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STATE-OWNED ENTERPRISES IN UZBEKISTAN: TAKING STOCK AND SOME REFORM PRIORITIES

Umidjon Abdullaev

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Umidjon Abdullaev is a principal economist at the European Bank for Reconstruction and Development in London, United Kingdom.

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Please contact the authors for information about this paper.

Email: abdullau@ebrd.com

Asian Development Bank Institute
Kasumigaseki Building, 8th Floor
3-2-5 Kasumigaseki, Chiyoda-ku
Tokyo 100-6008, Japan

Tel: +81-3-3593-5500
Fax: +81-3-3593-5571
URL: www.adbi.org
E-mail: info@adbi.org

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 study is to review the economic weight and degree of presence of SOEs in the economy of Uzbekistan, analyze in detail governance mechanisms 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.

Keywords: state-owned enterprises, governance, privatization

JEL Classification: L32, O25, G34

Contents

1. INTRODUCTION

Starting from end-2016, Uzbekistan embarked on a wide set of comprehensive structural reforms aimed at revitalizing key sectors, liberalizing its markets, and introducing market mechanisms in the economy. Given the still important role of state-owned enterprises (SOEs) across a number of sectors in the country, any package of economic reforms will necessarily have to take into account the high dominance of these enterprises across multiple sectors and address issues specifically related to, or stemming from, the dominance of SOEs in the economy.

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 the 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 last few 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 study 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 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, a number of state agencies, and a public repository of Uzbek legislation. In this respect, a major limitation of the study is the 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 sector of state-owned enterprises and the need for governance reforms, particularly in the transition region, have been analyzed by a number of authors. Dewenter and Malatesta (2001) analyze the performance of SOEs in a number of countries and confirm their subpar performance relative to private firms. In a recent study, Richmond et al. (2019) analyze the performance and footprint of SOEs across central, eastern, and southeastern Europe and provide policy recommendations for addressing a number of governance and efficiency issues. In a similar study, Böwer (2017) looks into the performance of SOEs in a number of emerging economies. The analysis contained in this 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 of Uzbekistan, providing detailed analysis of a number of issues concerning the governance structure of SOEs, and by evaluating the government's past privatization initiatives (for earlier studies, see Broadman (2000), Conrad and Lin (2005), and Conrad (2008)).

1 Analysis in this paper is based on data, structure of government agencies and related legislation known, valid and available as of end-2018. The Government of Uzbekistan has initiated a number of reforms in the area of the governance of SOEs throughout 2019. Thus, some of the observations made in this study may be subject to revisions as ongoing reforms efforts in this area materialize.

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 looks into the corporate governance and management structure of SOEs in Uzbekistan. Section 5 concludes with a set of recommendations.

2. ECONOMIC WEIGHT AND ROLE OF SOEs IN THE ECONOMY

SOEs in Uzbekistan have traditionally been viewed as a key tool for achieving the country's industrial policy objectives. During the past two decades Uzbekistan has 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 the 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 in the legislation to be of strategic importance for the economic development of the country.

Major SOEs overseeing sectors of the economy trace their history to sector ministries. Historically, the management of enterprises in Soviet-type economies had been carried out 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 of 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 enterprises, and implementing the state's sector development policies.

The 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 are not publicly available. Despite constraints related to the availability of such data, existing evidence suggests that SOEs are present in most sectors of the economy, including energy, mining, oil and gas, light and heavy manufacturing, telecommunications, and transport (Table 1). Uzbek legislation does not formally identify the term "state-owned enterprise," and thus no specific ownership thresholds designating an enterprise as "state-owned" exist. At the same time, the legislation allows for the establishment of a special type of entity called a "state unitary enterprise," which is by definition fully owned by the state and is commonly created as a special entity for managing state-owned property.[2] But the majority of large SOEs in the country are incorporated as joint-stock companies, commonly majority to

2 Legally, state unitary enterprises do not own state-owned property and they are only in a position to use the property assigned to them.

fully state-owned. Thus, analyzing only the set of “state unitary enterprises” will omit the large set of enterprises that are de facto also state-owned, though they do explicitly bear such designation. Thus, in this paper 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 are not publicly available. Major SOEs, including those listed in Table 1, are commonly fully or majority owned by the state.

Table 1: Examples of Major State-Owned Enterprises in Uzbekistan and Their Key Markets (as of end-2018)

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 plants
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

Source: Author's elaboration.

Until early 2019, the Centre for Management of State Assets (CMSA), a unit within with the former State Committee for Assistance to Privatized Enterprises and Support of Competition (also referred to as the State Committee on Competition (SCC)), had been the government agency responsible for the ownership, management and monitoring of the state’s portfolio of industrial and commercial enterprises.[3] The CMSA listed a little

[3] The Centre for Management for State Assets (CMSA) and its parent agency (State Committee for Assistance to Privatized Enterprises and Support of Competition) were reorganized in early 2019 into several agencies with functions of ownership and management of the portfolio of state-owned enterprises being transferred to a newly created State Assets Management Agency (SAMA). The study will, nevertheless, refer to CMSA in the text, where relevant, given it was the key legal ownership entity for SOEs in the country until end-2018.

over 1,400 enterprises in its 2016 report on the performance of enterprises it monitors, which likely includes core commercial and revenue-generating SOEs operating in Uzbekistan. The sector affiliation of enterprises in the CMSA reports shows that SOEs are present in most sectors of the economy, including the provision of various professional and technical services (engineering, standardization, testing, veterinary services), construction, information and communication (telecommunications and newspaper publishing), real estate (including ownership and management of markets), and various manufacturing activities (metals and metal products, fertilizers, food products, chemicals, and various machinery) (Table 2).

Table 2: Sectoral Distribution of Enterprises Monitored by the Centre for Management of State Assets (CMSA) (based on the 2016 Performance Report)

Sector	**Share** (%)	**Count**
Professional, scientific, and technical activities	25.4	356
Construction	18.1	254
Information and communication	7.9	111
Real estate activities	7.8	109
Manufacturing	6.1	85
Transportation and storage	5.9	83
Wholesale and retail trade; repair of motor vehicles and motorcycles	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, and remediation activities	2.1	29
Human health and social work activities	2.0	28
Other	7.7	108
Total		**1,401**

Source: 2016 list of enterprises monitored by the Centre for Management of State Assets and the enterprises registry of the State Committee of the Republic of Uzbekistan on Statistics.

Comprehensive and reliable data on the share of SOEs in GDP, sectoral and regional value-added, employment, and exports are not available. Official statistical sources provide information on the contribution to the economy of a group of enterprises that are classified as being in the "state sector." However, this classification category includes only enterprises that are fully owned by the state, making it too restrictive and of limited scope. The 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 a state ownership share (e.g., joint-stock or limited liability companies).

Despite a lack of reliable estimates of the contribution of SOEs to GDP, authorities report information on the contribution of enterprises with majority state ownership to industrial output. In particular, enterprises with majority state ownership accounted for 47% of the total industrial output in 2017. The contribution of such enterprises to industrial output varies considerably across regions, ranging from 26% in the Namangan region (Southeast Uzbekistan) to up to 80% in Navoi and Karakalpakstan (Northwest Uzbekistan). Alternative sources of data on economic weight and the contribution of SOEs to the economy are lacking. The 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. Little available survey data provides evidence of the more important role of SOEs in employment (than suggested by official estimates based on a restrictive definition of SOEs). 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. The survey's results also indicated that about 34% of the employed were self-employed, which suggests that employment in SOEs accounted for more than half of the total wage employment in the country (Ajwad et al. 2014).

Many SOEs are monopolies or dominant producers of goods and services in their sectors. Information on the 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 positions in different product and service markets, which is published by the Uzbekistan's competition authority (this registry does not include enterprises classified as natural monopolies). The early 2018 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 resulting in the quantity of enterprises exceeding the number of goods and services they provide across specific regional markets). Analysis of the list suggests that more than 90% of enterprises included in the registry are either state-owned or the state has some degree of control in them (e.g., joint ventures). SOEs hold a 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.[4]

State ownership also appears to be specifically prominent among joint-stock companies. In particular, as of end-2016, out of 659 existing JSCs the state had a direct ownership share in 158 enterprises (24% of all JSCs), while shares of a 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 the state has some degree of control and ownership in them. In terms of the volume of JSC share capital owned by the state, as of end-2016, 84% of the existing share capital of JSCs was directly or indirectly owned by the state (State Committee for Support of Privatized Enterprises 2017).

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, the role of major SOEs in sector supervision and, in some cases, regulation is the outcome of them being successors of now defunct sector ministries. In addition, this role continued to be reinforced during the last few decades due to SOEs being viewed by the government as a key tool for achieving its industrial policy objectives.

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

Supervisory and regulatory functions may range from the development, monitoring, and implementation of sector development programs to very specific control functions such as 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. This arrangement creates significant conflict between the responsibilities of some major SOEs related to developing and enforcing sector regulation, ensuring efficient performance of their operational subsidiaries, supervision of existing private sector competitors, if any, and regulation of the entry of new players. The government recently has started to transfer some of these supervisory and regulatory functions from SOEs to ministries or state agencies, though further work by the authorities on reducing such conflicts of interest and functions remains necessary.

Thus, despite a lack of data permitting more adequate analysis of the economic weight of SOEs in Uzbekistan, available evidence suggests that SOEs continue to play an important role in the country's economic performance. 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 perform sector supervision and, in some cases, the regulatory role they inherited from their predecessor institutions.

3. SCOPE AND PROGRESS OF PRIVATIZATION PROGRAMS

Privatization has traditionally been indicated as one of the main tools for reducing the role of the state in the economy. The 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 the late 1990s and onwards were carried out 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 the late 1990s and 2000s had a wide scope and ambition, though efforts to privatize large SOEs were not successful. Analysis of decrees initiating large privatization programs in the 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 do indicate that the government has continued to sell its assets in recent years but efforts have been focused on small and auxiliary enterprises and often on unused real estate property (Table 3).

Table 3: Privatization in Uzbekistan, Selected Years

	2005	2009	2010	2011	2015	2016	2017
Privatized enterprises	980	135	96	95	848	609	542
Privatization 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 have commonly been indicated to be not subject to privatization. The overall scope of Uzbekistan's privatization programs 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 law does not prescribe a specific method of privatization of state property and allows for auctions, share sale (initial or secondary public offering), or direct sale to a strategic investor.

The recent version of the list includes over 50 SOEs that are explicitly excluded from future privatization efforts (Government of the Republic of Uzbekistan 2017a). These include major SOEs in mining (Navoi and Almaly Mining and Metallurgy Complexes), telecommunications (Uzbektelecom JSC), oil and gas (core enterprises within Uzbekneftegas Holding Company), energy (Uzbekenergo JSC, Uzbekgidroenergo JSC), agriculture (Uzpakhtasanoateksport JSC, 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 regularly offered for privatization but the willingness of the state to retain the controlling stake in many of them is evident. The recent privatization efforts of the government were defined by a 2015 presidential decree, which offered a large set of SOEs for privatization (Government of the Republic of Uzbekistan 2015c). 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, textiles, 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 the 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, and 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, the state intends to retain a 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.

The government appears to be reviving its privatization efforts, though proposed recent initiatives focus primarily on simplification of the privatization process itself. In particular, in January 2017 a presidential decree allowed the approval of privatization of small nonstrategic SOEs and the sale of state-owned real estate property at zero cost by local authorities (Government of the Republic of Uzbekistan 2017b). The decree also allowed for the privatization process to proceed in the case of a single bidder and deferral of payment of privatization proceeds for up to three years. While introducing simplification to the privatization process is laudatory, the potential economic impact of this initiative will likely remain limited. For instance, a little over 340 out of 1,400 SOEs listed in the 2016 performance report of the Centre for Monitoring of State Assets (CMSA) are directly subordinate to local authorities and these primarily constitute local city markets, regional newspapers, and publishing houses, as well as enterprises in transportation, retail trade, construction, and municipal and various other technical services.

Overall, the 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 the significant presence of SOEs in key sectors of the economy is likely to continue in the near future. Existing privatization programs focus on noncore and relatively small regional enterprises, which limits the potential of these programs to spur the development of a vibrant private sector through privatization of state assets.

4. GOVERNANCE AND MANAGEMENT OF SOEs

4.1 Formal Corporate Governance Framework

Most large SOEs have been corporatized and basic elements of the governance structure of joint-stock companies are in place. 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. JSCs are the primary form used to incorporate major SOEs overseeing sectors of the economy, while their subsidiaries are commonly incorporated as JSCs, LLCs, or unitary enterprises. Nevertheless, the discussion in this section will focus on the governance practices of state-owned JSCs as the primary legal form used to incorporate large SOEs.

The operation of joint-stock companies, including state-owned ones, 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 1996). A typical state-owned JSC is governed by the general meeting of shareholders, the supervisory board, and the management. The latter can either be a single individual or a management board consisting of multiple directors. 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 recently improved. The law on the securities market imposes a set of disclosure and transparency requirements on listed JSCs (Government of the Republic of Uzbekistan 2015a). A separate government resolution imposes further disclosure requirements on official websites of JSCs (Government of the Republic of Uzbekistan 2014). A corporate governance code applicable to all JSCs was approved in early 2016 and its application is voluntary, which may likely result in differing degrees of compliance with its prescriptions. 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 an annual basis. Joint-stock companies, including SOEs, are expected to publish the result of these assessments on their 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 are necessary.[5]

Supervisory boards of major SOEs commonly include high-level government officials and representatives of relevant ministries. For instance, according to a government resolution, the Prime Minister chairs the supervisory board of Uzbekistan Railways JSC, while various deputy ministers make up its members. Deputy prime ministers chair supervisory boards of Uzbekenergo JSC, Uzavtosanoat JSC, and 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 2006a). 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 is specified (for instance, on remuneration, nomination, strategic planning, risk, or other issues). An audit committee reporting directly to the supervisory board is mandated to review the performance of an enterprise on 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 that at least 15% of the supervisory board should 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). The chairman of the management board (i.e., the CEO) is appointed by the shareholders' 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 CEO of Uzavtosanoat JSC, Uzbekenergo JSC, and Uzagroteksanoatholding JSC are additionally approved by the President's Office (Government of the Republic of Uzbekistan 2001, 2004a, 2016a). A management contract with a CEO is signed for a year and the shareholders' meeting (or the supervisory board if it is explicitly granted the right) decides whether to extend the management contract with the appointed CEO on an annual basis.

State ownership rights are formally exercised by delegating the management of the state's share in an enterprise to an individual or legal entity. Formally, management of state JSCs is carried out through delegation of the management of state shares in an enterprise to either (i) an individual, (ii) another SOE, or (iii) an asset management company. For the purpose of management of state assets, state trustees and SOEs are

[5] A summary of the analysis is available via http://www.csam.uz/Default.aspx?id=643.

appointed directly, while asset management companies are indicated to be selected on a competitive basis (Government of the Republic of Uzbekistan 2006a, 2013). Individuals and legal entities delegated to manage the state's share in enterprises are selected and appointed by a dedicated commission after the candidates for these roles are proposed by the ownership entity and approved by the Cabinet of Ministers (Government of the Republic of Uzbekistan 2003a, 2007).

Individuals entrusted with management of state assets may carry one of the 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 with the size of the 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 where a state share is nonexistent), the 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.

The SOE performance measurement system, as prescribed by the legislation, has notably improved in recent years. The system of monitoring the performance of SOEs evolved significantly in 2015, when a detailed and elaborate set of key performance indicators (KPIs) were introduced with an obligation for SOEs to start implementing the new set of KPIs from January 2016 (Government of the Republic of Uzbekistan 2015b). 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 13 mandatory performance indicators and an additional 13 supplementary ones. The performance of an enterprise is measured using the 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 the final remuneration of an SOE's management. In particular, the variable part of the management compensation is indicated to be adjusted to the performance of an SOE as measured by the integrated efficiency indicator. Moreover, a weak performance by 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 2015b).

A 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 shareholders' meeting. CEOs report on the performance of an enterprise against business plan targets to the supervisory board on a quarterly basis (Government of the Republic of Uzbekistan 2003b). In addition, on an annual basis CEOs of large SOEs and chairmen of their supervisory boards report to the Cabinet of Ministers on the performance of their SOEs (Government of the Republic of Uzbekistan 2006c).

Despite progress in the SOE performance measurement system, disclosure practices of key performance metrics need to improve. The SOE performance reports published by the CMSA on its website include the value of the integrated efficiency indicator for the monitored SOEs but neither each component of this indicator nor further details (like weights employed by each SOE in the computation) are available. The lack of details about this measure and the absence of a comparable measure for private sector companies prevent a more comprehensive and meaningful analysis being provided.

To summarize, key elements of the formal governance structure of SOEs appear to be in place, though more work on their further improvement is needed. Building blocks of the governance structure of SOEs, including a law on joint-stock companies, corporate governance code, and 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 the 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 compliance with standards and practices prescribed by the legislation.

4.2 Further Governance Mechanisms and Policies

Despite significant progress in introducing a 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 over the day-to-day operations of SOEs. These mechanisms influence the production and pricing decisions of SOEs as well as the incentive structure SOE management faces weakening the role of formal corporate governance mechanisms.

The bureaucratic rank of CEOs of major SOEs points to the 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, the actual role and position of CEOs of particularly large SOEs appear to be more extensive. For instance, the position of a CEO in a number of major SOEs, including Uzavtosanoat JSC, Uzbekneftegas JSC (and its major subsidiaries), Uzbekenergo JSC, Uzagroteksanoatholding JSC, and Uzbekoziqovqatholding Holding Company, is formally indicated to be equivalent to the rank of either a minister or first deputy minister. The position of a deputy CEO in these enterprises has the rank of a deputy minister (Government of the Republic of Uzbekistan 2004a, 2006d, 2001, 2016a, 2016b). This suggests that many large SOEs, despite corporatization and the introduction of modern corporate governance mechanisms and structures, continue to play a role equivalent to that of sector ministries or associations. The assignment of the rank of a minister or a deputy minister to executive management and the resulting blurring of accountability and reporting lines also undermines the role of supervisory boards in these enterprises. The government has recently indicated its plan to discontinue this practice, which, when fully implemented, should contribute to improving the accountability and reporting lines of CEOs of major SOEs.

The degree of autonomy of SOEs and their supervisory boards, especially in large SOEs, in determining 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 state documents that strongly influences the 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 investment projects, specify sources of their financing, indicate specific targets set for each agency or organization carrying out the project, and provide a framework for monitoring the delivery and performance.

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 an annual basis and commonly cover projects intended to be implemented during the following three years. This investment monitoring and control system has undergone some revision in 2018 but core components of the framework appear to have remained the same (Government of the Republic of Uzbekistan 2017c).

Many SOEs have also been strongly affected by the degree of government intervention in pricing decisions of goods they produce. These interventions have commonly been carried out through subjecting certain goods and services to price and distribution controls due to them being classified as being of strategic importance or the producer of these goods and services being designated as having a significant market power. In particular, the list of enterprises that are, or have recently been, subject to some form of price regulation appears significant. For instance, the list of enterprises that have been 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 as being of strategic importance, which makes them subject to price control regulation. In addition to goods that have traditionally been subject to some form of government control (e.g., electricity), the list of goods of strategic importance has commonly included natural gas, petrol and other fuels, coal, fertilizers, cotton, metals, construction materials (roof slates), and others. The Ministry of Finance is a key authority responsible for setting or approving 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 2004b, 2017d).

Government influence on SOEs has been prominent not only through pricing decisions but also through its practice of allocation of key goods across different types of consumers. The 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 2004b).

Material balances have commonly 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 2006e). Goods for public sector needs (including for SOEs) are commonly 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. The lack of publicly available information on approved material balances prevents estimation of the share of the 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 the opportunities for 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 started to undergo significant changes in 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 2017d). 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 commodity exchange only. These reform initiatives suggest that many SOEs in the coming years will gradually start being exposed to prices for key inputs that more adequately reflect their scarcity and latent demand from competing consumers (e.g., the 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, an oil and gas company, and Uzpakhtayog JSC, an edible oil producer, as well as state-owned and private sector producers of alcoholic products. The 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, compliance with contract obligations, and prevention of fraud (Government of the Republic of Uzbekistan 1996b, 1998, 2017e). A 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 Uzbekenergo JSC, and Uztransgaz JSC (revenues from the sale of electricity and natural gas, respectively) are explicitly prescribed by government resolutions (Government of the Republic of Uzbekistan 2017f).

Direct governance mechanisms employed by the government provide tools for channeling SOE operations towards achieving its industrial policy objectives but likely at the expense of the 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.

The existence of a range of governance mechanisms beyond those prescribed by the 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 the 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 prioritization of 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 the 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 the overall governance structure of the SOE sector including by separating regulatory and supervision from ownership and management functions currently observed 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 the Uzbek government's view of SOEs as being key tools for implementing its industrial policy objectives, it will likely resort to a gradual and cautious approach to reforming the SOE sector.

The degree of presence of the state and SOEs in the economy needs to be critically assessed. The current scope of sectors indicated to be of strategic importance appears very wide and covers almost all industrial sectors. In this respect, a comprehensive review of the degree of presence of SOEs should be initiated and a strategy for material reduction of their footprint should be developed, especially if there is sufficient evidence that the 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, the 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. The introduction of effective monitoring frameworks as well as improvements of the quality and quantity of available data on SOEs are equally important.

Related to the issue above is the pervasiveness of direct control mechanisms and limited use of regulatory mechanisms to govern sectors. Thus, effective regulatory mechanisms need to be introduced and regulators that are independent from major SOEs need to be created. The practice of granting supervisory and regulatory functions to existing SOEs should be re-examined and phased out (and recent government efforts to achieve this should be continued). A number of large SOEs are also members of commissions responsible for the issuance of licenses to new sector entrants. This practice should be re-examined too in view of the significant conflicts this arrangement generates. An appropriate regulatory framework independent from large SOEs is particularly necessary and absolutely vital for the successful performance of privatized enterprises and other private sector companies.

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

Board autonomy should be strengthened. The existence of highly prescriptive and closely monitored state investment and development programs limits boards' potential ability to fully define companies' investment and development strategy. The existence of government-determined and highly prescriptive resource allocation and price control mechanisms (though being phased gradually at the moment) with respect to a number of goods also restricts the 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 nonexistent. Most of these practices need to be re-examined to strengthen the professionalism of boards and to introduce a sufficient degree of autonomy in their decision-making.

Phasing out direct SOE control mechanisms is critical. A 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 and 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. The 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.

The SOE performance-monitoring system should prioritize SOE efficiency and its degree of transparency should be improved. The 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) appears to result in a wide range of quantitative targets imposed on SOEs. In such an environment, the new system of monitoring the performance of SOEs introduced in 2015 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 the economic efficiency of an enterprise. Comprehensive SOE evaluation methods, along the lines of the approach discussed in Taghizadeh-Hesary et al. (2019), should be considered as well.

A level playing field with the private sector should be created. 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 a 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 a significantly better competitive position than other private sector players. Creating a vibrant private sector and providing it with opportunities to expand will require elimination of such distortive practices and effective exposure of SOEs to competitive pressure from the private sector.

The scope of future privatization programs should be gradually expanded as this 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. Analysis of the reasons for the 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, are commendable.

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