

The Puzzling Success of Uzbekistan's Heterodox Development

by Terry McKinley, Director, CDPR

Beginning early in its transition to a more market-based economic system, Uzbekistan became well known for its heterodox economic policies. But since it has insisted on charting its own development path, it has incurred a continuous stream of criticisms from international financial institutions and mainstream economists.

The country has been repeatedly barraged with prophecies of its imminent failure. And yet it has managed—judging by many standard economic measures—to enjoy a significant degree of success. This has been a source of repeated puzzlement in orthodox circles.

Emblematic is a 1999 IMF Staff Paper by J. Zettelmeyer (Vol. 46, #3), which noted that although Uzbekistan had a “hesitant and idiosyncratic approach to reforms”, it was still outperforming other countries of the former Soviet Union. The paper labeled this surprising result ‘the Uzbek growth puzzle’.

At the start of the transition, Uzbekistan suffered from several severe external shocks. Soviet subsidies, which had been 7-9% of Uzbekistan's GDP in the late 1980s, were suddenly withdrawn. The country's terms of trade plummeted after it could no longer import cheap Soviet oil and relatively inexpensive food. And at least 300,000 professionals, mostly Russians and Ukrainians, flooded out of the country.

Ignoring the IMF

In the early 1990s, the IMF had stepped in to offer the country its standard policy recommendations: quickly liberalise markets and prices, open up to external trade and finance, rapidly privatise, free the economy from state control and tighten fiscal and monetary policies. Instead, Uzbekistan opted for a more gradual transformation of its economy.

As a consequence, its GDP declined by only about 18% between 1991 and 1995—a moderate reduction matched only by the richer transition economies of Central Europe. Moreover, government policies mitigated the impact of the economic downturn by instituting a decentralized form of social assistance, run by *mahallas* or community organizations, which targeted income subsidies to the poorer sections of the population.

Beginning in 1996—when many other transition economies were still struggling with recession—Uzbekistan's economy began to grow, and it averaged rates of over 4% from 1997 onwards. By 2001, its GDP had recovered to 103% of its 1989 level, making it the first former Soviet Republic to regain its pre-transition level.

Early on, Uzbekistan also began to structurally transform its economy, adopting an import-substitution strategy and beginning to diversify out of its heavy reliance on cotton exports. The country is blessed with a range of abundant natural resources, i.e., gold, other valued metals

such as silver, copper and tungsten, and, most importantly, gas and oil reserves.

While Uzbekistan had imported 60% of its oil during the Soviet period, by 1995 it had become self-sufficient in oil production—without any foreign direct investment. By 1995, the country was also producing 3.2 million tons of grain and by the 2000s was producing about 90% of its domestic needs.

The Crisis of the Late 1990s

By the mid 1990s, the government appeared to be moving closer to adopting IMF-supported liberalisation policies. But this honeymoon quickly soured when the economy was rocked by the 1996 cotton crisis. While cotton still accounted for about half of the country's foreign-exchange earnings, its world price fell by 15% and the country's production of it fell by a similar percentage. This crisis was compounded by the Russian financial crisis of 1998, when the sharp devaluation of the ruble dealt another severe blow to Uzbekistan's exports.

In the wake of the cotton crisis, the government suspended its stand-by loan with the IMF, and EBRD and World Bank loans subsequently dried up. The country was intent on pursuing more aggressively its previous strategy of import substitution, targeting credit to some of the more capital-intensive sectors of the economy, such as the oil and gas complex.

While the GDP growth rate continued to average about 4% during the early 2000s, it accelerated to over 7% by 2004 and exceeded 9% in 2007 and 2008 (see Table). This growth was based on rapid expansion of industry and fueled by increases in exports of commodities such as gold and gas. Domestic capital investment increased by more than 25% by 2007 and grew rapidly thereafter.

Key Macroeconomic Indicators (% change year on year)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009*
GDP	3.8	4.2	4.0	4.2	7.4	7.0	7.5	9.5	9.0	8.2
Industry	5.9	7.6	8.3	6.0	9.4	7.2	10.8	2.1	2.7	9.1
Agriculture	3.1	4.2	6.0	7.3	8.9	5.4	6.7	6.1	4.5	4.6
Exports	0.9	-2.9	-5.7	24.6	30.3	11.5	18.1	40.7	27.8	2.8
Capital Investment	1.0	4.0	3.6	4.8	7.3	5.7	9.3	25.8	28.3	32.7

Source: State Statistics Committee of the Republic of Uzbekistan. * 2009 is for January-June.

Thus, Uzbekistan confronted the global food and fuel crisis of 2008 from a fairly strong position. For example, food as a share of total imports had fallen from 21.5% during 1995-99 to only about 9% during 2003-2006. Meanwhile, machinery imports had grown to 47% of the total

while energy imports remained low, at 4%. The structure of Uzbekistan's exports and imports compared favourably to that of many other developing and emerging economies suffering at that time from sharply rising import prices (see McKinley and Weeks 2009).

During 2003-2006, Uzbekistan's energy exports constituted about 14% of total exports and gold exports about 29%. The country's cotton exports, as a share of the total, had fallen from about 42% to about 21%. According to the IMF, the balance on Uzbekistan's current account exceeded 9% of GDP in 2006 and shot up further to 12.8% of GDP by 2008.

Confronting the Global Crisis

How has Uzbekistan been affected by the global crisis? The impact has not been severe. Its economy has not been afflicted by financial contagion since its financial liberalization has been limited. While noting that Uzbekistan grew by 9% in 2008, the IMF predicted last October that the country's growth would drop to 7% in 2009. Still, it forecast that Uzbekistan would be one of the countries in the Caucasus and Central Asia region least affected by the global financial crisis.

Because of projected declines in remittances and non-energy exports, Uzbekistan's current-account surplus was forecast to drop from its peak of 12.8% of GDP in 2008 to a still credible 7.2% in 2009. The IMF noted that because Uzbekistan had ample foreign-exchange reserves, it would not likely face serious exchange-rate pressures. Moreover, its policymakers had mitigated the basis for sharp shocks to its currency's value through a continuous process of 'crawling peg devaluations'.

Government economic data through the first six months of 2009 show that Uzbekistan's GDP was growing at a rate of 8.2%, compared to the same period in 2008 (see Table). The country's industrial output was growing reasonably well, at a 9.1% rate, although its agricultural output increased more slowly, at a 4.6% rate.

The growth of Uzbekistan's exports suffered a sharp drop, from a rate of 27.8% in 2008 (year on year) to only 2.8% during the first six months of 2009. While there were reductions in exports across a broad range of sectors, including cotton, chemical products, metals, and machinery and

equipment, these declines were offset, to some degree, by Uzbekistan's exports of energy and oil products, which grew by a very high 240% rate.

The drop in Uzbekistan's non-energy exports during early 2009 would have taken a noticeable toll on its economy had the Government's new Anti-Crisis Programme not initiated a large counter-cyclical fiscal stimulus, equivalent to about 5% of GDP. Similar to China's stimulus, this programme imparted a sizeable boost to investment in fixed capital. Both public and private investment grew by 32.7% in early 2009, and helped stimulate a 32.5% growth rate in the construction sector.

It is noteworthy that Uzbekistan has had the 'fiscal space' to finance an ambitious investment programme, which has helped counteract any current slowdown and will likely support faster future economic growth. Unlike many other low-income economies, Uzbekistan has been able to mobilise total revenue of over 30% of GDP. During the 2000s, its consolidated government budget remained roughly in balance, while it began to recently channel its current-account surpluses into a new Fund for Reconstruction and Development.

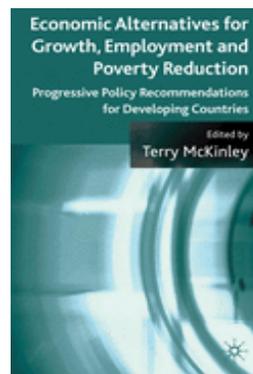
In Conclusion

In general, Uzbekistan's heterodox policies have served it fairly well. It was able to successfully moderate the hardships of its early transition, resume credible rates of economic growth by the late 1990s, and substantially restructure its economy to be more self-sufficient in such critical items as energy and food.

Its restructuring has enabled it to avoid some of the worst effects of the food and fuel crisis of mid-1998 and the global financial crisis and recession of 1998-1999. Aspects of Uzbekistan's development model could certainly be criticized (see McKinley and Weeks 2009). Employment growth has consistently lagged behind economic growth and poverty reduction has been slow.

Yet by any standard barometers of economic performance—as well as by comparison with other low-income countries—Uzbekistan has been relatively successful over two decades of transition and development, though its achievements appear to remain a frustrating puzzle to many orthodox economists.

This recent [book](#) provides a comprehensive set of recommendations for alternative economic policies that can generate growth, employment and poverty reduction in developing countries:



Reference:

McKinley, Terry and John Weeks (2009). "A Proposed Strategy for Growth, Employment and Poverty Reduction in Uzbekistan" in Terry McKinley (editor), *Economic Alternatives for Growth, Employment and Poverty Reduction: Progressive Policy Recommendations for Developing Countries*, Palgrave Macmillan.

Footnote:

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