies; (ii) funding for projects under the investment program is accumulated and made available through a dedicated funding agency (both budget and non-budget funding); and (iii) the National Agency for Project Management, a unit within the President's Office, is to become a key additional approval and monitoring authority of state investment programs (Government of the Republic of Uzbekistan, 2017d).

The practice of government directed allocation of key goods across different types of consumers likely affects performance of a number of major SOEs as well. Government influence is prominent not only in pricing decisions. Allocation of a number of goods produced by major SOEs has traditionally been subject to strict government control and allocation requirements as well. In particular, the Ministry of Economy with input from relevant SOEs and ministries annually produces so-called "material balances" (supply-and-use balances) to forecast the supply of certain types of goods for the following year and to determine how these goods will be redistributed across key types of consumers (government, SOEs, private sector, export and others) (Government of the Republic of Uzbekistan, 2004d).

Material balances are prepared for a number of goods including natural gas, oil and other fuels, electricity, coal, metals and certain metal products, fertilizers, wheat, cotton and others (Government of the Republic of Uzbekistan, 2006b). Goods for public sector needs (including for SOEs) are supplied at regulated prices, while the price of the share of goods made available through the commodity exchange is determined as a result of exchange trades. Lack of publicly available information on approved material balances prevents estimating the share of annual supply of such regulated goods allocated through government directed channels and, equivalently, the share made available through market mechanisms. The net effect of this policy on SOEs is also hard to estimate. On the one hand, many SOEs benefit from guaranteed access to key inputs at regulated prices but, on the other hand, the policy likely significantly restricts opportunities of suppliers of these goods to exploit market opportunities, either in domestic or foreign markets, and compresses their profitability.

Practices related to government directed allocation of key goods and control of their prices are expected to undergo significant changes starting from 2018. A decree approved in November 2017 has introduced a number of important changes to this system of price controls and allocation of goods in the economy (Government of the Republic of Uzbekistan, 2017b). In particular, the decree indicated that starting from January 2018 over 20 types of goods including fuel, metal products, cement, fertilizers, agricultural seeds and others should be allocated by their suppliers through the commodity exchange only. The degree to which this change has already been implemented in not The decree did retain a number of goods under government allocation control but, nevertheless, it is evident that 2018 will likely become the first year when many SOEs and the economy of Uzbekistan overall will gradually start being exposed to prices for key inputs that more adequately reflect their scarcity and latent demand from competing consumers (e.g., private sector).

Some SOEs are additionally subject to significant control of their finances. Mechanisms of direct control of financial flows have been in use in a number of SOEs as well. For instance, the Ministry of Finance uses a specialized unit of financial inspectors, who are commonly deployed on-site within selected subsidiaries of Uzbekneftegaz JSC, oil and gas company, Uzpakhtayog JSC, edible oil producer, as well as state-owned and private sector producers of alcoholic products. Primary responsibility of financial inspectors within these enterprises is day-to-day monitoring of their operations and finances to ensure correct computation and timely payment of taxes (e.g., excise tax), compliance with contract obligations and prevention of fraud (Government of the Republic of Uzbekistan, 1996a, 1998c, 2017a). Specific mechanism of allocation of revenues may be explicitly prescribed for some SOEs too. For example, uses of revenues by a number of subsidiaries of Uzbekneftegaz JSC, Uzbekenergo JSC and Uztransgaz JSC (revenues from the sale of oil products, electricity and natural gas, respectively) are explicitly prescribed by government resolutions (Government of the Republic of Uzbekistan, 2004e, 2017h).

Direct governance mechanisms employed by the government provide effective tools for channeling SOE operations towards achieving its industrial policy objectives but likely at the expense of efficiency of SOEs and their ability to respond to market signals. Moreover, these measures weaken the role of recently introduced formal corporate governance mechanisms (dual board structure following corporatization, disclosure requirements, use of performance KPIs), which, in essence, prioritize clear accountability lines and enterprise efficiency.

Existence of a range of governance mechanisms beyond those prescribed by formal governance structure likely restricts the ability of SOEs to flexibly use their resources and effectively react to market signals including price movements or changes in composition of demand. Strengthening the role of supervisory boards will require further reforms aimed at increasing their autonomy, phasing out direct control mechanisms and clarifying better accountability lines of CEOs of major SOEs. The latter, in particular, will require prioritizing accountability lines of the management to the supervisory board and not, for instance, directly to the executive branch of the government. Such reforms should also be supported by efforts to improve board professionalism, including by considering the introduction of independent board directors to major SOEs.

5 Conclusions and recommendations

There appear to be a number of overarching issues related to economic weight and governance of SOEs in Uzbekistan including (i) determining the optimal degree of presence of SOEs in the economy and reducing the degree of interference of the government in their day-to-day operations; (ii) improving overall governance structure of the SOE sector by separating regulatory and supervision from ownership and management functions currently concentrated in major SOEs overseeing sectors; (iii) strengthening the corporate governance mechanisms to create clear accountability lines of SOE management to the board and improve board autonomy and effectiveness; and (iv) exposing SOEs to competitive pressure from domestic and foreign private sector players and creating a level-playing field between SOEs and private sector enterprises. Nevertheless, due to Uzbek government's view of SOEs as key tools for implementing its industrial policy objectives, it will likely resort to gradual and cautious approach to reforming the SOE sector.

Critically reassessing and reducing the degree of presence of state and SOEs in the economy. Current scope of sectors indicated to be of strategic importance appears to be very wide and covers almost all key industrial sectors. In this respect, a comprehensive review of degree of presence of SOEs should be initiated and strategy for material reduction of their weight should be considered, especially if there is sufficient evidence that industrial policy objectives of the government can also be achieved under private ownership of enterprises and effective sector regulation. This primarily concerns SOEs operating in potentially competitive sectors. In addition, government's portfolio includes a large number of enterprises and consolidating its portfolio will help concentrate its efforts specifically on those sectors, where market failures are large and there is currently no feasible alternative to dominant state ownership.

Introducing strong regulatory governance mechanisms. Related to the issue above is pervasiveness of direct control mechanisms and limited use of regulatory mechanisms to govern sector performance. The issue is further aggravated by granting of supervisory and regulatory functions to a number of SOEs, which should be reexamined and phased out. A number of large SOEs are also members of commissions responsible for issuance of licenses to new sector entrants. This practice should be reexamined too in view of significant conflicts this arrangement generates. Appropriate regulatory framework independent from large SOEs is particularly necessary and vital for successful performance of privatized enterprises and other private sector companies.

Clarifying accountability lines of SOE management. Accountability lines for some CEOs, especially those of large SOEs, are not clear-cut. As discussed earlier, positions in management boards of large SOEs are equalized to the rank of ministers or deputy ministers, which makes them also directly accountable and part of the Cabinet of Ministers. This likely weakens the role of supervisory boards in terms of their ability to hold CEOs accountable and perform efficiently.

Strengthening board autonomy and efficiency. Existence of highly prescriptive and closely monitored state investment and development programs limits board's ability to fully define company's investment and development strategy. Existence of government determined and highly prescriptive resource allocation and price control mechanisms with respect to a number of goods also restricts ability of some boards to influence marketing, sales and export strategies. Board autonomy is likely curtailed further due to the fact that SOE boards commonly consist of only acting public officials and the institution of independent directors is non-existent. Most of these practices need to be reexamined to strengthen the professionalism of boards and to introduce sufficient degree of autonomy in their decision-making.

Phasing out direct SOE control mechanisms. Related issue is the presence of an array of direct control mechanisms over day-to-day operations of SOEs. These range from the deployment of full-time financial inspectors within selected enterprises, directives on specific allocation of revenues in a number of sectors (oil and gas, energy) to detailed SOE-specific directives on reducing the intensity of use of various resources. Use of such mechanisms by the government not only contributes to further uncertainty over formal accountability lines of SOE management to its board but also limits its ability to efficiently respond to changes in external conditions and exert effective control over its assets.

Streamlining the SOE performance monitoring system to prioritize SOE efficiency. Presence of a number of recurring government decrees and programs influencing SOE operations and performance (state investment and sector development programs, annual production and supply targets set by supply-and-use balances, localization projects and recurring cost-cutting initiatives) appear to result in a wide range of quantitative targets imposed on SOEs. In such environment, the new system of monitoring the performance of SOEs introduced in 2015 (see Annex C) will likely not be able to fully shift the set of incentives SOE management faces, in particular from the traditional objective of achieving quantitative production targets to the goal of increasing and maintaining economic efficiency of an enterprise.

Creating a level-playing field with the private sector. The degree of influence of market forces and market signals on SOEs has likely been significantly muted. This is primarily the result of SOEs commonly having preferential access to key resources including foreign exchange (at significantly appreciated rate until 2017), energy and other key inputs and subsidized financing. The fact that investment and sector development programs are commonly supported by an extensive set of narrowly targeted tax breaks, custom duty reliefs and similar measures puts SOEs involved in these programs in significantly better competitive position relatively to other private sector players. Creating a vibrant private sector and providing it opportunities to expand will require elimination of such distortive practices and effective exposure of SOEs to competitive pressure from the private sector.

Expanding the scope of future privatization programs. Scope of privatization programs appears to have substantially narrowed during the past decade. The government should reconsider its approach to privatization and consider expanding the scope of future programs akin to those it initiated until mid-2000s. Analysis of reasons of failure of past ambitious privatization initiatives should also help adequately design future programs and increase the likelihood of their success. In this respect, recent simplifications of the privatization process introduced by the government including granting the power to authorize small-scale privatizations to local authorities is commendable.

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A Examples of supervisory, regulatory and similar functions carried out by SOEs

Table A.1: Examples of supervisory, regulatory and similar functions carried out by industrial state-owned holding and joint-stock companies

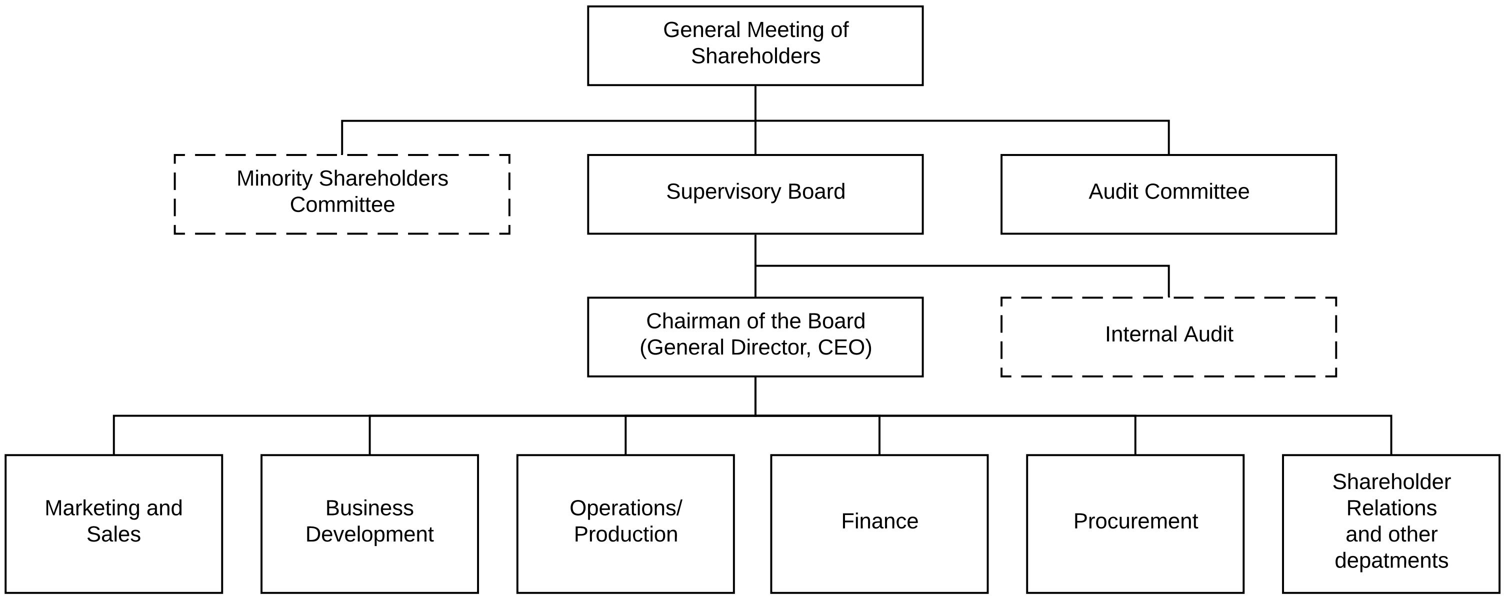
Sector	Enterprise	Product, service	Structure (subsidiaries and subordinate private enterprises)	Examples of supervisory, regulatory or similar functions
Agriculture	Uzpakhtasanoateksport Holding Company	Purchase, storage, processing and export of cotton	Over 180	· Monitoring and control of compliance with terms of contracts for supply of cotton and its processing by farmers and companies in the sector · Facilitation of the work of the National Audit Office in the sector · Development and implementation of a single policy on processes and standards in the cotton sector
	Uzdonmahsulot JSC	Grain storage, production of flour, bread products	Over 40	· Responsible for auditing activities within the sector, specifically for ensuring compliance with the terms of supply contracts within the sector (quantity, quality of grain and seeds) · Management of the system of quality control of grain and its valuation · Management of the process of state purchase of grain and seeds
Mining, oil and gas	Uzbekneftegas Holding Company	Oil and gas exploration and production	Over 90	· Member of a commission responsible for issuance of licenses for exploration and use of oil and gas fields · Contribution to the development of terms of usage of oil and gas fields as well as terms of the tendering process for licenses for use of oil an gas fields · Development and implementation of structural reforms and modernization of the oil and gas sector
Manufacturing	Uzagrotekhsanoatholding Holding Company	Production, servicing and leasing of agricultural machinery	Over 50	· Coordination of production of agricultural machinery and distribution of product demand across subordinate enterprises · Development of government support measures in the agricultural machinery sector · Development and implementation of single technical and investment policies across subordinate enterprises
	Uzavtosanoat JSC	Production of automobiles, trucks and buses	Over 30	· Development, implementation and monitoring of development programs in the automotives industry · Defining the scope of localization programs in the automotive industry
	Uzbekengilsanoat JSC	Production of textile products	Over 400	· Implementation of single technical and investment policies across the sector, facilitation of cooperation of companies in the textile sector · Development, implementation and monitoring of textile sector development programs
	Uzbekoziqovqatholding Holding Company	Production and export of food products	Over 400	· Development, implementation and monitoring of sector development programs · Management of the process of state purchase of fruits and vegetables (for state facilitated export of fruits and vegetables)
	Uzkimyosanoat JSC	Production of chemical products and fertilizers	Over 15	· Development, implementation and monitoring of sector development programs
	Uzstroymaterialy JSC	Production of construction materials	8	· Member of the state commission responsible for issuance of licenses for exploration of non-metallic mines · Facilitation of cooperation of companies in the sector · Coordination of production and monitoring of supply of construction materials to the needs of state development and investment programs in other sectors · Development and implementation of single technical and investment policies across owned and subordinate companies · Development, implementation and monitoring of sector development programs

Table A.1: Examples of supervisory, regulatory and similar functions carried out by industrial state-owned holding and joint-stock companies (continued)

Sector	Enterprise	Product, service	Structure (subsidiaries or subordinate private enterprises)	Examples of supervisory, regulatory or similar functions
	Uzvinpromholding Holding Company	Production of alcoholic and other beverages	Over 60	· Member of a commission responsible for issuance of licenses for production of alcohol products · Monitoring of compliance with state quality and technical requirements and standards · Responsible for regular quality control and standard compliance checks to determine if a company in the sector is able to retain the license · Develops and approves technical standards for alcohol products in the sector · Responsible for prevention of illegal production of alcohol products · Development, implementation and monitoring of sector development programs
Electricity supply	Uzbekenergo JSC	Production, distribution and sale of electricity	Over 50	· Defined by the government as the special authorized (regulatory) agency in the electricity sector · Development and approval of sector specific regulation · Monitoring and control of the performance of the network operator · Coordination of the work on technical regulation, standards and certification in the sector · Development, implementation and monitoring of sector development programs
Transportation	Uzbekistan Airways National Air Company	Air transportation, management of airports	-	· Issuance of a permission for construction works that may affect aviation safety (e.g., near airports)
	Uzbekistan Railways JSC	Rail transportation	-	· Issuance of a permission for the operation of rolling stock on (public) rail tracks · Issuance of a permission for construction and maintenance of infrastructure at railway access points · Member of a commission responsible for reviewing applications for passenger and cargo transportation licenses · Approval of usage of technical solutions aimed at extending the service life of rail stock · Approval of transit through Uzbekistan of alcohol and tobacco products using rail transport · Responsible for the coordination of activities related to development and usage of rail transport in the country · Responsible for ensuring compliance with technical requirements related to usage of rail transport in the country

Note: Examples of supervisory and regulatory functions are documented using information available at the time of writing (early 2018).
Source: Government decrees, sector regulation and enterprise websites.

B Typical governance structure of a joint-stock company



Source: Government of the Republic of Uzbekistan (2015e).

C Criteria for the assessment of performance of SOEs

A 2015 decree of the Cabinet of Ministers introduced the following set of performance indicators to measure the performance of SOEs starting from January 2016.

Mandatory performance indicators:

1. Earnings before interest, taxes, depreciation and amortization (EBITDA)
2. Cost to income ratio (CIR)
3. Return on capital employed (ROCE)
4. Return on equity (ROE)
5. Total shareholder return (TSR)
6. Return on assets (ROA)
7. Absolute liquidity ratio
8. Financial independence ratio (inverse of short-term debt to asset ratio)
9. Days payable outstanding
10. Days receivable outstanding
11. Debt service coverage ratio
12. Dividend payout ratio
13. Rate of decrease of accounts payable (in percent)

Optional performance indicators:

1. Depreciation rate of fixed assets
2. Rate of renewal of fixed assets
3. Productivity rate
4. Return on fixed assets
5. Capacity utilization rate
6. Energy efficiency (share of energy costs in total costs)
7. Share of innovative products in total sales
8. Share of R&D expenditures
9. Spending on training (per employee)
10. Employee turnover rate (computed as a ratio of employees at the beginning and at the end of a period)
11. Completion of the investment program (in absolute terms)
12. Rate of deployment of new capacity (percent of planned new capacity target)
13. Export performance (percent of planned exports target)

Source: Government of the Republic of Uzbekistan (2015a).