

Exploring the Process of Institutional Configurations during Economic Transition – Insights from Uzbekistan

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Abstract

Institutions constitute an incentive system that dictates and structures human interaction. The role of institutions thus becomes critical because they incentivize and de-incentivize actual and intended behavior of people, if they are effective, they structure and provide incentives and also structure economic, political and social activity. It is not only the economic world, social or political world in which we are living; rather we live in a world which is mixture of these. Institutions play an important role in reduction of uncertainty. Institutions are made of formal rules, informal constraints and the machinery for enforcement.

Institutional arrangements in any evolving and developing economy is of paramount importance as it channelizes the terms of exchange between different players in economic arena, it also acts as an enabler in negotiating the transactions costs in market place, assists in reduction of probable uncertainties of production and trade, configure capital accumulation and its mobility, leverages the pricing and sharing of risks and above all structure cooperation. It has been established that the differences in economic health of a nation is not only because of the natural and technological endowments, instead it is because of the socio-economic and politico-legal order and the policies pursued by the government. The soviet context provides a unique opportunity to the researchers in macroeconomic area for investigating a natural economic experiment of this magnitude. The interplay of various institutions therefore needs to be investigated to map the past present and the future trajectories of progress and growth. In this paper an attempt has been made to understand the framework of the institutions in Uzbekistan, to evaluate their effectiveness and to explore what more needs to be done to in the institutional front. The study is exploratory in nature drawing inferences and interpretations from published web sources and data from business monitor international.

Keywords: Uzbekistan; Institutional framework; Transition economies; Uzbek puzzle; Reforms

Introduction

To understand emergence and functioning of institutions one has to walk down the lanes of past and track the code of articulations. With the collapse of the Soviet Union at the beginning of the 1990's the countries of Armenia, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan and Uzbekistan were amongst the twenty-six countries that embarked upon a process of transition from planned to market-oriented economies. The six countries Tables 1-4 started the transition from significantly different initial points in terms of human development, structural composition of their economies and the type of transition strategy chosen [1].

From a distant view Central Asia may appear as a homogenous region, with similar scopes of development, political structures and ethnicity. Moreover, all the countries end with "stan" which psychologically adds to the conviction that Central Asian countries can be measured and judged with the same yardstick [2]. However, a closer look reveals that there is significant difference in the way of transition, natural resources and economic development. The way transition at Uzbekistan was managed, reflects the economic health today.

After the breakup of the Soviet Union, Uzbekistan's output fell less than in any other former Soviet republic, and growth turned positive in 1996/97. Uzbekistan was patronized by Soviet Union with subsidies of relatively high magnitude, if we trace the extent of subsidies received by Uzbekistan it is evident that over years from 1987-89 the availed subsidy increased from 7-9% to 21% in 1991 [3]. Loss of subsidy of this magnitude was a big blow after independence. Another support which it has enjoyed from Soviet Union was its integration with industrial complex of Soviet Union, after independence these relationships

were severed. The economy also rested on the fundamentals of soviet oil, apart from its large agriculture sector it also depended on food from elsewhere. Uzbekistan is a double-landlocked country, whose goods must cross two countries to reach a port, and it faced uneasy relations with several of its neighbors. Given the country's hesitant and idiosyncratic approach to reforms, this record has surprised many observers [4].

While exploring the relationship between the independence and the state of readiness for independence it is observed that Uzbekistan, along with the other four Central Asian republics, was thrown into independence for which it was totally unprepared. It gained its independence by default, in fact the Central Asian republics were the last to declare their independence from the Soviet Union. There were not any separatist efforts during the seventy years under the Soviet Union nor was there mass mobilization demanding freedom, as was the case in Eastern Europe [5]. This unpreparedness has some reflections in the existing institutional framework which leads to an interpretation that, Uzbekistan has reached critical point in time, the international

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Transition economies in Europe and the former Soviet Union	
CEE	Albania, Bulgaria, Croatia, Czech Republic, FYR Macedonia, Hungary, Poland, Romania, Slovak Republic, Slovenia
Baltics	Estonia, Latvia, Lithuania
CIS	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan
Transition economies in Asia	
	Cambodia, China, Laos, Vietnam

Source: Transition Economies: An IMF Perspective on Progress and Prospects Nov. 03, 2000^{20b}

Table 1: Classification of transition economies.

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Armenia	2679	2349	1714	1470	1473	1655	1792	1874	2000	2152	2338	2598	2957
Kazakhstan	4701	4264	4266	3871	3492	3370	3452	3558	3513	3813	4565	5225	5769
Kyrgyzstan	2010	1872	1651	1428	1180	1144	1217	1335	1349	1427	1546	1598	1572
Moldova	3089	2662	1962	1973	1396	1429	1308	1341	1251	1238	1278	1346	1431
Tajikistan	1909	1765	1275	1077	862	793	665	644	666	707	795	850	916
Uzbekistan	n/a	n/a	n/a	1321	1250	1258	1272	1318	1336	1404	1502	1561	1611

Source: World Bank, WDI 2003 (As cited by Torm, 2003)

Table 2: GDP per capita, ppp (current international \$).

	1990	'91	'92	'93	'94	'95	'96	'97	'98	'99	'00	'01	'02
Armenia													
• Agriculture	17	25	31	51	45	42	37	32	34	30	25	28	26
• Industry	51	49	39	11	37	32	33	33	31	32	36	34	33
• Services	31	26	30	22	18	26	31	35	35	38	39	38	41
Kazakhstan													
• Agriculture	n/a	n/a	21	18	15	13	13	12	9	11	9	9	9
• Industry	n/a	n/a	45	39	40	31	27	27	31	35	43	39	43
• Services	n/a	n/a	29	43	45	56	60	61	60	55	48	52	48
Kyrgyzstan													
• Agriculture	34	37	39	41	41	44	50	43	40	38	39	37	39
• Industry	36	36	38	32	26	20	18	22	23	27	26	28	26
• Services	30	28	23	27	34	37	32	36	38	36	34	34	35
Moldova													
• Agriculture	31	43	51	33	29	33	31	30	31	28	18	16	25
• Industry	39	33	32	44	38	32	31	29	24	19	20	24	24
• Services	30	24	18	24	32	35	38	41	46	53	52	50	51
Tajikistan													
• Agriculture	33	38	27	23	14	38	39	35	21	19	19	29	n/a
• Industry	38	38	45	46	41	39	31	27	26	25	26	29	n/a
• Services	29	25	28	30	35	23	30	37	47	57	55	41	n/a
Uzbekistan													
• Agriculture	33	37	35	30	37	32	26	31	31	34	35	34	33
• Industry	33	37	36	35	26	28	31	26	26	25	23	23	21
• Services	34	27	29	35	36	40	43	42	43	42	42	43	46

Source: World Bank, WDI 2003 (As cited by Torm, 2003)^{9b}

Table 3: Sectoral composition of GDP (in percentages).

community sees it at risk for instability in the future for itself as well as for the region [6].

Gorbachev's perestroika was one of the most criticized economic initiatives which resulted in large budgetary deficits, repressed inflation, downside in production and trade, large foreign debts and severely distorted relative prices [7]. Even when Uzbekistan was part of Russia it was not recognized as an independent state, the boundaries were later drawn. It was also one of the poorest former republics highly dependent upon Moscow for the budgetary transfers it received to help finance social and investment initiatives. Such succession of events

resulted in an urgent need to create a nations identity and dire need for political and economic reforms [8].

Broad Objectives

A new nation with excessive reliance in past over the parent nation acts and behaves like infant self searching for the avenues and agendas for self reliance and growth. Opinions of scholars may vary and contradict on several fronts because coins always have two sides. Some may appreciate the efforts and other may be critical about it, nevertheless evolution and history can enhance the understanding about the phenomenon under investigation serving as a means for preventive

	Armenia	Kazakhstan	Kyrgystan	Moldova	Tajikistan	Uzbekistan
Year of reform start	1992	1992	1992	1996	1997	1996
Speed of reforms	Rapid	Rapid	Rapid	Gradual	Gradual	Gradual
Enterprises						
• Large-scale Privatisation	3	3	3	3	2+	3-
• Small-scale Privatisation	3+	4	4	3+	3+	3
• Governance and enterprise restructuring	2	2	2	2	2-	2-
Market and Trade						
• Price liberalisation	3	3	3	3+	3	2
• Trade and Foreign exchange system	4	3+	4	4	3+	1
• Competition Policy	1	2	2	2	2-	2
Financial Institutions						
• Banking reform and interest rate liberalisation	2+	2+	2+	2+	1	2-
• Securities markets and non-banking financial institutions	2	2+	2	2	1	2

Source: EBRD Transition Report 2000 (As cited by Torm, 2003)^{19b}

Table 4: Progress in transition.

approach. This exploratory study is an attempt to understand the path chosen by Uzbekistan to emerge as an independent and self reliant republic. The analysis and thought reflected in the paper considers the age of this republic and manifestations of the issues in transition till the data sources permit.

In the light of the broad objectives mentioned above the specific objectives can be translated as:

1. To understand Institution building in Transition economies with reference to republic of Uzbekistan.
2. To understand the role of state as an enabler of institutional and economic development.
3. To identify the status of Institutional (sociopolitical and regulatory) development and key influencers thereon.
4. To identify and suggest measures which enabled the state to become self regulatory and sustainable.
5. To highlight the challenges specific to Uzbekistan and suggestions for future.

Methodology

The study is exploratory in nature. Published data sources from [9,10], Euromonitor International and Data Monitor have been searched to identify issues faced by the Republic of Uzbekistan. The start was made by keying-in words viz. Uzbekistan, Uzbekistan economy, Institutions, Transition economies, Role of state in transition economies. There was abundance of literature on institutions and its role in economic progress but context specific data was scarce with specific mention of Uzbekistan.

The obtained information from the secondary source was reviewed which provided some insights about the phenomenon under investigation but there was a need to synthesize and articulate the missing links which can provide an articulated view about the research issues. The synthesis was aimed at understanding the problems face by emerging economies and the Uzbekistan economy in general, how after the breakaway they grappled with issues of configuring the institutions,

how their economic configurations and policies were different from the other independent republics, what challenges can be forecasted for future. The synthesized information was critically analyzed in light of the stated objectives which are discussed in detail in the subsequent sections.

Findings and Discussions

Transition economies and institution building

“Hundreds of books have been written on the transition from capitalism to communism but not the other way. There is no known recipe for unmaking an omelet.” The Economist (March 24-30, 1990: 22).

A transition economy is one that is changing from planning to free markets. Transition is very different from development. Development is the process of turning a less complex organism into a more complex one. Transition can be likened to changing the organism from one type to another. Transition thus involves the study of the creation of markets; hence, therefore it is of interest to those who are related to economy. Institutions are precisely what transition economies lack. (Table 1).

It has been observed that all transition economies faced the difficult task of building new market-compatible institutions, this process, and the speed and success of reform more generally, has varied greatly across countries [10]. It has been observed that Poland and Turkmenistan started off with approximately the same level of GDP per capita in 1990, Poland's GDP per capita increased to more than twice the level of that of Turkmenistan by 2002 [10]. This leads to interest among researchers as to why some transition economies have performed better than others and how they have build up strong institutional frameworks after the fall of socialism. The reform strategies as revealed by the literature focus on two mechanisms shock versus gradualism, along with macroeconomic policies and initial economic conditions which stipulate the dramatic variation in growth across transition economy [11].

Literature on the process of institution building and transition economies focuses on the nations emerging from breakaways of the

socialist frameworks. The transition started with the rapid destruction of the institutions supporting socialism in all transition economies [10]. While most transition economies initiated economic reforms to liberalize their economies, only a few countries, including Estonia, Hungary and Poland, were able to build institutions to enforce the protection of property rights and implement an enabling business environment to encourage investments [12,13]. Lithuania and the Slovak Republic although initiated substantial macroeconomic reforms but were not successful because of the inefficient state enterprises.

Institutions are not usually created to be socially efficient, [rather] are created to serve the interests of those with bargaining power to create new rules [14]. Even after independence of the republics, the socialist elites remained the most powerful political interest group and had considerable influence on the transitions process of transition economies (their influence varied to the extent of authority entrenched). The quest for power may be interpreted as logic for slow pace of creation of market based institutions. It can also be interpreted that the nations which are rich in national resource endowments do provide further incentives to these elites for stringent control and unwillingness to foster robust and progressive institutions, and thus property right framework becomes distorted defining the approach adopted as “catalytic” or “extractive” [10].

“Governments in the first group of countries will interact with entrepreneurs according to what [15] have called the “invisible hand” model, according to which “the government is well-organized, generally uncorrupt, and relatively benevolent. It restricts itself to providing basic goods, such as contract enforcement, law and order.” Government in the second group of countries is disorganized and bureaucrats act in their private interests. Frye and Shleifer [15] have called this the “grabbing hand” model, according to which “the government consists of ... bureaucrats pursuing their own agendas, including taking bribes.”

Uzbekistan after its independence has opted for a gradual approach towards reforms; the actions remained guided by the socialist fabric with strong central guidance for the development of the industrial, manufacturing and agricultural sectors, thus visible administrative interventions in form of regulatory institutions in the beginning guided the economic pursuits.

Unfortunately, this gradual reform strategy relied heavily on three interventionist pillars [16], primarily; exchange and trade controls, directed resource allocation, output targets (especially agricultural) and sizable public investment. Zettelmeyer, [17] found that Uzbekistan’s good output performance during the early 1990s was mainly due to a combination of low initial industrialization, (scale of) cotton production, and self-sufficiency in energy. These three elements more than offset the impact of the government’s poor macroeconomic and structural policies. This conclusion that the government’s public investment and gradualist reform program were not the driving forces behind the relatively favorable output performance becomes implicit. Thus it can be interpreted that the institutional framework which guides transition economies towards free market mechanism was lacking.

The role of state

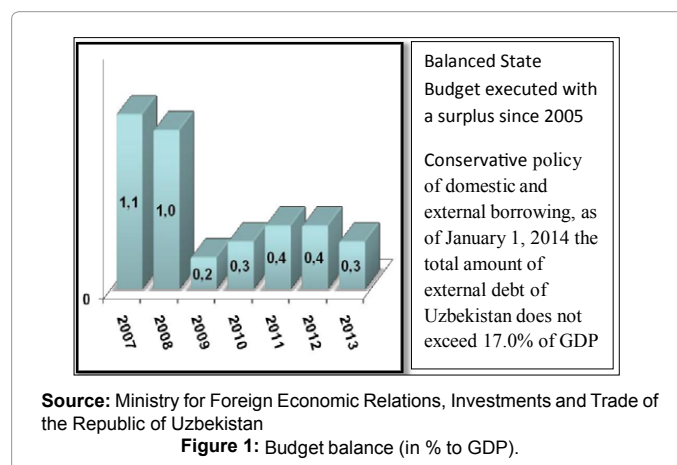
As discussed above it was not the government’s public investment and gradualist reform programme was not the driving force behind the relatively favorable output performance. State is a compulsory association that successfully claims the monopoly of the legitimate use of physical force within a specific community [18]. The concept of state, used in this working paper, essentially follows those essentials as

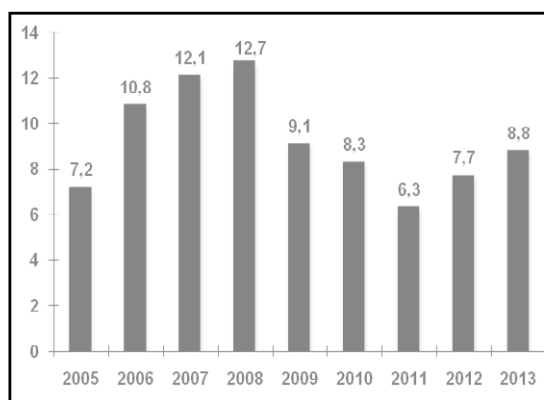
proposed by [19,20]. They view state is seen as a nexus of institutions for social control, authoritative policy formation and implementation, in which policy makers and social actors interact with each other and influence the path of economic, social, and political development, which in turn shapes the behavior of individuals and groups. In general, state institutions help to mediate conflicting social demands and produce specific policies and rules that govern social interactions within and beyond the political realm [21].

State necessarily should be interpreted as a complex nexus of converging institutions aimed towards the gains and incentives for the policy makers enabling right policies, its implementation and enforcement. One can therefore argue that institution building as a component of reforms has primarily two dimensions [21]; (1) creating the formal economic institutions which guide private sector development and coordination; and (2) crafting political institutions which are conducive to the proper and sound implementation and enforcement of economic institutions and policies.

While reviewing the role of government in Uzbekistan context one can earmark two clean and distinct time frames i.e. the first from independence till 2000 and that after 2000. In the period immediate to independence the government adopted discretionary and interventionist policies evidenced by the functioning of the financial sector. This sector was owned by Public sector banks stringently regulating the monetary policies. The legacy of administratively-determined interest and exchange rates and limits to access to cash resulted in deteriorating confidence in the financial system. This is reflected in the low level of monetization and heavy reliance of the banking sector on foreign loans as a liability base (In 2004, foreign loans constituted approximately 53 percent of the banking sector’s total liabilities, or 2.5 times its capital base) [16].

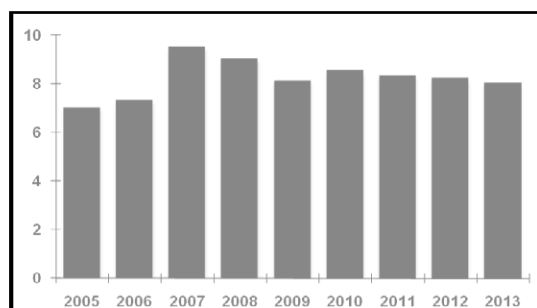
Inflation dynamics in Uzbekistan according to Ranaweeva [22], was visible due to disequilibria in the product and money markets—in an environment of multiple exchange rates, administrative controls, and import restrictions—were the major driving force. Post 2000 the initiatives taken by the government are pointing towards fairly progressive directions (Figure 1) wherein it has implemented measures to reduce exchange market distortions and a move towards currency convertibility thereby balancing the budget. Measures such as structure fiscal and monetary policies, restructuring the agricultural fallacies by converting farms into leaseholds and checks on borrowings are yet few initiatives which can improve the business environment and can catalyze the economic output (Figures 2 and 3). Market based reforms





Volume of industrial production has grown more than 3 times during 1990-2013

Figure 2: Industrial Production: Growth Rate (Year over Year in %).



From the period of independence, the development of GDP based on purchase power parity has increased 3.5 times

Figure 3: GDP Growth Rate (Year over Year in %).

like unification of the taxation system, clear registration procedures, curtailing red tapism are yet few more initiatives which can go long way. In the year 2004 and 2005 it has further reformed and liberalized the financial sector by relaxation and reported complete removal of cash constraints and clearance of all wages thus checking inflation (Figure 4) and pension arrears [16]. These structural measures could help Uzbekistan achieve sustained higher growth in the years ahead.

Development of institutions-key influencers

North and Thomas [23,24] discuss the importance of good institutions for economic development. Acemoglu, Johnson and Robinson [25] and others scholars Knack and Keefer, Mauro, Hall and Jones, Rodrik, and Engerman and Sokoloff [26-30] have narrowed down to the same conclusion. Easterly and Levine and Rodrik [31,32] show that institutions are more robustly associated with faster economic growth than policies. It has also been established that existence of property rights constitutes and essential prerequisite of institutions for economic progress [33-36]. The relationship between institutions and nations economy has been further validated by work [37-40] concluding that institutions may exert a profound influence on

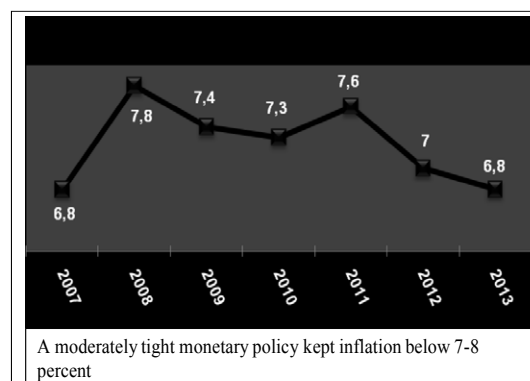
economic development in transition countries.

The role of institutions in voyage towards progress and prosperity can be understood in context of Latin American nations. When they became independent in the early nineteenth century they looked forward and adopted the American institutional framework because it had worked well for USA. The same did not materialize in their context because of the difference in the informal norms and the enforcement characteristics. Therefore institutions are nation and context specific, in other words they can be interpreted as phenotypes of unique DNAs. In the same light all the republics which emerged after disintegration of USSR either tried to adopt the similar socialist framework or aggressive market base reforms except Uzbekistan which customized its path of progress, with a slow systematic and cautious approach.

Two kinds of institutions should be distinguished: first, the *formal institutions*, mainly endogenous, at the economic, legal and political level; second, the *informal institutions*, exogenous, rooted in the social area and, for those reasons, more complex to capture. Rodrik [32] have proposed the topology of formal institutions, these are;

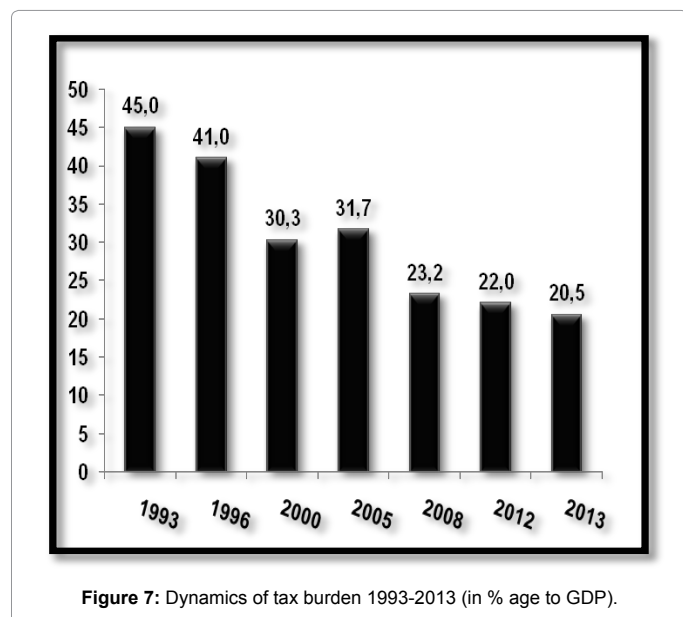
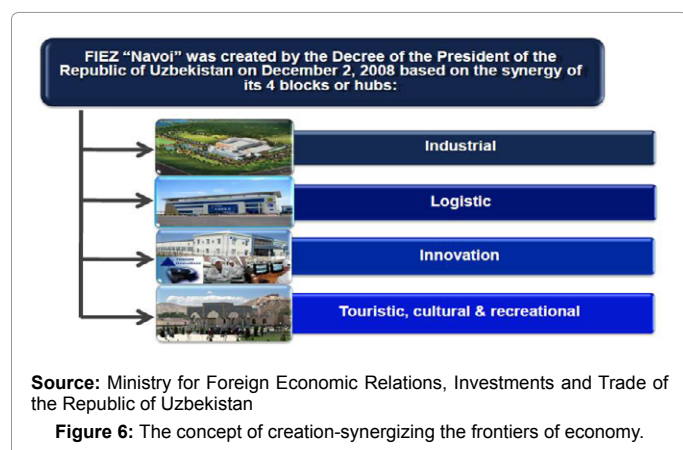
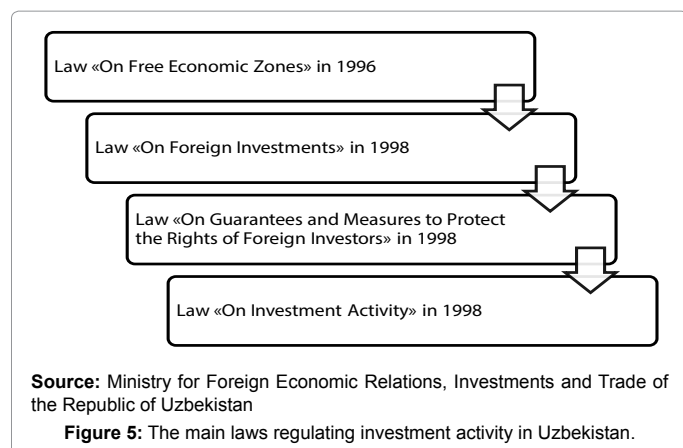
1. The *Market creating institutions* represent the rules of law that clearly define and protect property rights and make contracts fair and reliable for all actors.
2. The *Market regulating institutions* help to regulate market externalities, imperfect and asymmetric information or scale economies in sectors like transportation, telecommunication or environment.
3. The *Market stabilising institutions* reduce macroeconomic instabilities (low inflation rate, currency rate stability, balanced budget, financial discipline, fiscal rules, tax burden, trade policy, and banking system).
4. The *Market legitimising institutions* support social protection and manage social conflicts. It can be an insurance system or a welfare system that protects a minima people from a social dropping out.

Gerring and Thacker [41] consider Democracy, the Constitutional structures, and the State capacities as important elements. Political institutions are not only complementary to economics ones but they are also mutually reinforcing. For example, the transparency of the government actions contributes to shape a stable environment for actor. In Uzbekistan context the will induced by politico legal



Source: Ministry for Foreign Economic Relations, Investments and Trade of the Republic of Uzbekistan

Figure 4: Inflation 2007-2013 Inflation rate: In % to December of the previous year.



progressive ideology is instilling mechanisms for a sustained and progressive economy (Figure 5).

Key institutional changes and what next

Political framework: The leadership was in the hands of Islam

Karimov as a legacy from Moscow after demise of Soviet Union persistently following the communist pattern and framework. No major changes were expected within the same guiding ideology and framework [5]. The thought process was associated with the dependence on the former ideology signaling insufficient signals for transition. For uniqueness in the political institutional framework swift translation of power of different configuration would have necessitated adoption of a different kind of option which could have bought more changes. The first mega change “Navoi” can be interpreted as shift in the thought process among the political class. Contrary to the belief that the current political power enjoyed the status quo and was in evidently immune to the changes post transition (Figure 6).

Governance: The path chosen by Uzbekistan government was gradual transformation rather Shock-therapy which was otherwise followed by other former soviet republics. This mechanism is also known as “uzbek puzzle” in 1990s [42]. The data presented in Figures 7 and 8 are the testimony to the path so chosen. During the early period of transition focus of uzbek authorities was on prevention of dramatic output losses, fostering strong social protection and strengthening of the economy by focusing on the industrial sector. This concentrated focus on mutually supportive objectives was deterministic to the reform strategy.

Contrary to the earlier studies which have questioned on the long term sustainability of this strategy, the measures towards market reforms kept the focus on priority sectors intact. The results were fast change in the reforms related to small scale industries and retail with the changes in the priority sectors slow and cautious. The much needed financing objectives for the priority sectors were met via the state-controlled banking sector and from abroad. The resources from the energy and agriculture sectors were allocated to the priority sectors by price controls and direct administrative measures [43].

Managed growth: Using a regression model of output growth in 26 transition countries [10], found that the standard predictive models for transition economies “systematically under-predicts transition Uzbek growth,” including a mistaken prediction of a large output collapse in 1994 [17]. The author concludes that three factors explained part

External Debt by Country Groups and Uzbekistan in 2013	
Uzbekistan	17.0
Central and eastern Europe	65.6
Commonwealth of independent states	32.9
ASEAN	16.5
Latin America and Caribbean	24.8
Middle east and North America	24.7

Source: Ministry for Foreign Economic Relations, Investments and Trade of the Republic of Uzbekistan

Source: Ministry for Foreign Economic Relations, Investments and Trade of the Republic of Uzbekistan

Figure 8: External Debt by Country Groups and Uzbekistan in 2013.

(although not all) of Uzbekistan's better-than predicted growth: a low level initial industrialization (since industrial output tended to collapse in transition countries), the presence of cotton production (a readily exportable product), and the achievement of energy balance. The author found no significant effect from public investment but noted that measurement problems for that variable may have made any effect undetectable. He concludes that the final lesson is ambiguous, in that the favorable impact of cotton production and energy balance could be regarded either as reflecting favorable natural endowments or the regime's policies of "state control and cross-subsidization" [44,45].

Conclusions

Within the constraints of being land-locked the government of Uzbekistan through its recent strong Industrial policy is able to carry out large-scale progressive structural shifts. The key aspects of the progress are self reliance in energy and food self-sufficiency. Only few nations i.e. Turkmenistan and Azerbaijan are at par with the progress made by Uzbekistan. These nations are large resource exporters compared to Uzbekistan which earns revenues primarily from its exports in gas and gold. One can interpret, from an analyst point of view Uzbekistan to be a successful economy, the main task for future, apparently, should be to prevent "dizziness from success", to achieve possible economic risks for the future and to further strengthen the necessary government policy reforms, needed to maintain economic growth of the past 10 years (8%). one can identify the success of Uzbek economy even in absence of structured institutions which slowly is being structure by uzbek people. The other hand of the doubt as expressed by thinkers is to address the anomalies being crept into the system because of weak political configurations. There is a requirement relook into the political configurations a fresh.

Limitations

Inadequacy of published empirical data is the major limitation to this research. As always found exploratory research can be influenced by the biasness in the available sources there is no mechanism by which this biasness can be removed. The issues investigated in this research are necessarily to be looked by longitudinal perspective, cross-sectional revelations and data sources may not portray true picture. Institutional frame work is formal and informal both there is no mechanism to investigate the informal component; even in the formal Institutional framework we can only get information on the governance mechanism and not all facets of the institutions. This paper is more of in an essay format because it deals with the history and opinions which may question its validity as the opinions expressed are of the researcher. Nevertheless by all means it will add to the understanding about the key concepts targeted for investigation.

Directions for Future Research

Limitations mentioned in the preceding section if can be overcome provide direction for future research. The research can become meaningful and enriching if comparative framework among the economies which got independence with Uzbekistan can be done. As the research philosophy suggests this research can be further translated into empirical mode and conclusive inferences can be drawn.

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