

Joint report

Towards a better investment climate

Proposals from German
business in Uzbekistan

Berlin/Tashkent,
December 2020



About the German Economic Team

Financed by the Federal Ministry for Economics and Energy, the German Economic Team (GET) advises the governments of Moldova, Georgia, Ukraine, Belarus and Uzbekistan on economic policy matters. Furthermore, GET covers specific topics in other countries, such as Armenia. Berlin Economics has been commissioned with the implementation of the consultancy.

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About the German Eastern Business Association (OA)

The German Eastern Business Association (OA) is the major regional initiative of the German economy for 29 countries in Central Europe, Eastern and Southeastern Europe, in the South Caucasus and in Central Asia. The OA supports its members in their projects, arranges contacts and answers questions about market entry. In close cooperation with the federal government and the governments of the partner countries, they work to reduce trade barriers and improve economic conditions in the region. OAOEV was created in May 2018 through the merger of the Committee on Eastern European Economic Relations (founded in 1952) and the Eastern Europe Business Association of Germany (founded in 1989). It is supported by six central associations of German business and has around 350 member companies.

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About the Delegation of German Economy for Central Asia (AHK Central Asia)

The Delegation of German Economy for Central Asia (AHK Central Asia) is part of the worldwide network of German Foreign Chambers of Commerce and actively supported by the German government. From its offices in Tashkent, Uzbekistan and Almaty, Kazakhstan it advocates the interests of the German economy towards the economic and political decision makers of the host countries in the region, thereby being the voice of German business in Uzbekistan, Kazakhstan, Kirgistan, Tajikistan and Turkmenistan.

The Delegation is the competence center and partner of choice for German companies interested in, entering or already working on the markets of Central Asia and offers assistance in all spheres of business, starting with market research, information, assistance in market entry, political advocacy, consultancy, as well as offering business support in operative spheres like law consultancy, accounting or office-in-office-solutions. Furthermore the Delegation actively supports the development of business relations between Germany and the host countries in close cooperation with the local authorities, aiming to reduce barriers and improve business climate.

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About the German-Uzbek Economic Council

The German-Uzbek Business Council (Duwirat) was founded in Berlin in 2015 to represent the interests of German and Uzbek business. With its two co-chairs, the Prime Minister of the Republic of Uzbekistan Dr. Abdullah Aripov and Mr. Manfred Grundke, Managing Partner of the Knauf Group Iphofen it is very well represented.

About 40 member companies are currently active in the Duwirat on the German side. They have set themselves the task of promoting and further expanding economic cooperation between Germany and Uzbekistan. Particular attention is paid to building up a bilateral network, which should function both on a political and on a business level. The German-Uzbek Business Council works closely with the German Eastern Business Association, the Delegation of German Economy for Central Asia and the respective embassies.

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1 Introduction

Since 2017, Uzbekistan has been undergoing a dynamic and ambitious reform process. In the economic sector, these reforms primarily comprise the flexibilisation of the exchange rate, a comprehensive tax reform and the liberalisation of foreign trade. From the beginning, these reforms were not only very ambitious but also successful.

This can be seen by

- the strong growth of foreign trade, which increased from USD 24 bn in 2016 to almost USD 42 bn in 2019
- an improvement in the Doing Business Index, where Uzbekistan climbed from rank 87 in 2016 to rank 69 in 2020
- stronger foreign direct investment (FDI). According to the World Bank, FDI increased from 2% of GDP in 2016 to almost 4% of GDP in 2019.

Overall, the Uzbekistan's economy is changing from a closed, state-centred economic model to an open market economy.

Although the achievements of the past years are impressive and the pace of reform astonishing, such a fundamental change takes time and Uzbekistan still faces major challenges. These include a still very large share of the state in the economy and a growing working-age population, for which jobs need to be created. It is therefore in Uzbekistan's interest to offer the best conditions for both domestic and foreign companies, and to attract as much FDI as possible.

At the same time, companies continue to report difficulties to invest and to develop their businesses in Uzbekistan. By proposing concrete reforms, this study aims to contribute to improving conditions for existing companies and potential investors, to remove obstacles for investment and thus to contribute to Uzbekistan's development.

The reform proposals are based on advice from German companies operating in Uzbekistan and independent experts. The study was prepared in cooperation with the Representative Office of German Economy in Central Asia, the German Eastern Business Association and the German-Uzbek Economic Council.

The study is structured as follows: We describe the underlying approach and methodology in chapter 2. We make relatively broad and far-reaching reform proposals on the legal system in chapter 3. We continue with more specific proposals on regulation of the private sector in chapter 4. We present proposals on economic activities of the state through fully or partially state-owned enterprises (SOEs) in chapter 5. Proposals in the area of accounting and corporate taxation are presented in chapter 6. Finally, several proposals that are specific to individual sectors of the economy are presented in chapter 7. In chapter 8, we draw up a list of “quick wins”, characterised by a great ease of implementation and having a solid predicted impact, which could be a suitable starting point for the implementation of these recommendations by the government. The final chapter 9 points out “high-impact reforms”, which are more difficult to implement but would have the highest effect.

2 Approach and methodology

This study contains reform proposals from German and Germany-related businesses in Uzbekistan. It follows a bottom-up approach, based on a questionnaire prepared by the German Economic Team (GET). A large number of companies organised in the German Eastern Business Association and the Representative Office of German Economy in Central Asia as well as in the German-Uzbek Economic Council report about problems and regulatory hindrances that they face in their operations in Uzbekistan and make concrete proposals to resolve these issues. The proposals then underwent an extensive review and checking process by GET experts, external experts with specific expertise and the partner associations. The review process was centred on ensuring that the proposals are consistent with a general reform direction towards transparent, competitive markets, are consistent with pre-existing contractual obligations of Uzbekistan and contribute to equitable, sustainable growth.

The main aim of the study was to generate proposals for reform that businesses themselves desire and that are relatively easy to implement. The focus was not to identify only the most important reforms for Uzbekistan. While the overall task of grand reforms such as an independent justice, reduction of corruption and continuation of privatisation remains vital to successfully transform Uzbekistan towards a modern, open market economy, our explicit objective was to include smaller, incremental reforms. These reforms have the advantage of being easy to implement. They will lead to noticeable improvements for businesses in Uzbekistan already in the short run, resulting in increased investment and hence complementing larger, but slower grand reforms.

A restriction of our approach is that recommendations reflect the needs of incumbent companies and are reflecting the specific profile of German investors in Uzbekistan, as those are the majority of companies organised in the partner organisations to this study. However, the advantage of the range of partners collaborating on this study was that we received reform proposals from small to large companies and from a wide variety of sectors. Although our reform proposals stem from investors already present in Uzbekistan, they will often highlight the same issues that deter potential investors. Furthermore, implementation of the proposals will enable existing investors to invest more and expand their business activity in Uzbekistan.

3 Proposals regarding the legal system

Four proposals regard legal matters of relatively broad reach, including the introduction of legal principles, a code of work for state authorities and an overhaul of competition law as a whole. We hence present these proposals separately from proposals on still general, but more concrete matters of regulation of the private sector in the next chapter.

Reform proposals regarding the legal system: Overview

Code	Title
Leg-1	Introducing proportionality as a fundamental legal principle
Leg-2	Broadening investors' protection
Leg-3	Introducing a code for the work of state authorities
Leg-4	Reforming the legislation on competition law
Leg-5	Improving the official database of judicial decisions

Leg-1 Introducing proportionality as a fundamental legal principle

Responsible institution:

Ministry of Justice

Problem for companies:

Companies are at risk from overbearing action of public authorities, because “proportionality” does not have the status of a fundamental legal principle in Uzbekistan. Around the world, proportionality is commonly understood as a fundamental legal principle that constrains and guides the actions of all three branches of government. Without the requirement of proportionality, excessive action by public authorities typically includes disproportionate measures in cases of small infringements by companies. Examples include the freezing of entire company accounts because of minor tax disputes or arrears, causing a stoppage of all company activities, or the loss of all preferences granted in investment agreements due to minor or even merely formal infringements of the terms by the respective company. For potential investors, excessive enforcement action by public authorities due to the lack of this fundamental legal principle severely raises the risk of operating in Uzbekistan and most other ex-USSR countries.

Suggested reform measures:

Provisions should be added to the constitution and all other national laws containing basis for authority that any state intervention must conform to the principle of proportionality. This implies the requirement to be consistent with three criteria:

1. Is the intervention suitable for the purpose (suitability)?
2. Is there a less restrictive among various equally efficient means (necessity)?
3. Is there a proper relation between the benefits gained by fulfilling the purpose and the harm caused to the rights of the affected from obtaining that purpose (proportionality in strict sense)?

For executive actions, this implies that executive bodies should have discretionary authority to take decisions within a range of possible measures established by the legislator. Courts be able to check if executive authority has been executed in line with the empowering law and the constitution. In judicial

decisions, courts must be given and use discretionary power to balance relevant legal interests. This needs to be specified in the respective laws forming the basis for court decisions on individual matters. Legal provisions must take into account consequences for all affected legal and physical persons and empower the implementing authorities to act in a proportional manner – e.g. by prescribing ranges of possible sanctions that are suitable, necessary and proportional to the respective infringements.

To ensure this, existing legal impact assessment procedure should include proportionality aspects for legal changes. Where necessary, economic impact analyses should be conducted to fully inform the process. In case of violations of proportionality by the legislative, executive, and judicial branch of government, affected individuals and companies must have effective access to the courts for remedy and (proportional) compensation. As this is a major and indeed fundamental legal change, implementation must be accompanied by intensive trainings of all relevant staff, especially in the judicial branch, enforcement agencies (such as tax authorities) and legal services of the government/parliament.

Effect on Uzbekistan:

Introduction of the legal principle of proportionality would alleviate an entire range of problems, caused by excessive action of public authorities, that are endemic to business activities in transition countries. As an important example, companies would no longer be at risk from excessive penalties or account freezes and hence experience lower operational risks by conducting business in Uzbekistan. In sum, this reform would lead to a major and sustained improvement of business and investment climate.

Leg-2

Broadening investors' protection

Responsible institution:

Ministry of Justice

Problem for companies:

Under present legal rules, which are common to ex-Soviet countries, no protection against arbitrary legal changes exists. Investors took their investment decisions based on a certain legal framework and they need a stable and predictable legal framework over the whole investment cycle for their investment to be viable. Even if a basic level of protection is granted to many foreign companies by 48 bilateral investment treaties (including the German-Uzbek treaty concluded on 28 April 1993), high costs of international arbitration proceedings reduce the effective protection that bilateral treaties provide especially to smaller companies. Investors without applicable bilateral investment treaty as well as local investors remain unprotected against typical examples like fast changes in legislation inconsistent with one another or changes of key market rules on short notice which may lead to substantial losses.

Suggested reform measures:

A provision should be added to the “Law on investments and investment activities” that any investor can legitimately expect the state to grant and maintain stability and predictability of the legal framework. This will not grant an all-encompassing right to be protected from any changes of the circumstances prevailing at the time the investment is made. However, investors may rely on their legitimate and reasonable expectations which must be weighed and balanced in case of legal changes. If the state decides to undertake changes, affected people and companies must have effective ways to

claim protection and compensation through the legal system. If necessary, transitional provisions or compensation must be provided. Compared to the “grandfather’s clause” in the law where only some particular cases are covered, this would protect investors much more effectively.

Effect on Uzbekistan:

Introduction of the protection of legitimate expectations of companies would have a strong effect on investment climate, both international and domestic. Increasing investors ability to rely on continuity of the set of relevant legal rules reduces major risks for all investors. Concerning FDI, the reform would positively affect the OECD-rating of Uzbekistan and hence reduce financing costs of investments through ECA’s or other insurances.

Leg-3

Introducing a code for the work of state authorities

Responsible institution:

Ministry of Justice

Problem for companies:

A very problematic feature of the Uzbek business environment is that companies often are not able to get a clear understanding of their rights vis-a-vis the state and find themselves unable to enforce their rights before the state. One main reason for this is that almost every state body has its own administrative procedures and procedural rules. No common minimum standard for procedures (e.g. appeals, mandatory hearings) exists. It may happen that one state organ/administration hears the director of a company before taking a decision while other take a decision based purely on the existing files. This leads to a highly fragmented landscape of procedures, leading to uncertainties and high legal risks for companies in all interactions with the state.

Suggested reform measures:

We recommend introducing a code for the work of state authorities that clearly stipulates minimum standards for procedures. These include, *inter alia*, mandatory hearings of involved parties, rules on involved actors in procedures, information rights concerning documentation relevant for a case, compliance requirements regarding the principle of proportionality, protection of legitimate expectations. Also, unified appeals procedures should be created for claims by companies and natural persons against the state in its regulatory function. A good international “best practice” example to potentially follow would be the recent development of such a body of law for Kazakhstan by the German Foundation for International Legal Cooperation (IRZ).

Effect on Uzbekistan:

This would lead to a major improvement of the legal environment for companies and improve the investment and business climate in one of the most pressing areas of present deficiencies.

Responsible institutions:

Ministry of Economic Development and Poverty Reduction

Problem for companies:

The competition law and anti-monopoly-regulations are not up-to date and do not reflect the needs of participants in a transition economy. The regulations are mostly targeted to questions of merger control and only rudimentary on how to tackle the abuse of a dominant market position effectively. The huge problem of unfair competition in the country – and in particular competition to private and/or foreign companies by government-related companies – is not sufficiently regulated. Furthermore, authorities in charge are often unable or unwilling to combat structures constraining competition and are even misusing competition and anti-monopoly laws to prevent “unwanted” competition.

Suggested reform measures:

The competition and anti-monopoly-laws should be modernised according to international best-practice, especially with regard to combating the abuse of dominant market positions. This should take into account specific aspects of a transition country such as the separation of competencies for financial and other markets and especially the explicit application and implementation of the new regulations for SOEs and state-controlled companies. Effective penalties for infringement of the laws – e.g. in % of the turnover of the company – should be introduced to ensure effective enforcement.

Effect on Uzbekistan:

Improving business climate, boosting effectivity of the economy and reducing welfare losses as well as opening new possibilities for foreign investors in the country by reducing the country specific risks significantly.

Responsible institutions:

Ministry of Justice

Problem for companies:

A database of judicial decisions (accessible under <https://my.sud.uz/#/>) exists, but appears to be not comprehensive and decisions cannot be searched effectively. Hence, companies are often unable or challenged when attempting to inform themselves about matters of interpretation and application of legal rules by courts. This intensifies legal uncertainty and decision-making by companies and can also lead to mistakes and accidental violations of legal rules and their interpretations by courts.

Suggested reform measures:

We recommend the modification of the official electronic database towards a fully comprehensive register of all court decisions, including an easy-to-access and full-text search function over all court decisions.

Effect on Uzbekistan:

Improved understanding of the legal situation and higher predictability of court decisions will afford companies more safety in taking business decisions and hence improve the investment and business climate.

4 Proposals regarding the regulation of private sector activity

This chapter presents three proposals on more detailed regulatory/legal matters that still concern the private sector as a whole but are at a lower level than the broader proposals in the previous chapter.

Reform proposals on private sector regulation issues: Overview

Code	Title
Reg-1	Permitting advances on payments for investment goods
Reg-2	Recognising CIS conformity assessments for imports
Reg-3	Accepting notarised and apostilled foreign documents

Reg-1 Permitting advances on payments for investment goods

Responsible institutions:

Ministry of Finance

Problem for companies:

A 180-day limit for the delivery of goods or services after payments to foreign countries is in force in order to prevent uncontrolled capital outflows. However, for some specialised investment goods (e.g. custom-made machines), advances on payments (usually 15% of final purchase price) are required by manufacturers as a security before starting production of the custom-made product, which will often take longer than 180 days. Such advances on payments are not possible until 180 days before delivery under present regulations. In result, some producers will not be willing to accept orders from Uzbekistan for such products or will require higher prices to compensate for their risk.

Suggested reform measures:

Whilst the general limit of 180 days is not problematic for most traded goods, earlier advances on payments for specialised investment goods should be made possible. We recommend that the 180-day limit should be waived if the advance is made using an “irrevocable payment guarantee” by a well-established bank in the EU or another reliable legal environment. This guarantee ensures that if the seller of the good does not fulfil the contract (=does not deliver), the bank will refund the advance payment to the buyer, with the burden of proof for contract fulfilment resting on the seller. This is a common procedure in other CIS countries with similar limits on advance payments.

Effect on Uzbekistan:

This reform will help to facilitate the import of investment goods, hence benefiting the productivity of the Uzbek economy.

Reg-2**Recognising CIS conformity assessments for imports****Responsible institutions:**

Cabinet of Ministers of the Republic of Uzbekistan, Agency "Uzstandard"

Problem for companies:

Acquiring the necessary conformity assessments, which certify that imported products conform to Uzbek standards, is expensive and time-consuming in Uzbekistan. For example, for measuring equipment, a metrological certificate is necessary for each product. These difficulties are particularly severe for imports originating in non-CIS countries. Especially for imports with limited quantities, this can be a significant obstacle as sellers are unwilling to incur the costs and difficulties of obtaining the required certificates.

Suggested reform measures:

Efforts should be undertaken to recognise conformity certificates from other countries with comparable product standards, such as Russia, Belarus or other Central Asian countries.

Effect on Uzbekistan:

This reform would significantly facilitate the sale of products on the Uzbek market since products made in third countries (e.g. EU countries) that already have a conformity assessment from a "recognised country" could be sold without undergoing the conformity assessment process in Uzbekistan. Reduced costs of imported equipment will benefit the modernisation of the Uzbek economy and increase productivity.

Reg-3**Accepting notarised and apostilled foreign documents****Responsible institutions:**

Ministry of Justice

Problem for companies:

All foreign documents required by Uzbek authorities for official purposes need to be legalised by the Uzbek embassy in the relevant country, even excerpts from official registers of the foreign state. Until 2019, notarised and apostilled documents from foreign countries were accepted by Uzbek authorities. As Germany and three other countries have opted out from recognising Uzbek apostilles in the respective Hague convention, the Uzbek government stopped unilaterally recognising apostilles from these countries. This insistence on reciprocity, albeit formally correct, creates a significant bureaucratic burden and increases the length of procedures for foreign companies operating in Uzbekistan, e.g. for recurrent registrations of company representative offices in Uzbekistan.

Suggested reform measures:

Accepting notarised and apostilled documents from foreign countries with reliable legal environments (e.g. EU countries) without requiring legalisation of documents by the respective Uzbek embassy.

Effect on Uzbekistan:

Although this reform implies giving up a strict "quid pro quo" regime in bilateral document recognition, it will reduce unnecessary bureaucratic burden for investors.

5 Proposals on the regulation of state-owned enterprises (SOEs)

The state remains an important economic actor in Uzbekistan. Companies wholly or partially owned by the state (state-owned enterprises, SOEs) continue to play an important role in most sectors of the Uzbek economy. In the course of transforming the Uzbek economy to a market economy, this influence of the state on the economy will need to be reduced to suitable spheres such as the provision of public goods, the governance and procedural rules on SOEs should be improved and state influence on SOEs should be modernised. Three proposals concern the sphere of SOEs.

Reform proposals on issues regarding state-owned enterprises: Overview

Code	Title
SOE-1	Reducing state interference in the economy
SOE-2	Improving governance of partially state-owned enterprises
SOE-3	Improving publishing of SOE tenders

SOE-1 Reducing state interference in the economy

Problem for companies:

State-owned enterprises (SOEs) and state-controlled companies (SCCs) continue to play a large role in Uzbekistan's economy. SOEs and SCCs are extensively supported by state structures. They receive funding directly from the budget and off-budget sources. They enjoy almost unlimited administrative support and often get preferential access to networks or grids. SOEs and SCCs often act as monopolists and some are highly vertically integrated, further increasing monopoly power and reducing efficiency. In sum, the widespread existence of SOEs and SCCs as well as their treatment by the state severely distorts the playing field against fully private companies and also presents an obstacle to the intended WTO accession of Uzbekistan.

Suggested reform measure:

While a full shift away from excessive state ownership of private sector actors with a large-scale privatisation of SOEs and SCCs (with the possible exception of those providing public goods or working on natural monopolies such as grids) is highly desirable, this will take time to be implemented. In the short run, we recommend several measures to help address the lack of a level playing field between fully private companies and SOEs/SCCs.

- Increasing fiscal transparency of SOEs and SCCs by requiring that any kind of state support to, and revenues/dividends from them must be publicly disclosed
- Public revenues from SOEs and SCCs should enter the general fund of the budget instead of the specific budgets of the institutions they are associated with, in order to improve the efficiency of use of public revenues and to reduce incentives for institutions to distort the playing field in favour of SOEs or SCCs
- Primary focus should be on the unbundling of vertically integrated SOEs and SCCs which can then more effectively be privatised in further steps
- Equivalent access to grids and networks and other publicly controlled natural monopolies must be guaranteed by law for fully private companies and SOEs/SCCs

Effect on Uzbekistan:

A level playing field between private companies and a large body of state-owned or state-controlled companies is a prerequisite for a thriving private sector. Any move in this direction will strongly improve the growth and investment of private companies, also improving the efficiency of the economy and the fiscal revenues of the government through tax revenues from a thriving private sector rather than dividends from an inefficient and stale SOE/SCC sector. Furthermore, reforms in this direction will be required if Uzbekistan is to successfully join the WTO and increase its international economic linkages.

SOE-2**Improving governance of partially state-owned enterprises****Responsible institutions:**

Ministry of Economy

Problem for companies:

Companies that are partially owned by the Uzbek state require formal approval of government bodies for commercial decisions such as issuing tenders or undertaking substantial investments. Getting this approval can take months, hence imposing significant administrative difficulties and delaying decisions and growth of such companies.

Suggested reform measures:

Boards of (partial) SOEs should be able to decide themselves on all or almost all commercial matters without requiring ministry assent for normal business operations. Government vetoes on decisions should only be possible for few predetermined special cases, on matters of national interest (e.g. closing down entire factories etc. as in the German “Volkswagen law”). Supervisory control of the government as an owner should be exercised through the supervisory boards, annual general meetings of the shareholder of JSCs and normal reporting mechanisms, not through vetoing of individual business decisions.

Effect on Uzbekistan:

This reform will unlock significant growth potential in partially state-owned enterprises as CEOs will be empowered to decide quicker and in the best interest of the companies.

Responsible institutions:

Cabinet of Ministers of the Republic of Uzbekistan

Problem for companies:

Tenders for public institutions and state-owned enterprises (SOEs) are often not publicly or transparently announced (as foreseen by law #472 of 9 April 2018). This makes it difficult for potential bidders to be updated on potentially relevant tenders and leads to some tenders having fewer bids and hence less competition than what should be feasible.

Suggested reform measures:

Clarify the application of law #472 in order that public institutions and SOEs must announce tenders on a purpose-built and easy to search electronic portal, possibly within the infrastructure to the open data portal with sufficient lead time for potential bidders to identify relevant tenders and prepare bids.

Eventually moving to a fully integrated, electronic procurement solution for public/SOE tenders such as the “Prozorro.gov.ua” system in use in Ukraine would further reduce downstream risks of manipulation in tender procedures.

Effect on Uzbekistan:

Successfully improving the visibility of public and SOE tenders will result in more bidders and lower prices of procurement, while at the same time increasing incentives for companies to scale up local activities in Uzbekistan.

6 Proposals regarding tax and accounting issues

Three proposals regard matters of taxation and accounting. These spheres are interlinked as accounting profits are the basis for the calculation of the companies' taxable profit under the corporate income tax (CIT), although adjustments of accounting results for tax purposes are possible and frequently used.

Reform proposals on tax and accounting issues: Overview

Code	Title
Tax-1	Introducing IFRS for accounting and corporate taxation
Tax-2	Modernising the Bureau of Compulsory Enforcement
Tax-3	Abolishing the "act of acceptance"

Tax-1 Introducing IFRS for accounting and corporate taxation

Responsible institutions:

State Tax Committee, Ministry of Finance

Problem for companies:

National accounting standards are applicable for all companies except banks and form the basis for the calculation of the tax on corporate profits (Corporate Income Tax, CIT). These standards do not conform to internationally common standards such as IFRS (the most widely used standard, in use in Uzbekistan for banks only). Many internationally owned companies will hence do double accounting, with IFRS used for internal purposes and for the owners to have an accurate picture of the financial situation. Furthermore, although efforts have been made to improve national standards, not all expenditures made by companies for operating or investment purposes can be deducted from taxable profits. Complications exist regarding the application of inflation rates to depreciation values and balance sheets, discouraging the reinvestment of profits.

Suggested reform measures:

We recommend introducing IFRS rules for accounting and as the basis for calculating the CIT. Modelled on the IFRS introduction in Ukraine, which started in 2011, larger companies would have to use IFRS for accounting and tax burden calculation, whereas smaller companies could elect to use either a simplified IFRS for SMEs or even continue using existing national accounting standards for a transition period.

Appropriate and common corrections to IFRS profits for the CIT base should be applied, including e.g. thin capitalisation rules, minimum terms of amortisation set by state and a correction of accruals.

Effect on Uzbekistan:

This reform would strongly increase the attractiveness of Uzbekistan as a place to invest in. Internationally owned companies would face simpler accounting without a need for double accounting; potential investors can more easily get an understanding of the financials of local companies and the CIT burden would better reflect actual profits of companies.

Responsible institutions:

Bureau of Compulsory Enforcement (BPI) at the prosecutor's office

Problem for companies:

The Bureau of Compulsory Enforcement conducts a very rigid approach when enforcing claims of the state against companies. Before companies are given time to react (and perhaps simply pay the claim), all assets and accounts of a company can be frozen (“arrested”), stopping all activities of a company, even if the claim is only a small fraction of the value of the assets that are being frozen. Hence, disproportionately rigid enforcement of claims unduly hampers the business activity of companies that are cooperative and willing to comply with government claims.

Suggested reform measures:

Excessive measures such as account blocking should become illegal already if proposal Leg-1 on implementing the legal principle of proportionality is implemented. Nevertheless, the BPI should undergo a comprehensive modernisation, changing the approach towards companies from an adversarial to a cooperative one. Companies should not be perceived as “criminal, unless proven opposite” but as cooperative, unless proven otherwise. To enforce claims, companies should first be sent written, formal reminders. If the principle of proportionality is not yet implemented, particular regulation for the BPI should be implemented to ensure that asset freezes can only be implemented in proportion to the claim in question.

Effect on Uzbekistan:

More cooperative relations between companies and fiscal authorities will significantly help to improve business and investment climate.

Problem for companies:

The “act of completed works” (or “act of acceptance”) is a document for signing off services or goods provided by the receiver of the goods or services. It is a required documentation for tax purposes but serves no real purpose: An invoice and documentation of payment would be entirely sufficient for tax authorities. Furthermore, business partners from outside the space of the former Soviet Union are not used to such a document and, not understanding its purpose or implications, sometimes refuse to sign it. The “act of completed works” only adds complication and red tape to business transactions without having any intrinsic value.

Suggested reform measure:

Abolishment of the legal requirement of “acts of acceptance”, and acceptance of the invoice as primary document by state authorities (e.g. for tax purposes).

Effect on Uzbekistan:

An easily achieved improvement in business climate through the reduction of unnecessary paperwork.

7 Sector-specific proposals

Finally, four proposals are sector-specific insofar as only sector-specific regulations are addressed. These proposals regard the financial, agricultural, tourism and pharmaceuticals sector.

Sector-specific reform proposals: Overview

Code	Title
Sec-1	Agriculture: Improving lease contracts for agricultural land
Sec-2	Tourism: Implementing a national hotel classification scheme
Sec-3	Pharma: Facilitating imports of pharmaceuticals
Sec-4	Financial sector: Permitting UZB bonds to be stored abroad

Sec-1 Agriculture: Improving lease contracts for agricultural land

Responsible institution:

Ministry of Agriculture and Water Resources

Problem for companies:

State ownership of all agricultural land in Uzbekistan (except for small garden-sized plots) is enshrined in the constitution. Private ownership of agricultural land is not necessary, but secure long-term lease contracts are required for an efficient agricultural sector. Although many lease contracts, the usual title for farmers, have a 49-year term, they are neither transferable nor secure. Lease contracts can be terminated in case of violations of the contract, low effectivity of production or non-compliance of the state quotas for crops. Lessors were in past instances obliged to give away the land to form e.g. the clusters for cotton production. This leads to a short-term orientation of smaller farmers, who are not incentivised to conduct proper stewardship of their land and instead try to maximise crop yields in the short run.

Suggested reform measures:

The legal security of long-term lease contracts for agricultural land should be improved by stipulating in the relevant law the irredeemable character of a contract. Termination of a lease contract by the government should be restricted by a narrowly defined range of reasons (e.g. non-use for agricultural purposes, grossly inadequate maintenance of meliorations etc.) by the state in a defined procedure allowing the land owner to react on certain allegations fully supervised by competent courts.

Effect on Uzbekistan:

This reform would give farmers more security of land title, incentivising more investments and better stewardship of the agricultural land. Agricultural productivity would increase over the medium term.

Sec-2

Tourism: Implementing a national hotel classification scheme

Responsible institution:

State Committee for Tourism Development

Problem for companies:

The tourism and gastronomy sector in Uzbekistan has recently seen positive developments and investment. However, the lack of binding standards for the industry and especially of a hotel classification scheme (national hotel stars system) often leads to the use of lower quality materials in construction and results in disappointing consumer experiences, harming the emerging reputation of Uzbekistan as a tourist destination.

Suggested reform measures:

Implementing a system of construction standards for the hotel industry and a national hotel classification system (national stars) to incentivise high-quality construction and service delivery, as conducted in many other countries.

Effect on Uzbekistan:

Higher quality of hotels and better consumer experiences will contribute to the further and sustainable growth and investment of the emerging tourism industry.

Sec-3

Pharma: Facilitating imports of pharmaceuticals

Responsible institution:

Ministry of Health

Problem for companies:

Due to new regulation coming into effect in August 2020, medicines for the Uzbek market need an entire make-up for the Uzbek market, requiring both the packaging and leaflet in Uzbek language. Previously, a package in Russian language was accepted and only the leaflet was required in Uzbek language. As the market is not large, this new regulation discourages the production of low-quantity, highly specialised medicines for the Uzbek market. In addition, the envisaged change in the customs code, limiting the maximum storage period for products at customs warehouses to one year, would further complicate and hence limit imports of such specialised products to Uzbekistan.

Suggested reform measures:

Permitting medication with packaging in Russian language, combined with Uzbek language leaflets as was the case until August 2020. Furthermore, permitting goods to remain in customs warehouses for up to 3 years would facilitate production planning processes.

Effect on Uzbekistan:

More specialised pharmaceuticals (e.g. for rare diseases) will be available in Uzbekistan, along with increased competition on the market for medications, hence leading to better treatment options and lower prices of pharmaceuticals.

Responsible institutions:

Ministry of Finance, Ministry of Justice, Central Bank

Problem for companies:

Apart from attracting FDI into Uzbekistan, attracting portfolio investments is also of great importance to the country. Currently, access to UZS-denominated sovereign bonds is difficult for international investors as the local Central Securities Depository (CSD) is not linked to an international central securities depository (ICSD) such as Clearstream or Euroclear. Without this link, international investors must open an account with a local bank in order to invest into local bonds. Due to high bureaucratic hurdles and transaction costs, it leads to international investors practically not investing in the local bond market.

Suggested reform measures:

The interest of international investors in the local sovereign debt market will increase, if the local Central Securities Depository is linked to an ICSD. Hence, the Uzbek local CDS (State enterprise “Central Securities Depository”) should be linked with an ICSD such as Clearstream or Euroclear. While the concrete connection can take various forms, we suggest that respective negotiations between the parties should start.

Effect on Uzbekistan:

This reform will increase the interest of foreign investors in buying UZS-denominated sovereign bonds. In effect, more local currency bond issuance to foreigners will reduce financing costs and FX exposure of the national debt and develop a local currency sovereign yield curve. This should also facilitate the development of a local currency corporate bond market.

8 Quick wins

In order to generate quick wins – visible successes of reform measures that lead to noticeable improvements for as wide a range of businesses as possible, reinforcing the momentum for reforms in the government – we see five reform proposals as standing out. These proposals are all characterised by being very easy to implement as they involve abolishing superfluous and ineffectual requirements, simply accepting documents or improving an existing electronic database. This is much easier and faster compared to proposals that require building up new institutions or regulatory schemes. We recommend speedy priority implementation of the following reform proposals:

Five “quick wins”

Code	Title
Tax-3	Abolishing the “act of acceptance”
Sec-1	Agriculture: Improving lease contracts for agricultural land
Reg-2	Recognising CIS conformity assessments for imports
Leg-5	Improving the official database of judicial decisions
Reg-3	Accepting notarised and apostilled foreign documents

Abolishing the Soviet legacy “act of acceptance”, solidifying land lease contracts, recognising conformity assessments from other CIS member states with comparable product standards and accepting notarised and apostilled documents from Germany and the three other countries involved will be extremely quick and easy for the Uzbek government to implement. All that is required is abolishing the need for these acts, stipulating the irredeemable character of a land lease contract along with a court procedure, abolishing the need for specific Uzbek conformity assessments when CIS conformity assessments exist, and restoring the unilateral acceptance of foreign documents. With these quick actions, bureaucratic, time and money-consuming hindrances for companies can easily be removed. Investments into agriculture will be spurred as land leases are no more at risk of sudden cancellation. Businesses will certainly notice and appreciate such reforms, especially the elimination of the need for acts of acceptance that are a considerable and entirely unnecessary burden especially for Western companies not being used to these documents.

Ensuring the comprehensiveness and improving the functionality of the database of judicial decisions will require a little more work on the side of public institutions, but should still be a quickly implementable improvement with a significant effect on the transparency of the legal environment, a real advance in the business climate of Uzbekistan.

9 High-impact reforms

Finally, we would like to highlight five high-impact reform proposals. These proposals focus on key weaknesses of the Uzbek economy and its regulatory environment but will require some more work and elaboration for successful implementation.

Five “high-impact reforms”

Code	Title
Leg-1	Introducing proportionality as a legal principle
Leg-2	Broadening investors’ protection
Leg-3	Introducing a code for the work of state authorities
SOE-1	Reducing state interference in the economy
Tax-1	Introducing IFRS for accounting and corporate taxation

These reforms are more far-reaching than most other proposals in this study. Indeed, the first four represent a fundamental change in the interaction between the public and private sectors. Introducing proportionality will alleviate the risk of excessive fines being levied at companies for small infringements and ensure that court decisions consider all interests at hand, rather than only formal aspects. Broadening investors’ protection by the state obliging itself to grant and maintain stability and predictability of the legal framework will remove much of the legal uncertainty endemic to transition countries that often deters investors. Investors must have trust that a legal basis on which they plan their business will not be affected by arbitrary measures after their investment was made or they are compensated if their reasonable and legitimate expectations are violated. Similarly, a code of work of state authorities would be another key break with Soviet legacy law. In the old philosophy, the state and its institutions enjoyed almost complete impunity and were not bound to general procedures. This was and is a key deterrent to investors.

In sum, these reforms amount to the state binding itself from the present situation of essentially acting without constraints to a predictable, balanced and fair behaviour towards individuals and companies. Such binding commitment by the state to respect rules of play in interaction with individuals and companies is the norm in mature jurisdictions and of great importance to investors. Taken together, these three reforms would already amount to a game-changer for the interest of international investors in the Uzbek economy, translating the political commitment to reform into a visible and substantial leap ahead.

Another key change that will have to accompany Uzbekistan’s progress towards a successful market economy will be a reduction of the importance of state-owned and -controlled companies as well as the establishment of a level playing field between fully private and state-owned or -controlled companies. Finally, introducing IFRS for accounting and taxation of corporate profits will undo many unnecessary complications created by the current accounting standards that do not adequately represent the actual profits of companies.

Uzbekistan is undergoing fundamental and rapid change in these years. Many market participants are watching the country closely to see what reform steps will be taken. Hence, Uzbekistan should seize

the opportunity to reinforce its commitment to becoming a market economy and regional leader in the business and investment environment by attempting these far-reaching reforms now.