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Private-public partnership in Uzbekistan: problems, opportunities and ways of introduction



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This report reflects opinions and views of the working group, which may not coincide with the official point of view of the United Nations Development Programme in Uzbekistan, Chamber of Commerce and Industry of the Republic of Uzbekistan, State Committee of the Republic of Uzbekistan on demonopolization, support of competition and entrepreneurship and Center for Economic Research.

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Abstract

This report analyses ways and opportunities of using private-public partnership (PPP) model in the economy of Uzbekistan, proposing participation of commercial firms in establishing and operating economic and social infrastructure facilities. Special focus is attached to the regulatory framework, institutional and other prerequisites of full-scale implementation of private-public partnership; «bottlenecks», preventing introduction of the proposed model have been identified, and a set of measures has been suggested aimed at creating conditions for effective involvement of the private sector in the infrastructure sectors of the country. Special focus is attached to the PPP implementation in the housing-communal services sector that would allow to accumulate knowledge and experience, improve instruments and to proceed eventually to full-scale PPP application to other infrastructure sectors.

Working group members:

Team leader:	B. Ulashov A. Shaykhov
Research coordinator:	S. Koshnazarov
National experts:	F. Karabaev M. Khaidarov A. Khakimov B. Khodjaev B. Rajapov A. Saidov N. Talibdjanov
International consultant:	L. Polishuk

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Executive summary

This report discusses possibilities of applying the private-public partnership (PPP) model in Uzbekistan, proposing participation of commercial firms in the operation of economic and social infrastructure facilities.

Modern effectively functioning infrastructure is a major material prerequisite of economic growth, vital for the well being of the population. In spite of the fact that significant resources are allocated to public infrastructure in Uzbekistan, its present condition lags behind requirements of fast growing economy, and inhibits achieving the purposes of Welfare Improvement Strategy of the Republic of Uzbekistan. The situation is complicated by aging of the capital stock in infrastructure whose significant part has been created decades ago. The intention of the government to reduce its presence in the economy, and to reduce taxes, increases the difficulty of allocating sufficient budget resources to reduce and eventually eliminate an increasing «investment gap» in infrastructure. The situation is aggravated further by low efficiency of resources invested in infrastructure due to poor work incentives, weak management and the difficulties in eliminating mismanagement and abuse.

The listed problems call for the adoption of urgent and effective measures - otherwise mounting deficiencies in infrastructure will become a barrier to economic growth, and undermine achievements of economic policy in developing private sector, improving business and investment climate, achieving macroeconomic stability, and so forth. PPP suggests an attractive solution, which promises to overcome *«double deficiency» in infrastructure - first, shortage of resources, and second, poor efficiency of resource use.*

PPP has attracted private investments of hundred billions of dollars to developing countries' infrastructure, and due to sound management, decreased project cost and budgetary expenses, while at the same time improved the quality, reliability and availability of services provided. However, experience of developing countries has also revealed a number of serious issues in PPP realization. Successful implementation of PPP model requires a clear identification of pros and cons of private sector involvement in infrastructure. Apart from access to private capital, the main benefits of PPP are connected with higher economic efficiency, orientation to a final result, and an optimal allocation of responsibilities and risks between the state, and the private investor/operator. Difficulties in PPP implementation can arise because of miscalculations during contract negotiations, contract execution, resulting partly from the lack of experience in the state bodies and private sector, and partly due to political and social risks in privatization of key infrastructure facilities.

Eight large-scale PPP facilities have been realized in Uzbekistan for the last 15 years, and more than 700 million dollars of private capital has been invested for this purpose. Besides, PPP is practiced de facto on micro level in branches of municipal services. Experience is evidence of the significant potential and viability of PPP model in the conditions of Uzbekistan, however scale of use of

the PPP model is less impressive compared to leading countries applying this model such as Brazil, Argentina, China, Malaysia, India, Philippines, Turkey and others.

The analysis of obstacles to wider application of the PPP model in Uzbekistan reveals a number of «bottlenecks», including gaps in the legislation, number of serious institutional restrictions, lack of experience in cooperation between state bodies and private enterprises, deficiencies in public procurement procedures, and unresolved issues in drafting and executing PPP contracts. There are deficiencies in private investments, shortage of qualified personnel, and lack of PPP instruments accommodated to Uzbekistan conditions. Under existing circumstances a “direct” PPP introduction to Uzbekistan is impractical since the listed obstacles would probably result in failure, thereby discrediting the PPP concept in the government and society for a long time, and undermining trust of the private sector.

A solution could be a program of well-coordinated urgent actions for the *creation of conditions* for the use of PPP model in the scale proportionate to requirements of economy. This would require specific reforms of the regulatory framework, *adaptation* of PPP’ approaches and mechanisms to the current conditions, and a *gradual expansion of the PPP use* based on progress in the necessary reforms and experience gained. The process of gaining the necessary experience and demonstrating feasibility of the PPP model is needed before it can be expanded to a larger scale. This is the intention of the suggested complex measures. Such process should include the following components: a) pilot projects; b) legal reform; c) toolkit development; d) training; e) expert support; and f) stakeholders’ dialogue.

In selection of pilot projects, it is necessary to maximize chances of success with limited private investments, and with gaps in institutional environment. Housing and communal services offer the best opportunity. In this sector a rather small projects can be realized with modest or hardly any investment. Large losses of physical and financial resources are happening in the housing and communal services infrastructure. Elimination these losses by more effective management and operation of these facilities will have a valuable demonstration effect, convincing the state bodies, private sector and the public in the advantages of the PPP model.

Introducing the PPP model in housing and communal services could serve as a practical demonstration of feasibility. For some time now, municipal authorities and public housing residents use agreements with private management companies for repair and service of public housing infrastructure. The next step should be expanding agreements with the private management companies from individual to territorial and municipal section and cities. Functionally, this could be accomplished by transferring to private management companies elements of municipal infrastructure, and possibly other functions for general upkeep and smooth operation. The report recommends to limit the term of the PPP pilot contracts to several years and, probably, to divide at the beginning operational and investment components with incentives to attract additional resources from international donors, states, or foreign investors under state sovereign guarantees.

It could be expected that with an effective choice of a private operator it will be possible to avoid tariffs' growth for municipal services in a several housing and communal services. If by the virtue of general price inflation or other objective reasons (at simultaneous improvement of quality, reliability and availability of services) it will not be possible to avoid tariffs' growth, its consequences should accord to government' decisions, and be compensated by targeted subsidies to socially vulnerable layers of the population. For this purpose, it is recommended to use already approved model of distribution of subsidies through mahalla.

Expanding the PPP model in housing and communal services sector of Uzbekistan represents not only financial and economic problems, but also a sociopolitical task. Actually, the issue is to change the model of access of the population to housing and municipal services from the present poor quality and availability, opacity and de facto «privatization» of many municipal services, accompanied by mass non-payments - to guaranteed deliveries, with precisely stipulated and executed mutual obligations of the parties involved. New «social contract» on infrastructure services should become subject of wide dialogue with participation of the authorities, private sector, experts - analysts, and civil society. Result of such dialogue will be «Uzbek model» of modernizing infrastructure, reflecting achievements of world practice, and responding well to national features.

Content:

Introduction.....	7
Section 1. Current status of infrastructure development in Uzbekistan.....	8
1.1. Economic and social importance of infrastructure.....	8
1.2. Growing deficit of infrastructure.....	8
1.3. Reasons for lagging infrastructure.....	9
1.4. Search of solutions in private sector.....	12
Section 2. Private-public partnership: role and importance in infrastructure development.....	15
2.1. PPP general specifications.....	15
2.2. PPP advantages.....	16
2.3. PPP problems.....	17
Section 3. PPP in Uzbekistan: prerequisites, obstacles, order of introduction.....	19
3.1. First steps.....	19
3.2. Conditions for PPP in Uzbekistan.....	21
3.3. Set of measures in PPP promotion.....	25
Section 4. «Micro-PPP»: attraction of private sector to housing-communal services sector.....	29
4.1. Why to start with HCS sector?.....	29
4.2. How to arrange PPP in HCS sector?.....	31
4.3. Administrative issues.....	34
Conclusions and recommendations.....	37
List of bibliography cited.....	39
Annex.....	40

Boxes

1. "Bottlenecks" in Uzbekistan's infrastructure	9
2. Private-public partnerships in water supply in Bukhara and Samarqand	19
3. Private managing companies in Uzbekistan	20
4. Law of the Republic of Uzbekistan on concessions	21
5. Training programme on capacity building on PPP, suggested by Institute of Private- Public Partnerships (USA)	27
6. PPP and tariffs growth in developing countries	31
7. Role of mahalla in social protection system of Uzbekistan	34
8. PPP in combating poverty	41

Tables

1. Wear level of water, heating and sewer networks by regions	10
2. Difference between income of water supply organizations out of sale of 1 cub.m water, and incurred operational costs (2005, soums)	11
3. Funding sources for infrastructure and social spheres in 2007	13
4. Large private-public partnerships in Uzbekistan	19

Diagrams

1. Level of tariffs for population in relation to costs for cold water supply, central heating, hot water supply and sewer system (as of 01.01.2007)	12
2. Share of capital investments into infrastructure and public utilities construction by financing sources in 2006 (%)	13

Charts

1. State budget expenses for subsidizing "publicly important" services, % GDP	33
2. Dynamics of investments on PPP in developing countries, 1990-2005 (bln USD, 2005)	40

Introduction

In the modern world private companies representing themselves as investors and/or operators of infrastructure facilities and services, are widely involved for the last decades in construction and operation of economic and social infrastructure facilities. Such practice is contrary to the traditional understanding of public infrastructure as the domain of a state. However, it opens access to private investments into public infrastructure and improves economic efficiency of infrastructure facilities. At the same time, whereas infrastructure facilities quite often possess characteristics of natural monopolies, and infrastructure services have characteristics of public benefits, traditional privatization models in infrastructure are inapplicable as a state should keep its presence in the given sector as a customer and also as a regulator and supervisor of private operators. Joint provision of infrastructure services at a similar division of labor is known as *private-public partnership (PPP)*.

PPP idea is of growing interest in the government circles of Uzbekistan (where it receives special support from the State committee on demonopolization, support of competition and entrepreneurship), and in the business - community, where the expert council on private-public partnership has been created under the aegis of Chamber of Commerce and Industry of Uzbekistan with the support of United Nations Development Programme. This interest is quite clear: the country is searching for ways to modernize and develop infrastructure, whose present conditions lags behind requirements of fast growing economy and improving living standards.

A number of PPP projects have already been implemented in Uzbekistan, but the scales of using this approach remain modest. In this report the preconditions of a wider attraction of private sector in national infrastructure and the circumstances, promoting or impeding the solution of this task, are analyzed. On this basis, a program of actions, envisaging implementation of pilot projects with simultaneous establishment of conditions for a wider and effective PPP application in the country, is proposed.

The report is organized as follows. The first section provides a brief review of current condition and problems of social and economic infrastructure development in Uzbekistan, and gives conclusion on much need for the PPP model. The second section discusses modern views of pros and cons of PPP, that are to be considered while developing a strategy of introducing this model into the national economy. Experience in implementing PPP in developing countries that is instructive for Uzbekistan and presented in the Appendix to this report is also closely related with the materials of this section.

The third section considers economic, legal, institutional and other preconditions of PPP implementation in Uzbekistan, specifies existing gaps and «bottlenecks» and suggests measures to overcome them. The analysis made in the report results in a conclusion that in the near future efforts on testing and introducing PPP in Uzbekistan should focus in public utilities sector, in particular housing and communal services. PPP peculiarities in this sector are considered in the fourth section. In conclusion the key findings and features of PPP «Uzbek model» suggested by the authors, adapted to social and economic conditions of the country and coordinated with the general strategy of reforms and rising welfare, are summarized.

Section 1. Current status of infrastructure development in Uzbekistan

1.1. Economic and social importance of infrastructure

Economic growth directly depends on infrastructure development

Modern infrastructure has a key role in social and economic development of the states. Country comparisons testify that the increase of infrastructure capacities per capita by 1 % on average associates with the same GDP per capita growth¹. The causal nature of this connection remains a subject of scientific disputes, but it is doubtless that the growing economy demonstrates higher quantitative and qualitative requirements to infrastructure. Thus pace and stability of economic growth appear in direct dependence on ability of the country to provide and support growth at proportional development of infrastructure.

Opportunities of various strata of the population in taking advantage of benefits of economic growth also directly depend on infrastructure conditions. Infrastructure services are not only the major consumer benefits but also are means for increase of labor productivity and improvement of market access. Both functions of infrastructure - support of economic growth and expansion of its facilities- has a great importance for overcoming poverty, accumulating human capital, and increasing the welfare of the country.

Realizing the role of infrastructure in social and economic development, the government of Uzbekistan for years of independence has directed significant resources to this sector. The infrastructure today remains a priority direction of expenditures of budgetary funds, state non-budgetary funds, and external loans guaranteed by the government. In a result, the modern road transport network and air communication system have been created in the country, the power system is developing, and other sectors and facilities of infrastructure are being modernized. For years of independence, access of the population to water supply system has extended by one and a half time - from 50 up to 75 % of households, and access to natural gas - almost by 4 times, having covered 78 % of families.

1.2. Growing deficit of infrastructure

Economic growth, private sector development and favorable market conditions lead to increase of burden on infrastructure capacities

Despite all these achievements, according to some sources, serious problems and imbalances, attributes of which can be found practically in all sectors and segments of the given sector of the economy, are maintained and being aggravated in social and economic infrastructure of the country (see Box 1).

At the heart of such imbalances lies a growing gap between demand for infrastructure services, produced by the economy and the society, and supply of these services. Increasing in demand is direct consequence of economic growth of Uzbekistan with the rates approaching to 10 % per year. Successes of the economic policy, directed on development of private sector, and also favorable market conditions, have naturally led to increase of burden on

¹ *Infrastructure for Development. World Bank, 1994.*

Box 1. «Bottlenecks» in infrastructure of Uzbekistan

The National Railway Company «Uzbekiston Temir Yullari» needs large investments for replacement of a rolling stock, and also for construction of new and to increase capacity and electrification of existing lines. Physical and moral wear of passenger transport is especially high where the majority of cars were produced 20-30 and more years ago. Relatively modest investments which are allocated by the company out of own means, and with attraction of foreign loans, lay as heavy burden on tariffs as an investment component. Consequently rail transportation appears uncompetitive in comparison with automobile, and by cost is coming closer to the air transportation.

Similar problems are observed in other sectors of infrastructure. For example, the volume of potable water supplied by water pipes has decreased by 20 % for the last years, and wear and breakdown of water supply systems have reached 27,5 % of total length of the system. In many cities, including some regional centers, potable water is supplied under the schedule no more than 3-5 hours per day.

Deficiency of the electric power has led to temporary (for example, on days-off) terminations of electricity supply, and «scheduled» cut-offs in number of regions of the country. For the same reason, there are examples of refusal in using electric machines and mechanisms in countryside. Parameters of supplied electricity frequently do not correspond to the established requirements, and the number of emergency shutdowns is growing.

Waste cleaning system does not cope with problems of maintaining due sanitary condition of settlements and recycling waste products. Removal of household waste is delayed for months in the majority of settlements. Specialized motor transport is in a failure condition - from 50 up to 80 % of machines are subject to retirement. In a result, the volume of waste removal registered by statistics is sharply reduced – from 9,5 mln.cub.m in 1996 up to 5,2 mln.cub.m in 2000, and 3,5 mln.cub.m in 2004.

infrastructure capacities. Against a background of market development and institutional environment improvement lagging infrastructure is becoming a «bottleneck» which is not allowing the country to fully realize potential economic growth². The said proves to be true, in particular, by the data of Chamber of Commerce and Industry of Uzbekistan, that the Uzbekistan businessmen consider connections to electricity, water and gas supply networks, and uninterrupted supply with these resources as one of significant obstacles to doing business.

High demand to infrastructure is made by strategy of welfare improvement as well, which envisages wider access of growing private sector to power supply networks and transport highways, improvement of health and education services, increase of availability and quality of housing and communal services, first of all water and gas supply³. Finally, movements occurring in the society, and in particular continuing urbanization, also increase need for infrastructure services.

1.3. Reasons for lagging infrastructure

Inability of infrastructure «to keep up» with growing economy and with high-scale social objectives is explained by a number of reasons. Firstly, «scissors» between supply and demand arise as a result of *progressing physical and moral wear of equipments and communications*. The capacities created 30-40 and more years ago occupy the significant share among production facilities of Uzbekistan's infrastructure. In addition, provision of various provinces (oblasts) and regions (rayons) with infrastructure facilities are different, and deficiency of infrastructure is recorded especially sharply in a number of regions of the country. Thus, the point is not only on increment of infrastructure capacities for maintaining economic growth, but also on *mass*

Production facilities of Uzbekistan's infrastructure have become considerably obsolete

² Such «infrastructure deficit» had taken place in 90-ies of the last century in China where immediate measures on attracting investments into infrastructure and on increasing effectiveness in using physical resources and production capacities (see *Infrastructure for Development*. World Bank, 1994).

³ *Welfare Improvement Strategy Paper of the Republic of Uzbekistan for 2005-2010*. Government of Uzbekistan, 2005

modernization and replacement of earlier created capacities, as well as on large-scale structural shifts in infrastructure in order to respond to changing needs of the economy and the society.

Coincidence of the accelerated economic growth of Uzbekistan with a «life cycle» phase of national infrastructure which includes mass retirement of existing capacities, demands significant investments into the given sector. According to the assessments of government institutions need for capital investments for providing population with potable water has made more than 850 bln soums as for the beginning of 2007. Insufficiency of capital investments being directed to infrastructure for creating new and replacement of retiring capacities results in rising so-called «investment gap» observed in many developing countries. Developing countries on average spend 3-3.5 % of GDP for infrastructure whereas according to available estimations needs of these countries for such expenses make about 7 % of GDP⁴.

Capital investments in infrastructure are not sufficient

Table 1. Wear level of water, heating and sewer networks by regions (in %, as of January 1, 2006)

Name of the region	Wear of water-pipe system	Wear of heating system	Wear of sewer system
Total in Uzbekistan	28,5	11,0	20,0
town	34,7	12,0	19,7
village	25,4	6,9	22,2
Rep. Karakalpakstan	41,2	16,8	47,0
Andijon	25,0	9,8	9,9
Bukhara	33,6	7,2	44,0
Jizzak	43,4	17,5	31,0
Qashqadaryo	26,6	3,0	48,5
Navoi	49,5	2,9	0,1
Namangan	15,1	2,5	23,5
Samarqand	17,0	4,6	24,6
Surkhandaryo	16,1	0,7	14,0
Sirdaryo	36,0	13,8	6,1
Tashkent	45,9	9,3	38,1
Fargona	32,0	2,6	46,0
Khorazm	35,2	4,5	15,8
Tashkent city	15,6	30,5	4,4

Source: Ministry of Economy, 2006

Obvious attributes of investment gap are observed recently in Uzbekistan as well. At the end of 90-ies the state investments (including off-budget funds and government-guaranteed loans) made 12% and more percent of GDP, however by 2003 they were reduced up to 5,1%⁵. By reducing tax burden and its presence in the economy, the state has reduced budgetary expenditures from more than 40 % of GDP in 1999, up to 32 % in 2004. Reductions practically had not affected dominating articles of expenditure of budgetary resources - education and pension system, and have also been carried out to a great extent at the expense of the state investment. Consequently, the second reason of infrastructure deficit in the country is an objective

dilemma of the economic policy of the state aspiring to support budgetary and macroeconomic discipline, and create favorable conditions for private sector development, limited therefore in its investment opportunities.

After mass amortization of production capacities, and limited investment opportunities of the state, *low efficiency in using available resources and equipment* – is the third reason of lagging infrastructure.

⁴ Fay, M., and T. Yeppes. *Investing in Infrastructure – What is needed from 2000 to 2010? World Bank Policy Research Working Paper No. 3102, 2003.*

⁵ *It is necessary to consider that state (or guaranteed by the state) investments in Uzbekistan have been directed not only to infrastructure, but also in other sectors of economy, including heavy industry; however, such practice has begun to decline for the last years.*

Inefficient use of infrastructure becomes apparent in different forms⁶. Signs of *operational inefficiency* are low coefficient of efficiency (CE) and significant losses of resources. For example, according to experts estimations, CE of many boiler-houses does not exceed 65-70%, up to 20 % of generated energy is lost in electricity supply networks, water losses in the networks reach 50%⁷. There are examples, when expensive equipments procured out of proceeds of foreign loans have remained unused and become unfit for use by virtue of negligence or miscalculations. Infrastructure sector insufficiently adapts to increasing deficiency of water resources of Uzbekistan and to rise in prices of energy, whose share can reach 2/3 of costs for operation of infrastructure facilities and networks.

Use of resources and equipment in infrastructure sectors is inefficient

Another variety of inefficiency - *inability to support infrastructure capacities in capable condition* that leads to their premature wear, often stoppages and breakdowns. Above-mentioned examples of unsatisfactory condition of many infrastructure facilities and networks in Uzbekistan may not be completely attributed on the account of natural wear and also testify non-observance of operational requirements and lacks of maintenance and preventive measures.

Budgetary – financial inefficiency of infrastructure is the source of significant losses. System of tariffs is in many respects obsolete and does not reflect real costs on chargeable infrastructure services since in calculating the tariffs a principle «from what has been achieved» is still being used. Such tariffs, as a rule, do not include amortization and investment components thus, deprive infrastructure enterprises in using own resources for modernization and development (see Diagram 1 and Table 2).

Special complaints are caused by payments collecting system for water, heating and electric power. An obvious sign of the problem is the debts of the population for utilities services which have made above 96 bln soums as of beginning of 2006, and are continuing quickly to accrue despite still significant state subsidies. Shortage of measuring devices is filled with billing for services depending on area of apartment, or a house, including number of family members, thus, in opinion of experts, mistakes and abusing is frequently committed. Opacity of payments' system makes possible misappropriation of means, causing the population, budget and actually infrastructure sector suffer from the system.

Table 2. Difference between income of water supply organizations out of sale of 1 cub.m water, and incurred operational costs (in soums, 2005,)

Region	Variation between income and expenses	Region	Variation between income and expenses
Uzbekistan	-545,0	Namangan	59,0
town	-846,0	Samarqand	-773,0
village	26,0	Surhandaryo	123,0
Rep.Karakalpakstan	899,0	Sirdaryo	-2633,0
Andijon	-69,0	Tashkent	-1997,0
Bukhara	-3591,0	Fargona	-440,0
Jizzak	-160,0	Khorazm	-941,0
Qashqadaryo	-446,0	Tashkent city	-396,0
Navoi	-177,0		

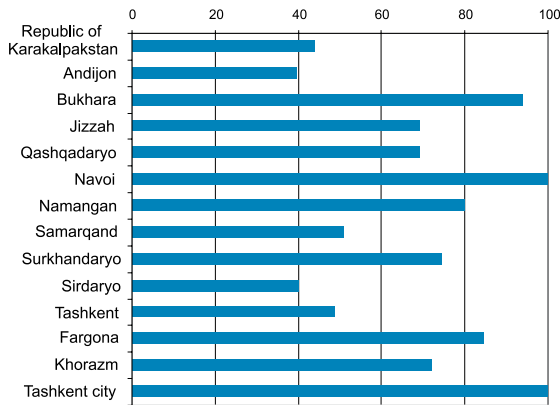
Source: Ministry of Economy, 2006

⁶ See, for example, *Infrastructure for Development*. World Bank, 1994

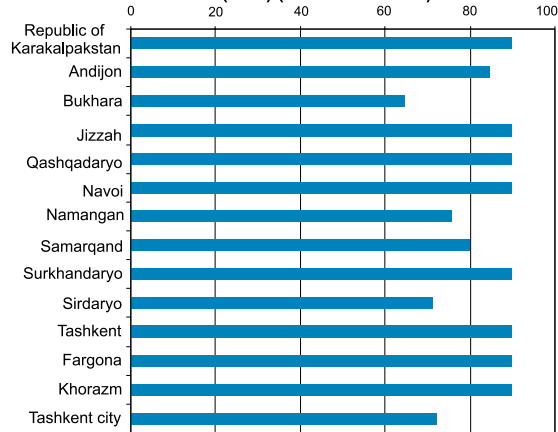
⁷ By the information of Swiss Agency for Development and Cooperation (SDC), water losses in the channel system of Bukhara and Samarkand make 39% and 48% respectively.

Diagram 1

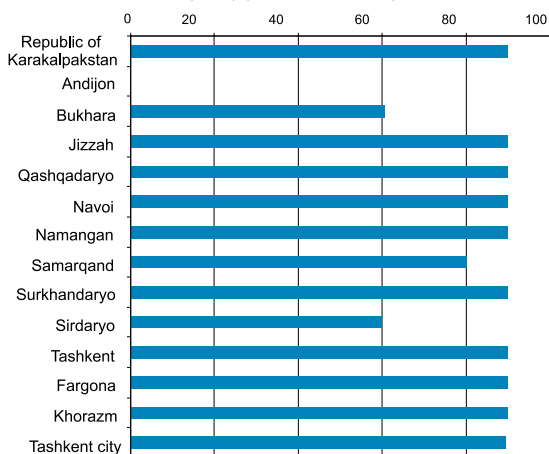
Level of tariffs for population in relation to costs for cold water supply (in %) (as of 01.01.2007)



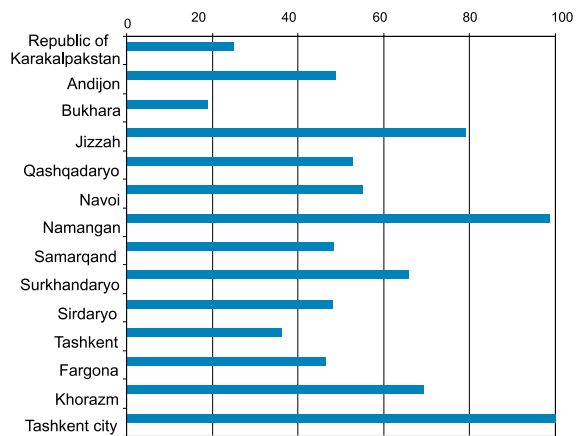
Level of tariffs for population in relation to costs for central heating (in %) (as of 01.01.2007)



Level of tariffs for population in relation to costs for hot water supply (in %) (as of 01.01.2007)



Level of tariffs for population in relation to costs for sewer system (in %) (as of 01.01.2007)



Prime cause of infrastructure inefficiency is *insufficiency of incentives* to productive use of available resources, and more complete and qualitative satisfaction of demand of the economy and the society. Operators of infrastructure facilities do not also, at least officially, have necessary *powers* in making financial, technical and administrative decisions, and do not bear due responsibility for final results of their activity.

1.4. Search of solutions in the private sector

The listed problems require taking urgent and effective measures - otherwise increasing deficiency of infrastructure becomes a barrier to economic growth, and devalue achievements in economic policy of the previous years, including efforts of the government of Uzbekistan on development of private sector, improvement of business and investment climate, achievements in macroeconomic stability, and others. The above said refers to already invested significant resources in infrastructure, and the production assets, accumulated in this sector. Shortage and losses of water, heat and energy thus depreciate available capacities on distribution and transportation of these resources.

Active attraction of private sector, both national and foreign, allows overcoming infrastructure deficiency

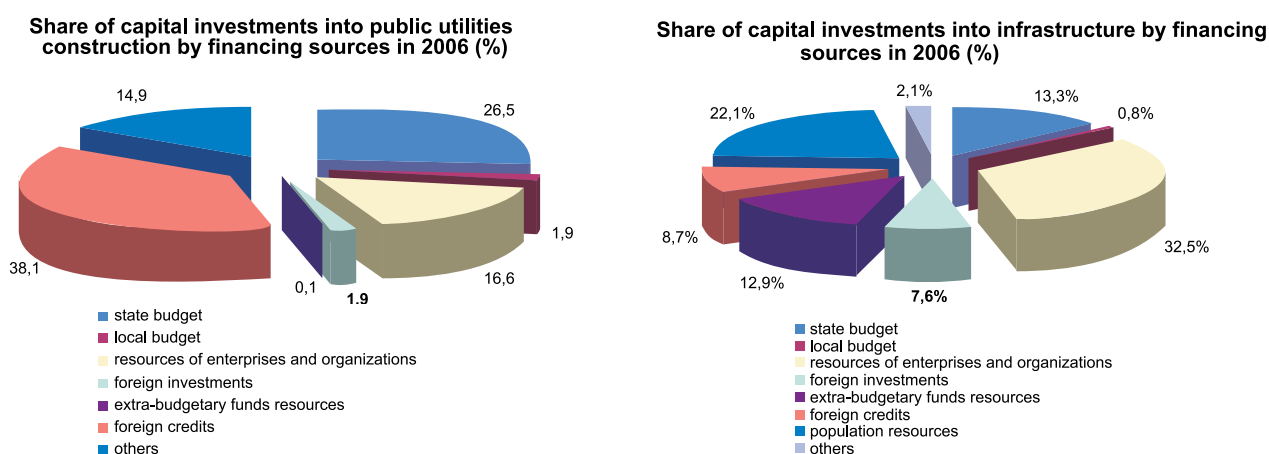
«Double deficiency» - expressed first in shortage of resources and, second, in insufficient efficiency of their use lies on the basis of infrastructure problems of Uzbekistan like of many other developing countries. The state cannot cope this deficiency with own resources since it has no necessary resources and comes across with insoluble difficulties in increasing production efficiency in public sector. More active attraction of private sector, both national and foreign, to overcoming the infrastructure deficiency, could be seen as a way out (see the Diagram 2).

Two third of investments into national infrastructure in Uzbekistan today is already given by non-state sources (housing and communal services, irrigation, electric power industry, railway, automobile and air transport, education and public health services) (Table 3.)⁸. It is to be expected that private investments will further grow expanding opportunities of mobilizing resources for infrastructure.

The conventional superiority of private sector over state with regard to production efficiency opens a way to the solution of the second problem of infrastructure «double deficiency». The international experience testifies that infrastructure sector efficiency is ensured with transferring the sector onto a commercial basis (including clearness of tasks and rules, financial and management autonomy, rigidity of budgetary restriction and responsibility before consumers and investors), and introduction of competitive principles in the sector⁹. Entrance of private enterprises into infrastructure will certainly promote fulfillment of the listed requirements.

Market-economy based solution of infrastructure problems suits both priorities of Uzbekistan's economic strategy which envisages continuation of privatizing the economy, encouragement of private initiative and competition, and prevalent objective realities in national economy, social and budgetary spheres. Obviously the matter does not concern that the state has abandoned infrastructure sector - the question is in what form and scales

Diagram 2.



Source: State Statistics Committee of Uzbekistan, 2007

⁸ It should be kept in mind, that this figure gives exaggerated presentation about the role of non state sources, as the half of investments, non referred to the non state, make capital investments of enterprises and agencies, in many of them state is the dominating shareholder.

⁹ Infrastructure for Development. World Bank, 1994, p. 33

Table 3. Funding sources for infrastructure and social spheres in 2007*

bln soums

	Centralized capital investments	Centralized capital investments through Extra-budgetary National road fund resources	Centralized capital investments through Extra-budgetary School education fund resources	Resources of Fund for Reconstruction and Development of Uzbekistan	Own resources of enterprises and organizations	Foreign loans under guarantee of Government of Uzbekistan	Total
Total:	383,9	109,3	182,6	33,5 (\$26,7 mln)	151,7	351,4	1212,4
Housing-communal services	5,4					63,1	68,5
Irrigation (water facilities)	15,0			21,5 (\$17,1 mln)	3,1	36,7	76,3
Electricity					59,8	7,3	67,1
Railway Infrastructure					78,5	112,3	190,8
Highways		107,5					107,5
Auto-transport				12 (\$9,6 mln)		12,3	24,3
Airports	13,1						13,1
Education	349,0	1,8	182,6		10,3	85,5	629,2
Health care	1,4					34,3	35,7

*According to estimates of projects, included in the Resolution of the President of the Republic of Uzbekistan, dated 09.10.2006 No.PP-484 "On investment program of the Republic Uzbekistan for 2007"

the state should keep its presence in the sector and how the state can divide power, risks, functions and resources with private sector. To this question modern practice gives various answer, known under the collective name of *private-public partnership (PPP)*.

Section 2. Private-public partnership: role and importance in infrastructure development

2.1. PPP general specifications

Private-public partnership (PPP) assumes participation of business firms in creating and operating facilities of manufacturing, utilities and social infrastructure, and providing public benefits and services. The listed functions traditionally refer to sphere of state authorities, but during the last twenty years, private enterprises are also actively involved in fulfilling those functions.

Access of private business to infrastructure sector is represented as unobvious step. Actually, infrastructure facilities by their nature are «public benefits», and frequently have characteristics of natural monopolies, consequently transfer of these facilities to the private sector are fraught with well-known «market failures». In order to prevent such «failures» a state keeps its presence at privatized infrastructure sectors, first, as the customer, and second, in a role of regulator and the controller of private firms' activity. The state and private business become partners in such case – from this the name of the model has come from.

For a private operator the joint project represents commercial undertaking and should pay back the incurred costs, and ensure profit. Incomes of the private operator are formed by contract payments and government subsidies and/or a payment raised from beneficiaries of the services.

It is necessary to distinguish PPP from traditional privatization, proposing transfer property rights for the industrial enterprises and other assets to private sector. PPP features are firstly private sector is attracted to providing public benefits and services in infrastructure sector and, secondly, the property rights concerning PPP facilities are not alienated entirely for the benefit of the private investor and the operator. As a rule, transfer of these rights is limited functionally and on time, and is conditioned by meeting the requirements established by the state.

PPP in elementary forms can be limited to 1) outsourcing by the state its functions to private enterprises, but in more advanced alternatives 2) including investment component as well. In that case, PPP is not lead to biddings on procurements and to state contracts on construction works, and does necessarily assume operation of investment facility by the investor during certain period of time so that the investor repays the invested resources.

PPP can be realized in diverse forms, among which three basic types of partnership are widely spread – service contracts, build – operate contracts and concessions.

Service contracts (operation, maintenance and service contracts) envisage *transferring* infrastructure facilities and/or certain operations and functions of infrastructure sector *to a private enterprise*. The capacities of infrastructure, necessary for executing contract obligations, are usually transferred to the private operator on a rental basis.

Private-public partnership (PPP) assumes participation of business firms in creation and operation of industrial, municipal and social infrastructure facilities, and providing public benefits and services

In PPP, the private sector is involved in providing public benefits and services in infrastructure sector, and the property rights in relation of PPP facilities are not alienated entirely for the benefit of the private investor

PPP can be realized in diverse forms, among which three basic types of partnership are most widespread - service contracts, build – operate contracts and concessions

Build - operate contract (build-operate-transfer) has a goal of creating by a private investor *new infrastructure capacities*, which finally carry over into property of and under the management of the state, but this is preceded with the period of operation, stipulated by the contract, of newly created facilities by the investor in order to get necessary return on the private investments.

Finally, in case of concessions, the state concedes to the private investor *power* on providing infrastructure services on concession conditions, stipulated by the contract, and the investor creates new and/or modernizes and expands existing capacities, and operates them during the concession contract period. In this case, operation of infrastructure facility by the private enterprise is the basic *purpose* of the partnership, whereas in the build - operate contract option, operation of the created facility is *the means* of compensating the incurred capital expenses before this facility is transferred to the state.

Service contracts, generally speaking, do not assume private investments, but also do not exclude them for expansion or modernization of rented capacities. In two other PPP options private investments are an integral part of partnership, which makes such model attractive in conditions of limited budgetary funds. The opportunity to develop infrastructure without increasing government expenditures and public debt has been considered as the main advantage of PPP for a long time; this point of view is reflected in the «Private Finance Initiative» concept, under which the first PPP projects were realized in the 80th.

Since then, however, understanding of PPP benefits has considerably changed. It became clear that PPP projects are not neutral for the budget - for example, if a contract stipulates a payment by the state to the services of a private operator, then obligation to make such payment during the contract period actually represents increase of public debt. The opportunity of mobilization of private capital in infrastructure even today remains important motive of turning to PPP, but introducing *market incentives* in infrastructure in this model is especially appreciated, which allows using both private, and public resources more efficiently. Certainly, these benefits are not provided for gratis, and, starting introducing PPP, it is necessary to understand clearly pros and cons of this idea.

2.2 PPP advantages

Besides mobilization of private investments and increase of infrastructure sector efficiency, PPP possesses a number of other important advantages¹⁰.

Orientation to final result. Combination of design, investment and operation components in a single PPP contract gives significant gain, in comparison with the traditional form of build contracts. The matter is that, final obligations of the private partner regarding the given services (quantity, quality, availability and others) are prescribed in the contract, whereupon the latter independently decides how most effectively to fulfill these requirements and, hence, designs and realizes investment part of the project. The private

PPP contracts are focused on final result

¹⁰ Sadka, E., *Public-Private Partnerships: A Public Economics Perspective*. IMF Working Paper WP/06/77, 2006

partner, knowing that he will have to operate the facility being created for a long time, reasoning from own interests provides high quality of design and building works. If an executor of works was responsible only for investment component, it would be much more difficult to formulate the qualitative terms of reference and control their performance, especially in conditions of lack of experience and qualified personnel in the state bodies. In that case, non-fitment between stages of designing, building and operation would entail additional costs.

Distribution of risks. Creating and operating infrastructure projects are connected with significant risks. Uncertainty of conditions in project implementation is bound up with fluctuations of macroeconomic conditions, difficulties in forecasting demand, possible changes in legislation, deviations of construction costs and operation from projected values and so forth. PPP allows distributing risks between the parties based upon the ability of the latter to control uncertainty sources and to be adapted to changing conditions. The private partner should undertake production and building risks, and also respond to demand fluctuations by improving quality of services, more vigorous marketing, and so forth. The government should deal with system and macroeconomic risks, compensating them by due correction of PPP conditions.

Barrier to «white elephants». Large-scale state investment is quite often accompanied by serious miscalculations related to expected costs, terms of building, needs for facilities beign created and etc., hence constructed facilities in th end do not repay the invested resources. The private partner risks in such projects by own resources which force him/her to carry out more careful and realistic pre-design analysis. The consent of the private partner to implement PPP project gives additional confidence in economic validity and efficiency of the undertaking.

PPP acts in such cases as an original filter not allowing passing «white elephants» - doubtful projects with high probability of big financial losses.

2.3. PPP problems

Despite its attractiveness, PPP idea is related to serious problems, ignoring which has lead a lot of PPP projects to failure. Shortcomings and advantages of PPP quite often appear to be continuation of each other, so as effective implementation of the given model appears as uneasy business.

Danger of weakening control over government expenditures and incomes. As already specified that PPP projects from a certain point of view lead to growth of cost commitments and debts of the state. The financial and administrative autonomy of such projects specifies, that corresponding budgetary obligations and their repayment are deduced for limits of the state financial planning, control and the reporting, which can negatively affect quality of public finances' management. Meanwhile, boundary position of PPP between private and public sectors is fraught with corruption, and other abusing at a choice of the private partner, which can take place at conclusion of contracts, definition payments mode, and so forth.

PPP allows distributing risks between the parties based upon from the ability of the latter to control uncertainty sources and to be adapted to changing conditions

PPP represents itself as a filter, which does not allow passing doubtful projects with high probability of big financial losses

Realization of PPP projects can negatively affect quality of management of the state

Aspiration of the private partner in increasing project income can lead to saving capital and operational costs, due to decrease in quality

Quality guarantee problems. Aspiration of private partner in increasing profitability of the project can lead to saving capital and operational expenses, at the expense of reducing quality (regularity, reliability, availability and so forth) of provided services. Similar fears arise when the quality standards are insufficiently precisely indicated in the contract (for example, if the standards are beyond measurement and verification) and/or no effective mechanisms of controlling and obliging the private partner to fulfill contract requirements are available.

Miscalculations in estimating project profitability, and risks of contracts revision. A private partner can be offered unfairly generous financial terms, actually providing exclusive monopoly profit («rent») at the expense of the budget or the infrastructure service users. The opposite extreme is also possible, when incomes of private partners turn out to be insufficient for the incurred costs payback. In such cases, in order to prevent suspension of socially significant infrastructure facility the state can be compelled to revise contract terms, raising payments from the budget or authorizing growth of tariffs. As a result, budgetary restriction of PPP project is «softened» that can cause undesirable de-motivating influence on the private partner. The latter can take advantage of the his/her de facto monopoly position to achieve additional benefits from the state; in its turn, the state receives levers of pressure upon the investor, who has invested significant resources in infrastructure capacities, having no applications outside the partnership with the state. Such types of risks are aggravated by weakness of the conventional law system, including the mechanisms of dispute settlement.

Political and social risks. State quite often resorts to explicit and implicit subsidies in providing social and public utilities services to population (implicit subsidy is the tolerant attitude to non-payments for services). A private partner liquidates similar privileges, unless they are stipulated by the contract indicating a source of replacing dropping-out incomes, and introduces more strict payment discipline. It may have a negative impact on availability of the services being provided, especially to people with moderate income, and lead to increase of social and political tension.

Lack of experience and production capacities. In private sector, there may not be enterprises, who have necessary economic and financial opportunities, capacities and know-how in order to implement PPP projects (in this case, attracting foreign companies becomes a way out). Moreover, public institutions may not have enough experience in drawing up and fulfilling PPP contracts.

Section 3. PPP in Uzbekistan: prerequisites, obstacles, order of introduction

3.1. First steps

According to database of Public-Private Infrastructure Advisory Facility (PPIAF) organized by the World Bank 8 PPP projects with private investments with total amount of 794 mln. USD have been initiated in Uzbekistan for 1990-2005¹¹. Two out of eight projects, having 47% share of private investments, discontinued later.

Database of PPIAF registers only large-scale projects of private-public partnerships in Uzbekistan; apart from that there are numerous examples of private sector participation in infrastructure at micro level in the country mainly in sphere of housing and communal services. Since 2002 privatization of housing – operational managements and some other public utilities is ongoing.

A resolution «On further measures on developing associations of private accommodation proprietors and establishing real housing services market», adopted by Cabinet of Ministers in 2006, foresees creation of specialized managing and servicing organizations, providing services to associations of private accommodation proprietors on a contractual basis. As of today, 143

Table 4. Large private-public partnerships in Uzbekistan

Year	Number of newly started projects	Sector	Project type	Private investments (\$ mln)
1992	1	Telecom	New facility	3
1996	4	Telecom	New facility	351
1997	2	Telecom	New facility	118
1998				31
1999				13
2000				26
2001	1	Water supply	Contract for management	130
2002				23
2003				10
2004				3
2005				85
Total	8			794

Source: Private Participation in Infrastructure Database, World Bank

Box 2. Private – public partnerships in water supply in Bukhara and Samarqand

In order to increase efficiency, quality and availability of water supply in Bukhara and Samarqand non-standard PPP model has been realized. In this project investment component was provided by international donors while a private operator without investing own funds operates within the framework of a service contract. The donors consortium, including the World Bank and Swiss Agency for Development and Cooperation (SDC), has provided technical assistance, grant and investment loan for a total amount of 49 mln USD for rehabilitation and modernization of water-channel facilities in the two cities. The authorities of the two cities are responsible for the loan service. The financial and material contribution to the project from uzbek party is estimated at 12 mln USD.

A French company initially chosen as a private operator shortly after launching the works under the contract has demanded its revision with the purpose of increasing tariffs, referring to changed economic conditions. The Uzbek party did not agree on this requirement and the contract was terminated. According the second bidding results, an Austrian-Swedish company, who among participants of the bidding has proposed most favorable financial terms, had been determined as the new private operator. Activity of this company caused numerous complaints, as a result the contract has not been prolonged, and in 2007 PPP was transformed into an ordinary investment project (with participation of an international institutional consultant), whose implementers were water-channels of the two cities.

¹¹ By PPIAF (<http://ppi.worldbank.org/>) in calculations in GDP, investments in PPP in Uzbekistan somewhat lower than Kazakh investments, but leave behind Ukraine and Russian investments

Box 3. Private managing companies in Uzbekistan

In Samarqand region the company "Samarqand Oltin Asr" who started its activity in May, 2006, has concluded contracts with 13 associations of private accommodation proprietors (APAP). The company has established three local boiler-houses and is serving 51 houses at reasonable tariffs, and has also fulfilled significant volume of repair work by the order of customers. The private firm "Shuhrat Hamkor Service", working in Namangan region, provides emergency and dispatching services for 8 multi-stored houses with 352 apartments. A tariff, accessible to residents for repair, maintenance of inter-house communications, an emergency and dispatching services, is established at a rate of 43 soums per 1 sq.m, efficiency of collecting payments for public utilities has increased by mass installation of electric-power-meters and cold- water-meters, that has allowed to reduce sharply debts of the population. In Bukhara region the managing companies "Kuruvchi Kommunalchi synthesis" and "Kalb Iftihor Faiz" serve 17 APAP and 169 multi-stored houses. The companies established competitive tariffs for repair, maintenance of inter-house communications, emergency and dispatching services at the rates of 43 soums and 56 souma for 1 sq.m. of accomodation, respectively.

individual managing companies function in Uzbekistan, providing operational, repair and emergency - dispatching services (Box 3).

Successful activity of the managing companies allows putting a question on expanding scope of their functions. So, the State committee on demonopolization, jointly with Joint-Stock Company «Uztransgas», is developing typical contracts on transferring to the managing companies

Authorities in the areas consider opportunities of outsourcing to private operators selling, distribution of and collecting payments for electric power and natural gas

functions of selling natural gas to wholesale and retail consumers and collecting payments. The managing companies are succeeding to considerably improve payment discipline due to exact identification of a circle of payers and greater accuracy in collecting payments with simultaneous improvement of quality and reliability of the provided services. Besides the managing companies, the authorities in the regions consider opportunities of outsourcing to private operators selling, distribution of and collecting payments for electric power and natural gas. In particular, Samarqand region khokimiyat (municipality) involves mahallas in collecting payments for natural gas, which conclude the corresponding contract with gas supplying organization and banking institutions. The established system allows not only collecting current payments more effectively, but also allows gradually reducing accounts receivable for the previous periods. Similarly, the State committee on demonopolization, together with state Joint-Stock Company «Uzbekenergo» has carried out competitive selection of an independent operator for distributing and selling electric energy in Bektemir area of Tashkent city. According to competition results, the said functions have been transferred to the company "Shosh Invest Group" since April 2007.

The mentioned examples testify the viability of PPP idea in conditions of Uzbekistan, and at the same time, the availability of serious obstacles to large-scale implementation of PPP potential in the country. Scales of private capital investments in PPP projects are non-comparable with the size of «investment gap» in infrastructure, which is reaching several percent of GDP. Large private investments into infrastructure are still limited mainly to mobile communication - one of the least risky segments of infrastructure sector for investors, which are hardly considered priority in respect to the needs of social and economic development of Uzbekistan. During implementation of large-scale projects, almost insuperable conflicts arise between the parties, fraught with cancellation of achieved agreements and abandonment of private investors and operators from partnership. Projects at micro level are easier to implement, as they give tangible gain, but remain isolated undertakings unable to considerably improve situation in public utilities sector of the country.

3.2. Conditions for PPP in Uzbekistan

In order to understand the idea about the factors, favoring or interfering PPP development in the country, it is useful addressing to materials of UNDP Public Private Partnership for the Urban Environment (PPPUE) program¹². The following factors and restrictions are listed in these materials, allowing to judge availability of legal, institutional, economic and other preconditions for productive participation of private sector in infrastructure of the country.

Legislation and state regulation. The legal base for PPP in Uzbekistan is created by national legislation on privatization, restructuring and regulating natural monopolies, on measures on developing competition, introducing rent and concessions, attracting foreign investments, as well as on reforming certain sectors of social and economic infrastructure. Since many PPP projects have concession basis, national concession legislation avails a great value. Among one of the first post-Soviet states, Uzbekistan accepted the law «On concessions» in 1995. Unfortunately, by virtue of a number of lacks, this law remains mainly on a paper, and thus requires serious revision (Box 4).

The law on natural monopolies refers to pipelines for transportation of hydro carbonic raw material, manufacturing and transportation of electric and thermal energy, railways, postal services, water pipelines, sewer networks, air navigation services, ports and airports. The basic tools of state regulations are price regulation, identification of consumers subject to obligatory service, and/or establishment of minimum level of providing the consumers with monopoly services. Cabinet of Ministers of the Republic of Uzbekistan, represented by the State committee on demonopolization, support of competition and entrepreneurship is the regulating body in the sphere of natural monopolies, whereas the authority of price regulation belongs to the Ministry of Finance.

Such distribution of powers is fraught with conflict of interests, as the Ministry of Finance, being responsible for budgetary incomes, by virtue of the functional role is to a lesser extent concerned with other functions of prices for natural monopoly services. In some cases, especially with reference to utilities services sector, Ministry of Finance delegates approval of tariffs or their ceilings on goods and services of natural monopolies to financial

The Law of the Republic of Uzbekistan «On concessions» due to some shortcomings requires serious revision

Box 4. Law of Uzbekistan on concessions

The basic claims to the law will consist in the following. Firstly, circle of concessionaires is limited to foreign investors, which excludes national business from significant part of potential PPP projects. Secondly, though the law determines types of economic activities as the subject of concession, the subject strictly binds the activities with existing tangible assets (property, land areas and reserves), whereas the modern view of concession consists in granting rights by the state to private firm for conducting economic activities under imperfect competition conditions (presence at concessionaire of certain «market power»). Finally, the law limits duration of concession agreements to 15 years (against widespread 50 years) that constrains conclusion of agreements on large facilities with long recovery period. In comparison with foreign countries, the legal regime of concessions in Uzbekistan receives low estimation in terms of defining purview of the law, the quality of the state support and availability of financial instruments favorable for attracting loans by concessionaires, as well as the quality of concession agreements and procedures for awarding concession. From the moment of the acceptance of the law in 1995, not a single complete concession agreement has been concluded, therefore assessment of the practice of concession implementation regime in the country is based on «quasi-concessions», granted on a municipal level in the sphere of public transport. International experts give a low grade to processes of concessionaires selection, performance and termination of similar agreements.

Source: EBRD Legal Indicators Survey 2006; Concession Assessment Project report on the quality of concession legislation in early transition countries, EBRD 2007.

¹² <http://pppue.undp.2margraf.com/>

Current practice does not meet modern principles of tariff regulation that envisage assignment of this function to independent regulating bodies

departments of regional khokimiyats. For the latter, the primary task is balance of incomes and expenses of republican and regional budgets, as well as social protection of population, whereas needs of development and modernization of the sector at the same time do not receive sufficient attention.

Existing practice does not meet modern principles of tariff regulation that envisage assignment of this function to independent regulating bodies. As a result in a number of sectors where tariffs should compensate entirely current and capital costs, they still remain below necessary level. There is also another extreme that infrastructure sectors are transferred to self-repayment conditions, while since specificity of these sectors, their services should be subsidized in the interests of social and economic efficiency.

Institutional restrictions. Institutions in Uzbekistan are evolving in direction of private sector development, encouragement of competition, and continuation of privatization. Such vector of institutional shifts will certainly favor to PPP expansion. At the same time, the country has no sufficient experience in effective and transparent private-public partnership.

Sales of shares of the enterprises to private investors, including infrastructure sectors, are the prevailing alternative of privatization. Thus, 40 and 44 % of shares of Open Society «Fergana electric systems» and «Bukhara electric systems», respectively, and also over 25 % shares of national postal services company «Uzbekistan pochta» have been sold to foreign investors. In all mentioned cases, the state maintains majority shares. At the same time, the government program of privatization allows the opportunity of reducing state share in the property of generating and distributing enterprises of power sector up to 15 %, especially if the buyer takes up additional investment obligations, the demand for which was estimated at 105 mln dollars in 2006. At the same time the state intends to reserve majority shares not in enterprises, admitted as strategic, among which will most probably be some facilities and networks of infrastructure.

Partial privatization of infrastructure enterprises under condition of additional investments attraction can be considered as PPP option, however, separation of powers and obligations between public and private partners in such cases differs from conventional one - the line of separation cuts the package of property rights «crosswise», leaving to each participant partial rights of control and income, whereas in traditional understanding of PPP, the rights are distributed «lengthwise» - the private partner receives full commercial independence and all profit, whereas the state reserves regulating powers. This difference has a principal importance for the private investor, especially if the package of majority shares remains for the state. It's not accidental that privatization of maintenance-operational and housing-operational units, where the state did not hold the share of the property, occurred much more actively than in other segments of infrastructure. It is also necessary to expect that partial privatization of infrastructure enterprises that had already been carried out can create legal obstacles for transition to PPP, as it will infringe on interests of private, including foreign investors, who has acquired shares of these enterprises.

PPP introduction in Uzbekistan can be interfered by insufficient experience of equitable cooperation between public agencies and private enterprises, and still non-overcome distrust between public and private sector. It is also necessary not to overlook the threat of corruption, for which there can be new opportunities when transactions between the state and commercial firms expand.

Financial restrictions. PPP prospects in Uzbekistan depend on readiness and capabilities of private investors to invest their own resources in infrastructure sector of the country. Despite rise in investment activity, its scales in Uzbekistan remain insufficient for implementing large PPP projects in noticeable quantity. According to the reporting data for 2006, all volume of foreign investments into infrastructure sectors of Uzbekistan has made 157,7 bln soums, whereas residents - mainly enterprises and organizations - in total invested 664 bln soums in infrastructure. The main part of these investments was made by the companies controlled by the state, especially for their own production assets, and considering such capital investments as private should be done with significant reservations. Privatization transactions for the same year have made 59,26 bln soums, with investment obligations of 37,6 mln dollars and 7,2 bln soums. Meanwhile PPP projects, realized in thousands in developing countries, required investments for each project at the rate of hundred millions and more.

It is to be expected that difficulties in «securitization» of such projects, i.e. issuing financial instruments under these projects, will become an obstacle to attract large foreign investments in PPP in Uzbekistan. The national financial markets are at early stage of development, and will hardly be capable to solving the problem of financial assets mobilization in infrastructure in the near future, whereas foreign investors have to receive reliable guarantees for investment return. Macroeconomic stability in Uzbekistan and the policy of the government on attracting foreign capital will certainly reduce investment risks¹³, but assertion of the idea about Uzbekistan, as the country with attractive investment climate, in international corporate and financial circles, will require time and the further efforts.

Financial restrictions to a lesser extent prevent PPP implementation in the country in the form of service contracts, excluding investment components.

Conclusion and implementation of contracts. Since infrastructure sector is restrictedly competitive, the operator of PPP facility receives certain market authority for contract period. In these conditions, competitive regime of private partner selection by means of open and transparent competitive procedure has exclusively a great importance. Uzbekistan has experience of carrying out investment competitions, which should promote PPP introduction in the country. At the same time, the sustainable procurement system of goods, works and services, which would lean on advanced engineering and consulting infrastructure, and full information base, has not yet been created. Today potential participants of competitions can not always receive in time full necessary information about the situation of infrastructure enterprises, have

PPP prospects in Uzbekistan depend on readiness and capabilities of private investors to invest their resources in infrastructure sector of the country

Potential participants of competitions can not always receive full necessary information in time about the situation of infrastructure enterprises, have no reliable data on market capacity, pre-investment research materials and feasibility studies

¹³ An important step in this direction is the Resolution of the President of the Republic Uzbekistan № PP - 672 dated July 20, 2007 "On measures for further deepening of privatization processes and active attraction of foreign investments in 2007-2010", which expands a scope of guarantees and privileges to foreign investors.

no reliable data on market capacity, pre-investment research materials and feasibility studies. This leads to reduction of competitiveness of competitive selection procedure, and does not guarantee achievements of the best result for the society at used resources («value for money» principle). Businessmen and potential investors can not always obtain objective information. Absence of reliable initial assessment of subject of competitive tenders also adversely affects their results. Finally, very important is ability to correctly formulate competition conditions and securely verify their implementation, and that the competitor possesses necessary professional and organizational qualities. PPP experience in water supply in Bukhara and Samarqand cities emphasizes importance of such requirement, without meeting which the competition winner selection, based upon proposed financial terms only, is fraught with problems during project implementation.

PPP contracts possess significant specificity, especially at availability of investment components, as it was already noted investors in developing countries aspire to compensate gaps of institutional environments by complicating and working out such contracts in detail. In contracts obligations of parties, target parameters, for achievement of which private partner is responsible, principles of tariff policy, bonuses and penalty sanctions, mechanisms of compensating losses if parties do not perform their obligations, reasons for contract revision, procedures of disputes settlement and contract cancellation. Experience of drawing up and implementing such contracts in Uzbekistan is insignificant yet. There are also no typical PPP tools adapted for local needs, which could be used at drawing up concrete agreements.

Personnel problem and public opinion. PPP projects implementation requires educated staff, both in private and in public sectors, especially staff both with special technical knowledge, necessary for work in modern sectors of infrastructure and competence in administrative, legal and financial issues. Such qualification can be obtained through experience and/or participation in training programs. Taking into account that PPP introduction in the country is at an initial stage, and regular training on administrative, legal and financial aspects of PPP has not been carried out, it is necessary to expect that personnel deficiency can become an obstacle to mass participation of private sector in infrastructure. Shortage of skills in such issues as modern financial analysis and planning, state regulation of private enterprises in infrastructure, carrying out tenders, monitoring and controlling contracts implementation and public relations could be especially serious.

According to experts' opinion, it is also possible to expect deficiency of qualified engineering and technical staff, as the growth of debts and low salaries in a number of infrastructure sectors has led to experts outflow.

Success of PPP projects in a great extent depends on public participation and support. In Uzbek society, the long-term tradition has generated expectations that infrastructure services are provided by the state free-of-charge, or in strongly underestimated, sometimes symbolical prices. Attempts of the state to limit subsidizing tariffs have led to wave of non-payments. In such conditions, possible increase of payment for infrastructure, and strengthening payment discipline, dictated by objective economic necessity,

Serious importance is attached to shortage of skills in modern financial analysis and planning, state regulation of private enterprises in infrastructure, carrying out tenders, monitoring and controlling contract implementation and public relations

can be unfairly accepted in public opinion when infrastructure facilities are transferred to private enterprises, and thus may lead to refusing the PPP idea by the society. The risk of such scenario is real, but should not be exaggerated, since even today infrastructure services (in particular, municipal services and public health services) are widely consumed informally, and thus de facto appear as chargeable services.

3.3. Set of measures in PPP promotion

PPP model in Uzbekistan should be built creatively, taking into account the country realities. Such approach will be consistent with modern view of effective reform strategy, when universal recipes are replaced by search of own decisions, reflecting features of economy and institutes of individual countries. Reforms are projected not as one-stage effort, but as a process, where preconditions for the following steps are created on each stage. At the intermediate stages of such process new institutes and mechanisms, introduction of which is the purpose of reforms, function with certain restrictions that are gradually removed, expanding scales of innovation and allowing its implementation in more advanced forms.

The previous analysis allows ascertaining that despite high requirement for private investments into infrastructure, «frontal» PPP introduction in Uzbekistan at the present moment is unfeasible. National and foreign investors are not ready to allocate necessary resources, but even if financial resources are available, existing gaps in the legislation and shortage of experience would most likely lead such campaign on failure, having discredited thus PPP idea in the government and the society as well as having undermined trust of private sector for a long time.

Way out from the situation could be a program of urgent actions on *creating conditions* for PPP application in the scales, adequate to requirements of the economy and logics of reforms, *adapting* forms and mechanisms of PPP to the current conditions, and *gradual expanding PPP* in breadth (growth in number and scales of projects) and in depth (approaching to the most advanced PPP models) as necessary preconditions arise. Advantage of the suggested strategy is accumulation of experience and demonstration of the capacity of the PPP model as part of process in preparation for its mass introduction.

Such process should include the following components:

- pilot projects
- legal reform
- developing tools
- training
- expert support
- stakeholders dialogue

In pilot projects selection it is necessary to maximize chances of success in conditions of limited private investments and institutional environment gaps. From this point of view the preference undoubtedly should be given to small projects with modest needs for investments or - in the form of rent and service contracts. Small scales of PPP limit risks and losses in case of possible failures, and absence of investments simplifies contracts, which, not

A program of urgent actions is needed that addresses issues on creating conditions for PPP application in the scales adequate to requirements of the economy and logics of reforms, adapting forms and mechanisms of PPP to current conditions, and gradual expanding PPPs as necessary preconditions arise

Pilots should be selected in the sectors, where losses at present situation are the greatest, first of all in housing and communal (utilities) services sector

demanding return for the invested resources, can be concluded for a shorter period. Unfortunately, short-term contracts reduce stimulus of the operator to increase capitalization in the entrusted infrastructure facility, but this lack is justified by smaller sensitivity of such contracts to mistakes in forecasting, to errors while carrying out tenders, and to lack of experience in applying more complex tools. It is also important, that simple short-term contracts to a lesser degree require state regulation (for example, with the purpose of tariffs revision), whose efficiency causes doubts at the moment.

Pilots should be selected in the sectors, where losses at present situation are the greatest, and this will allow, firstly, achieving noticeable results as early as at the initial stages of PPP introduction, having unloaded the budget and having increased quality of services, and secondly, will give the basis to expect success, despite initial absence of some preconditions for effective PPP implementation and possible imperfection of pilot projects. Successful implementation of such projects will have important demonstration effect, convincing state bodies, private sector and the public in PPP advantages.

Housing and communal services (utilities) sector satisfies the listed requirements in the greatest extent, where PPP projects can be implemented at micro-level, providing significant gain due to reducing losses, increasing technological and financial discipline and using available resources more effectively. Thus, the pilot component of the strategy is recommended to be implemented in the sector of housing and communal services (see more in detail in the final section of the report). Certainly, such recommendation does not exclude simultaneous preparation, and under favorable conditions - implementation of PPP projects in other infrastructure sectors.

It is necessary to develop drafts of amendments, first of all, in laws on concessions and natural monopolies

For establishing strong legal PPP basis, it is necessary to analyze existing legislation, touching upon activity of private enterprises in infrastructure, and to develop coordinated drafts of amendments in laws on concessions and natural monopolies (see the previous section of the report), and also, possibly in laws on investment activity, on guarantees and measures on protecting rights of foreign investors, on rent, on privatization, on leasing, etc. In opinion of experts of Chamber of Commerce and Industry of Uzbekistan, carrying out such legal reform is the prime precondition of wide PPP introduction in national economy. In legal analysis and recommendations, prepared on its basis, the special attention should be given not only to the letter of the law, but also to the practice of law enforcement, keeping in mind that in Uzbekistan it quite often lags behind the quality of legislative rules, including touching upon PPP¹⁴.

Set of PPP tools should include a) methods of financial evaluation of project; b) methodical instructions on carrying out competitive selection of private investor and operator (notification about competition, evaluation of competitors applications, winner selection, contract negotiations); c) methodical recommendations on preparing application form for participation, including technical and financial parts; d) typical contracts for various PPP options; and e) recommendations on their implementation. Set

¹⁴ An important step in this direction is the Resolution of the President of the Republic Uzbekistan № PP - 672 dated July 20, 2007 "On measures for further deepening of privatization processes and active attraction of foreign investments in 2007-2010", which expands a scope of guarantees and privileges to foreign investors.

of tools may also include alternatives of government support for PPP projects and methods of risks insurance.

During development of set of tools it is necessary to take advantage on international materials, manuals and methodical instructions, developed by international organizations, including World Bank, ADB and UNDP¹⁵. These sources are insufficient - their recommendations need to be concretized in view of realities and needs of Uzbekistan, and also in view of already available experience in privatization of infrastructure sectors.

Training as a part of the PPP program introduction should be designed for audiences of two types - first, national experts, who are in charge of elaborating legislation, regulation and contract conclusion and implementation procedures, and, second, government officials and employees of companies, acting as partners of the state. Importance of training is proven by abundance of training programs on PPP, organized both by international donors and private firms¹⁶. For mass improvement of professional

skills of government employees, especially in the regions, and private sector representatives, it is necessary to educate own teaching personnel, preliminarily carrying out necessary programs on increasing qualifications in format «training for trainers».

Expert support for PPP introduction in Uzbekistan requires, in addition to already mentioned legal analysis, implementation of applied economic researches and professional monitoring. The following components should be included in the program of researches.

- Analysis of financial condition and resource security of infrastructure sectors that allows revealing available reserves of efficiency and estimating investment needs.
- Analysis of social consequences of PPP projects implementation and applicability of existing programs on social protection of population for compensating possible tariff increases.

Box 5. Program of training course on increasing competency on PPP issues, suggested by Institute of Public-Private Partnerships (USA)

1st module: concept, motivation and contract versions of PPP (review of PPP forms; international experience in PPP; new PPP versions through donor support)

2nd module: project evaluation and feasibility study (FS) (objectives and basic elements of FS; principle of economic return "value for money" and comparison with status quo; project evaluation criteria; risk control and allocation; attraction of independent consultants)

3rd module: project financing and investment analysis (variants of financing; principles of financing scheme selection; problems and risks of financing)

4th module: process of identifying private partner (forms of partner selection - competition, competitive negotiations, attraction of predetermined operator / investor; analysis of application evaluation criteria; ensuring process transparency)

5th module: public-stakeholder relations (methods of maintaining relations with interested parties; forming dialogue program; taking interests of workers into account)

6th module: management, monitoring and evaluation of contracts (use of PPP contract as tool for regulation; establishment of independent regulating body; forms of economic regulation; contract implementation monitoring).

Source: Institute for Public-Private Partnerships, Inc.

¹⁵ UNDP' *Public Private Partnership for the Urban Environment (PPPUE) program* (<http://pppue.undp.2margraf.com/en/index.htm>) ; World Bank's *Concessions for Infrastructure Toolkits* (<http://rru.world-bank.org/Toolkits/InfrastructureConcessions/>) ; *Developing Best Practices for Promoting Private Sector Investment in Infrastructure*, Asian Development Bank; *Public-Private Infrastructure Advisory Facility Toolkit* (<http://wbln0018.world-bank.org/ppiaf/activity.nsf/toolkits>)

¹⁶ The most famous among such firms – Institute for Public-Private Partnerships, Inc. (IPPP) with its headquarter in Washington DC, offering various courses and consulting services on Public-Private Partnerships. World bank supports training program *Learning Program on Public-Private Partnership in Infrastructure*, UNDP organizes regional training workshops on PPP.

It is necessary to support dialogue of stakeholders with participation of representatives of government authority, business and population on issues of private partner selection and PPP project implementation procedures

- Learning theory and practice of regulating private enterprises in infrastructure sectors with the purpose of developing proposals on organization of tenders for PPP projects and controlling implementation of such projects.

- Analysis of available experience of private enterprise participation in infrastructure facilities of Uzbekistan, comparison of this experience with international practices and on this basis development of recommendations for pilot projects

Implementation of the given set of researches is purposeful to be entrusted to a single research center (in particular, Center for Economic Research), which in interaction with main stakeholders would provide expert support of the program.

It is also necessary to ensure an opportunity to carry out independent expert appraisal and audit of PPP projects with the help of national and international experts, and also to train national staff for current consultation on PPP issues.

PPP touches upon interests not only partners directly involved in the project - the state bodies and private enterprises, but also consumers of privatized services of infrastructure. The society should receive guarantees of non-infringing upon their interests during PPP implementation that is achieved by keeping dialogue of stakeholders with participation of representatives of government authority, business, and the population. The form of such dialogue is public consultations and hearings on anticipating works under the project and providing public support. Achievement of this purpose is promoted also by publicity, transparency and controllability of procedures of private partner selection and realization of PPP projects by the society. Finally, the society possesses the important role as collective controller of quality of services provided through PPP projects (see on this in more detail in the final section of the report).

It is purposeful to organize stakeholders dialogue under aegis of Chamber of Commerce and Industry. The business community would represent both private providers and consumers of PPP services in such dialogue. To participate in the discussions representatives of the interested ministries and agencies, regional and city khokimiyats, Oliy Majlis and Councils of People's Deputies, Federations of societies on protecting consumer rights in Uzbekistan, Fund «Mahalla» and other public associations should be attracted.

Implementation of set of the listed measures should be preceded by drawing up detailed action plan with participation of the interested parties, establishing stages and terms of individual actions, determining responsible organizations and mechanisms of coordinating and controlling the implementation. It is purposeful to adopt such plan in the form of resolution of the Cabinet of Ministers.

Section 4. «Micro-PPP»: attraction of private sector to housing-communal services sector

4.1. Why to start with HCS sector?

In the previous section of the report conclusion was made that strategy of PPP introduction in Uzbekistan must be gradual and at the initial stage ensure implementation of pilot projects. The latter, solving essential social and economic problems, must demonstrate evidently and convincingly advantages of PPP idea in spite of absence of some important preconditions for its full implementation in the country. It was noted that small projects, not demanding significant capital expenses, are least sensitive to quality of institutional environment. Further, for pilot projects it is necessary to choose sectors, where present condition of technical, administrative and financial discipline gives rise to unfavorable criticism, as in that case, results of more effective control, expected from PPP, can become apparent especially visually.

Housing and communal services (HCS) sector fully meet the formulated requirements. Indeed, firstly, significant progress in this sector can be achieved at the local level, when private partner takes up the responsibility for HCS facilities, serving urban or rural area. Secondly, HCS sector stands out among other infrastructure sectors of the country in terms of scales of mismanagement and losses. It specifies inability of the existing model of financing and operating the infrastructure for sustainable development on the basis of self-repayment, consequently, the state budget and the population have to pay off for infrastructure inefficiency. According the available data, HCS sector in Uzbekistan has huge reserves, which can be realized under condition of reducing unproductive spending of resources, introducing effective management, and more rational and transparent income collection system. These reserves in a number of cases may appear sufficient for ensuring profitability of HCS facilities without additional budgetary outlays and substantial increase in existing tariffs. If this is the case, then PPP projects can be implemented in the «facilitated» form without essential investment component.

Thirdly, at a local level it is easier to solve quality control task that is very important for PPP¹⁷. Municipal authorities and local community, including mahalla, should be involved in solving this task. Collective participation of the population in PPP implementation will raise efficiency and transparency of municipal economy and promote reduction of social and political risks, which can be fraught with privatization of infrastructure facilities.

Fourthly, PPP introduction on micro level opens opportunity for experimentation and accumulation of necessary experience (large-

HCS sector stands out among other infrastructure sectors of the country in terms of scales of mismanagement and losses

At a local level it is easier to solve quality control task

¹⁷ Be reminded that without effective quality control of services private operator has opportunity to save costs at the expense of degrading quality of work, and privatization in such cases is undesirable. For lines of housing and communal services, quality control does not cause special complexities; a classic example of a state power, most suitable for outsourcing, is scavenging service, where requirements to a private operator is easily formulated and could be checked without effort (see for example. Hart, O. et al., "The Proper Scope of Government: Theory and Applications to Prisons", *Quarterly Journal of Economics*, v. 112(4), 1997.)

PPP introduction on micro level opens the opportunity for experimentation and accumulation of necessary experience

Since part of HCS is vital, increase of tariffs for these services up to level of self-repayment is risky action

Effective PPP reveals real costs of operation of HCS, makes budgetary restrictions of the sector enterprises more rigid and financial flows transparent

scale projects with risks of big losses are less suitable for such training in practice). In addition, in various regions, cities, rural and urban districts alternative approaches and tools of PPP could be tested that will allow revealing and extending the most effective options to the whole country. Best PPP projects will allow establishing standards of effective management of municipal services, and giving an objective evaluation of quality of management and operation HCS, both in traditional forms, and with use of PPP. Besides, such standards will be extremely useful at carrying out competitions for selecting private operator, allowing authorities to establish valid requirements to the project results.

Finally, fifthly, as it appears from the previous section of the report, in Uzbekistan greatest experience in attraction private enterprises in infrastructure has been accumulated in HCS sphere.

Despite the listed advantages, the idea of reforming HCS on the basis of private-public partnership is prejudiced at times¹⁸; thus attention is paid to insignificant volume of private investments in HCS in comparison with other infrastructure sectors (see. Diagram 2 in the Appendix, where city infrastructure is represented by water supply and sewer system, and also, partly, transport sector). Modest volumes of registered investments are related to difficulties in collecting payments, completely covering costs in number of HCS sectors, especially in water supply; such difficulties grow, if the task is to make HCS networks accessible to needy groups of the population, village people and so forth. As part of HCS services is vital, increase of tariffs for these services up to self-repayment level is risky action. Investment contracts in HCS concluded for long-term demand frequent revision, especially when quality of state regulation is poor. Finally, city and municipal authorities, which mostly conclude PPP contracts in HCS, are considered as less reliable partners than the national governments, and at the same time have insufficient large powers.

Such fears either reflect popular beliefs or are overcome by due organization of PPP in HCS. The first error is that PPP inevitably results in increase of tariffs for HCS services. As it was already specified unproductive losses in number of HCS segments are so great that only more effective utilization of available material and financial resources in many cases allows the private operator to compensate costs and realize necessary profit. The second error is the opinion that if after transferring HCS infrastructure into PPP mode there will be real increase of tariffs, then this is the result of transferring infrastructures to private enterprise. Indeed, well organized PPP reveals real costs of operation of HCS, makes budgetary restrictions of the sector enterprises more rigid and financial flows transparent, and puts inevitable question to society and state that how these costs will be compensated, what part of charges will be taken up by state and what part should be covered by consumers (Box 6).

¹⁸ Annez, P. *Urban Infrastructure Finance from Private Operators: What Have We Learned from Recent Experience?* World Bank Policy Research Working Paper 4045, 2006.

One more error is related to the answer to the last question, according to which, privatization of municipal services automatically excludes opportunity of subsidizing them by state, as «private enterprise should not receive state subsidies». In fact, economic theory and practice testify purposefulness of such subsidies under certain conditions, for example, in case if rendered services create public benefit that surpasses personal one (public transport), have key values for accumulation of «human capital» (education) or are part of «package» of basic social and economic rights, guaranteed by the state (water supply).

Box 6. PPP and tariff increase in developing countries

«As infrastructure services are widely consumed in society and are frequently considered as irreplaceable, in developing countries there is a long-term tradition of keeping tariffs at levels, which do not compensate costs. In the beginning of 90th, incomes in water supply compensated on average no more than 30% of costs, and in supply of electric power - no more than 60%. In state ownership deficit was covered by either budgetary transfers or saving of non-amortization related expenses, resulting in wear of fixed capital.

Regardless from form of ownership to infrastructure assets, the sector services should be finally paid either by consumers or taxpayers. Participation of private sector does not change this basic equation, but the governments sometimes has lost sight of it. Private sector has been invited to finance infrastructure, when resources in the budget came to an end. In some cases, reduction in costs as a result of privatization has allowed to cover expenses at prices, which did not allow making it in state ownership. But, if prices have been established much lower than costs, increase of efficiency in itself does not prevent increase in prices, at least, if budgetary subsidies are not maintained.

... Last decade has clearly shown that though [PPP] is not panacea, it should not be counted as an original cause of the arisen problems. In the new conditions, appeared after privatization, it became much more difficult to hide problems of unfairly low prices. Contracts obligatory to implementation and strict budgetary restrictions have replaced lack of accountability and financial discipline of the state enterprises. They have highlighted problems, left in ignorance, when infrastructure was managed by the state. Though governments sometimes also made private operators «whipping boys», imposing them responsible for rises in prices, nevertheless they realized that return to state ownership will not solve the problems».

Source: C. Harris, *Private Participation in Infrastructure in Developing Countries. Trends, Impacts, and Policy Lessons*. World Bank, 2003, pp. 13-15.

4.2. How to arrange PPP in HCS?

Until now introduction of PPP elements in housing and communal services sector of Uzbekistan was limited to concluding by managing companies agreements with associations of proprietors of habitation (quantity of which comes nearer to 1,500 and cover more than 90 % of apartment houses fund in the country), and also to assigning to private firms certain functions in managing infrastructure facilities, more often, related to collecting incomes and in some cases, distributing energy and heat.

Following step should become expansion of scales of agreements with private companies geographically - up to the level of municipal formations and cities (in this case regional and city khokimiyats should act as customers), and functionally, by transferring elements of public utilities infrastructure and wider set of functions, including engineering, logistical and financial administration, collecting incomes and so forth, to individual enterprises authority. In this case, the important PPP advantage will be realized that consists in transferring full operational cycle to the private operator, when a customer in the person of local authorities sets final requirements in the form of availability and regularity of services, as well as allowable tariffs, giving solution of all «intermediate» questions at discretion of a executor of the contract. The present practice of partial «functional» outsourcing gives only limited effect.

Selection of PPP contract term is important. As it was already noted there is a dilemma - on the one hand, the lengthier term of rent or concession is, the stronger stimulus of private operator to proprietary attitude for production

It is necessary to expand scales of agreements with private companies by transferring wider set of functions to their responsibility, including engineering, logistical and financial administration, and collecting incomes

Further researches and experimentation are recommended to identify necessary term of PPP contract in HCS

and other assets is, and the more opportunities there are for getting necessary investment return. On the other hand, long-term contracts in absence of necessary experience and institutions are considerably less reliable and will most likely require numerous corrections. Solution of this dilemma needs further researches and experimentations; based on available data, including foreign ones, authors of the report recommend limiting at the beginning contract term on providing HCS to several years.

Relative short-term contracts, certainly, does not *entirely eliminate economic risks, which should be rationally allocated between public and private partner*. This is an uneasy task, having no universal solution, as the state guarantees, reducing business risk, may burden the budget and thus weaken stimulus of private partner to effective operation of infrastructure enterprises. Nevertheless, such option can become justified, if budget costs do not exceed public expenditure before PPP introduction, and HCS quality, stipulated by the contract, is reliably controlled.

International experience confirms that PPP in HCS given correct organization of business is able to considerably raise efficiency and quality of public utilities, but with smaller success is attracting investments into the sector. In the cases, when HCS enterprises and units are well provided with fixed capital, PPP may not include investment component at all. (In a number of HCS sectors availability of reserve capacities, not reflected in official data is indicated by the practice, which has received wider circulation in informal provision of HCS - for example, scavenging - which is rendered under private arrangement with use of technical equipment of the municipal enterprises, but in contravention of the established system of payments and registration).

At the same time, modernizing and developing HCS sector, as a whole are obviously impossible without attracting significant resources into the sector; for the projects being now developed by «Uzkommunkhizmat» agency and regional khokimiyats, need for credit resources is estimated at \$650 million in the nearest years¹⁹. When investments are required, it is necessary to consider opportunity of *separating investment and operational components*, as it was made in PPP projects in water supply system of Bukhara and Samarqand. Investments can be provided by international financial institutions, state or foreign investor under state guarantees,²⁰ whereas private operator takes up obligations on operating HCS enterprise. It is necessary to realize that such palliative is imperfect, as it deprives PPP of one of the advantages of the latter - combination of investment and operational functions in one contract, but under existing conditions it can nevertheless appear expedient. Certainly, it is necessary to encourage in every possible way acceptance of investment functions by private provider as well, but putting investment obligations forward as an indispensable condition of the contract can appear counterproductive at the present time. It is also necessary to emphasize that removing investment component from pilot PPP project frameworks is

When investments are required, it is necessary to consider opportunity of separating investment and operational components

¹⁹ Annez, P. *Urban Infrastructure Finance from Private Operators: What Have We Learned from Recent Experience?* World Bank Policy Research Working Paper 4045, 2006.

²⁰ *Target investment programs approved by the Cabinet of Ministers envisages attraction of international loans under state guarantees into housing and communal services sector.*

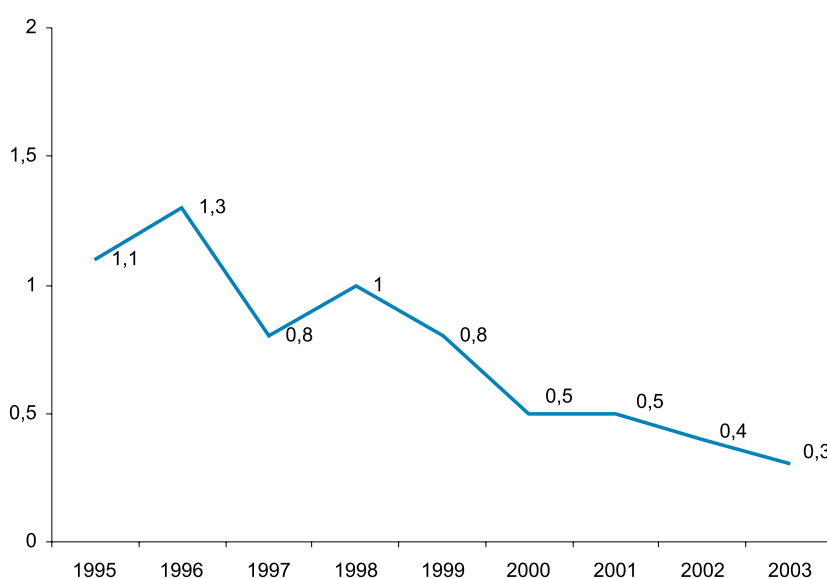
proposed as a provisional measure during the transition period, so that as necessary preconditions to proceed subsequently to full PPP model are being created, where the private partner acts as the operator and the investor.

It is important to ensure commercial attractiveness of PPP projects in HCS sector for private partner. Burdensome duties of some HCS can become an obstacle in this respect. In some cases, it can appear expedient to restructure such debts (that has also been stipulated in PPP projects on water supply in Bukhara and Samarqand cities), or in general to recognize them completely or in part bad ones, and in single order to write them off, having conditioned such decision on strict compliance of further contract obligations.

It is important to ensure commercial attractiveness of PPP projects in HCS for private partner

Tariff policy is the key issue in effective organization of PPP in HCS sector. In a number of HCS sectors in effective carrying out tenders on selecting a private operator, there are good chances to avoid increases in prices for public utilities or, at least to keep such increase in reasonable limits. As it follows from the above-mentioned analysis, such outcome is more probable when there are more losses because of inefficient management before privatization, and when existing tariffs are closer to level, which provides compensation of costs. We have no reliable estimation of preventable losses in HCS

Chart 1. State budget expenses for subsidizing "publicly important" services, % GDP



Source: Republic of Uzbekistan Public Expenditure Review. World Bank, 2005

system, but by the available scanty information, weakness of stimulus and control, non-compliance of technological and payment discipline, as well as corruption and other abuses allow estimating such losses as rather significant that raises chances of «painless» privatization for consumers. Besides, policy of reducing subsidization in HCS sectors, carried out during last decade, results in such conclusion. For some services, including housing service and scavenging, subsidies have been eliminated completely, in other sectors they have been consistently reduced.

In case it will not be possible to avoid appreciable increase of tariffs, social and political risks of such step can be reduced by means of address compensations to low income people, stipulated since 2003 by the decision of the government of Uzbekistan. General subsidization of tariffs can be justified as universal measure; it is known, however, that subsidies are inefficient as social protection measure, since benefit from subsidies is received by all groups of population, and the most part of subsidies falls on more well-to-do layers²¹. The main problem of target subsidies is reliable identification

²¹ In India at the end of 90-ies, 0,5 % of GDP was spent on subsidies in water supply, but only the quarter of these expenses were spent to the needy families, making up half of the population (Reforming Infrastructure. Privatization, Regulation, and Competition. World Bank, 2004).

Box 7. Role of mahalla in social protection system of Uzbekistan

In 1994 Uzbekistan among CIS states was first to refuse general system of social benefits for the favor of target support of low-income families and individual persons. It has allowed five-fold increase of payments to socially vulnerable groups of the population without increasing total amount of resources, allocated for social protection purposes. Administration of two major elements of social support system - grants for children and support for needy - have been entrusted to mahalla; thus decisions on allocating the allowances have been made by Councils of elders. Such step represented an original decision, dictated, on the one hand, by difficulties of formal identification of recipients of assistance at early stages of forming new economic and state institutions, and, on the other hand- availability of effective palliative as traditional institution of social communications, control and mutual support.

The institute of mahalla as a whole effectively copes with the assigned task; however the given scheme is not free from set of errors. In this regard the government plans to supplement the current system with means of estimating agricultural and entrepreneurship income, as well as with advanced methods of evaluating poverty line, differentiated by various regions of the country. It is also assumed to consolidate various kinds of target social payments that since 2003 include compensations for price increases of HCS .

Sources: *Welfare Improvement Strategy Paper of the Republic of Uzbekistan for 2005-2010 Interim PRSP Document (I-WISP)*, Tashkent, 2005; A. Coudouel et al, *Targeting Social Assistance in a Transition Economy: The Mahallas in Uzbekistan*, Economic and Social Policy Series no. 63, UNISF, 1998.

of recipients, which is usually based on the data on structure, incomes and assets of family²². Collection and processing of such data in Uzbekistan conditions may be intractable problem, therefore it is necessary to learn opportunities as an alternative to involve “mahallas” in distributing compensation payments for increase in tariffs for public utilities, who possess necessary information and authority, and have been already actively participating in administering state social protection programs for more than ten years (Box 7). It is expedient that such compensations are to be financed by part of budgetary

funds, released as a result of cutting general subsidization of HCS enterprises – indeed such maneuver of financial resources is stipulated by Welfare Improvement Strategy in Republic of Uzbekistan for 2005-2010.

4.3. Administrative issues

Introduction of PPP in HCS system in Uzbekistan is consistent with overall direction of economic reforms in the country, and will allow moving forward in solving tasks in developing housing and public utilities sector, assigned by the government

PPP introduction in HCS system in Uzbekistan is consistent with the overall direction of economic reforms in the country, and allows moving forward in solving tasks of developing housing and public utilities sector, assigned by the government, including cost reductions without damaging quality of services, refusal from outdated approaches to tariffs settings, creation of competitive environment in HCS sector and entrance of new providers to the sector, effective accounting of service consumption, improvement of sector management, competitive selection of investors, etc. These tasks are included in the agenda of the Concept of deepening economic reforms in system of public utilities, adopted in 1998 by the Resolution of the Cabinet of Ministers, and ideas of private-public partnership are conformable to the state decisions, adopted in developing the concept.

Attracting private sector into HCS sector of the country directly touches upon powers of two state bodies, which have been jointly entrusted with implementation of the proposed program - the State Committee on demonopolization, support of competition and entrepreneurship (State Committee on Demonopolization) and «Uzkommunkhizmat» agency, responsible for HCS sector in the government. Scope of duties of State Committee on Demonopolization includes creating conditions for private

²² See more details on compensation subsidies possibilities for needy in “package” by introducing PPP, Estache, A., A. Gomez-Lobo, and D. Leipziger. *Utility Privatization and the Needs of the Poor in Latin America: Have We Learned Enough To Get it Right?* World Bank Policy Research Working Paper 2407. World Bank, 2000.

sector development, conducting analysis of financial and economic situations and competitiveness of enterprises, restructuring natural monopolies and controlling their activities, creating legal base for competitive environment, implementing state regulation, and protecting consumer rights.

Agency «Uzkommunkhizmat» is responsible for development and implementation of state policy in HCS, formation of legal base and creation of competitive environment in rendering public utilities. Apart from that the Agency conducts monitoring compliance of legislation in public utilities sphere, including specifications and requirements, by local state authorities, legal entities and citizens. The Agency duties also include assistance in attracting investments, including foreign ones, for development, re-equipment and modernization of public utilities networks and enterprises, equipping with devices for counting and controlling over supplying and consuming water and thermal energy. «Uzkommunkhizmat» within the limits of its powers may adopt legal regulations that are obligatory for ministries, state committees, departments, bodies of economic board, khokimiyats, enterprises, establishments, organizations, officials and citizens.

It is not difficult to see that powers of two agencies appreciably overlap, thus coordination of their activities and actions on PPP introduction in HCS sector with other state bodies, including Ministry of Finance, is very important. Coordinating functions are expedient to be transferred to the Republican commission under the Cabinet of Ministers on tariffs and monitoring implementation of Program of reforms in housing and public utilities sector, formed in 2005, which has been entrusted rendering assistance in creating competitive market of public utilities and developing private business in this sphere. It is expedient to entrust the commission with powers of special state body, responsible for implementing PPP policy in whole, including legal, administrative, organizational, financial and economic aspects, and for drafting necessary methodical, standard and tool base.

As state representatives in PPP contracts in HCS sphere it is natural to see local authorities, mainly regional and city khokimiyats, which according to the law have a right to join contractual relations, and which are responsible for elaborating and implementing local budgets, as well as managing local public utilities. Contracts should be the subject of discussion and approval by respective Councils of People's Deputies with participation of representatives of local population, including mahalla.

It is necessary to keep in mind that according to the current legislation, khokimiyats of oblasts and cities may have engineering infrastructure facilities and other enterprises and establishments, located in the territory of the respective region, in their property, and transfer them to temporary or permanent use and possession. This circumstance opens a legal opportunity of transferring HCS infrastructure to a private partner on the bases of concession, rent and other forms, stipulated by the PPP contract. At the same time, separation of state ownership of Republic Uzbekistan onto republican and administrative-territorial formations ones (municipal property), stipulated by the privatization law, has not taken place so far. As a result khokimiyats formally have not yet entered into property rights and are not

Attracting private sector into HCS sector of the country directly touches upon powers of two state bodies, State Committee on Demonopolization and agency "Uzkommunkhizmat"

PPP coordinating functions are expedient to be transferred to the Republican commission under the Cabinet of Ministers on tariffs and monitoring implementation of Program of reforms in HCS sector

Representatives of the state in PPP contracts in HCS sphere may be local authorities, mainly regional (oblast) and city khokimiyats

competent to sign contracts on using state property. Wide PPP introduction in HCS sector demands solution of this legal collision.

Thus, it is expedient to keep participation of central governmental bodies in appropriate forms in PPP contracts, concluded between private enterprises and municipal authorities in the suitable form. Representation of the government would be logical to entrust to the above mentioned Republican commission under the Cabinet of Ministers on tariffs and monitoring implementation of Program of reforms in HCS sector. In such case, the Commission on behalf of the government of the country could be a guarantor for the achieved agreements, compensating above mentioned increased risks of arrangements with municipal authorities²³. In case of necessity central authorities could also undertake the functions of an investor or a guarantor in paying external loans, and in addition, provide uninterrupted supply of local networks and facilities of HCS with resources, allocated to main networks. In cases international financial institutions provide investments into PPP projects, it is also meaningful to involve donor organizations as institutional consultants as well. PPP contracts will become multilateral in this case that makes their conclusion more labor-intensive, but more carefully prepared analysis, separation of functions and powers, mutual control and guarantee system considerably increase chances of success, especially at early stages of PPP introduction into the national economy.

²³ *International experience testifies that involvement of central authorities promoted success of privatization of enterprises of housing and public utilities at the local level (Annez, P. cit.)*

Conclusions and recommendations

PPP introduction in Uzbekistan is essential and urgent problem. Resources of private enterprises, their experience, stimulus and other advantages are able to ensure prompt promotion in modernization of social and economic infrastructure, not burdening thus budget with heavy operational expenses and substantial increase of public debt. PPP is capable of overcoming negative tendencies that are arising in some infrastructure sectors, including wear of fixed capital, significant losses of resources, non-transparency of tariff policy, weakness of management, technological and payment discipline, etc.

At the same time, PPP represents rather a delicate tool, applying which requires experience, solution of some legal and procedural issues, as well as deep professional analysis. In Uzbekistan at the present time there are no legal, institutional, financial and personnel preconditions for successful introduction of PPP model in full scales, adequate to the needs of development of industrial and social infrastructure. In these conditions it would be a mistake, under pressure of urgent needs of the economy and limitations of budgetary funds, to immediately start mass application of PPP in infrastructure sectors of the country. Under existing conditions, such step is fraught with unacceptable high risks and probable discredit of PPP idea in the government, the private sector and the society

In exchange, immediate start of vigorous steps on creating necessary conditions for PPP application in the scales adequate to requirements of the economy and accumulating simultaneously experience and demonstration of PPP model efficiency during realization of carefully selected and prepared pilot projects is proposed. The program of actions on solving the identified tasks should include, inter alia, creation of full legislative base of PPP, including necessary government regulations and subordinate legislation, development of properly adapted toolkit, necessary training, expert support, identification of responsible organizations, as well as mechanisms of coordinating and controlling the implementation. In the process of realization of such program, use of PPP in the economy of Uzbekistan will expand in breadth (increase in quantity and scales of projects) and in depth (transition to the most advanced PPP forms).

In opinion of the authors of this report, at the beginning necessary experience should be accumulated during implementation of rather small PPP projects in the sphere of housing and public utilities. Such approach allows combining advantages of experimentation with achievements of the progress in reforming cities and inhabited localities infrastructure. It is necessary to carefully select regions for carrying out pilots, paying special attention to readiness and interest of regional and city authorities in transferring HCS facilities to a contract basis, and to availability of qualified operators in private sector.

PPP introduction in Uzbekistan should be consistent with the program of economic reforms, carried out in the country, including privatization, improving antimonopoly policy, decentralization of the government, HCS reforms and increasing efficiency and addressness of social protection of

Private enterprises are able to ensure prompt promotion in modernization of social and economic infrastructure, not burdening the state budget

At intermediate stages preference can be given to more simple models, whose implementation is least problematic under arising circumstances

needy layers of the population. PPP allows performing maneuver with public finances and due to reduction of losses, covered by the budget, allocating resources for financially supporting low-income families in the form of target grants for paying public utilities, provided by the private provider.

Conclusions of this report and the recommendations made on its basis create an opportunity to create "Uzbek model" of PPP, whose distinctive features consist as follows.

Firstly, PPP introduction is synchronized with creation of necessary conditions. At intermediate stages the preference can be given to more simple palliative models, whose implementation is least problematic under arising circumstances.

Secondly, PPP can be multilateral, including besides company-operator, representatives of central and local authorities, international financial institutions (representing financing and/or consulting services) and the public.

Thirdly, dialogue of stakeholders on PPP issues is conducted with participation of representatives of executive and legislative branches of powers in the center and in the provinces, private sector (including foreign investors), civil society and donor organizations. Such dialogue minimizes social and political risks, ensuring openness and transparency of PPP, as well as public trust and support for proposed reforms.

Fourthly, in PPP models an important role is given to traditional institute of mahallas, which is represented as an inspector and a controller of quality of services, as well as a manager of target programs of social compensations, if any are included in PPP "package".

To participation in realization of the proposed programs it is necessary to involve international donor community and learn the opportunity of establishing a donor consortium, whose various participants could in coordination support investment, analytical, legislative, training and pilot components of the project.

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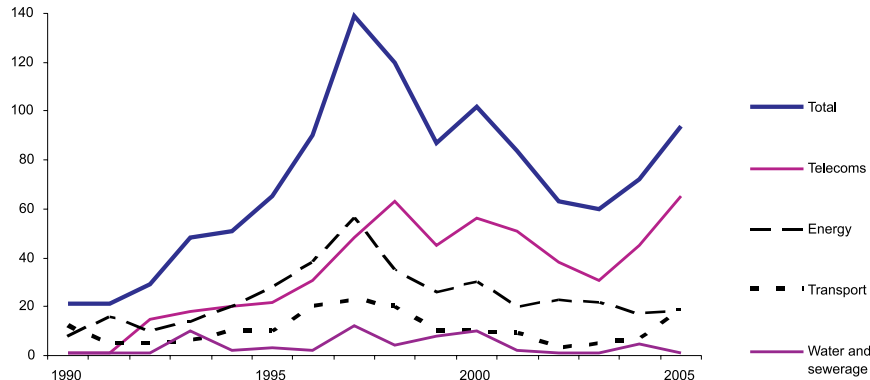
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Appendix 1. Experience of PPP in developing countries

PPP idea has been put forward and originally realized in industrially developed countries, but soon was picked up also in developing countries, which have experienced urgent need for expansion and modernization of infrastructure. For this purpose developing countries had no necessary budgetary funds and could not provide due efficiency of infrastructure sector within the framework of public sector²⁴. Uzbekistan can learn useful lessons from more than fifteen-year history of PPP implementation in developing countries, taking into account and creatively applying the best practices, as well as avoiding mistakes admitted by other states.

Big-scale growth of private investments into infrastructure of developing countries was observed in the 90-ies of the last century. For 1990-2001, over 2 500 large-scale PPP projects have been realized in these countries for a total sum of 755 bln USD²⁵. By the end of 90-ies, investments in PPP have appreciably decreased (Chart 2), though for the last years significant growth is again being observed in this sphere, approaching annual volumes of investments to the peak level, achieved ten years ago.

Chart 2. Dynamics of investments on PPP in developing countries, 1990 - 2005 (USD bln, 2005)



Source: PPIAF Note 16, 2007

Appreciable shifts also occur in PPP geography²⁶. Latin America was leader during the last decade in this area, share of which made up to half of investments in PPP in the developing world, and the second place was taken by East Asia countries (27%). Nowadays share of Latin America decreased to 31%, and transition economy countries of Central and Eastern Europe, and former USSR took the second place (27%). After the PPP pioneering states, this model is more widely introduced in developing countries, however

the leaders in general maintain their positions - 80% of total investments belongs to 20 developing countries, among which Brazil, Argentina, China, Malaysia, India, Philippines, Turkey are predominant. Growing interest to PPP is being observed in Central Asia and Caucasus.

²⁴ In the majority of less developed countries, including the most safe, in infrastructure sector, which is in the state ownership, there are problems, which Uzbekistan faces: chronic deficiency of means, inefficient subsidizing of tariffs, low return on resources, losses comparable to investment needs, lack of access to infrastructure on village, and among less provided layers of the population, risks of abusing and corruption. (See C. Harris, *Private Participation in Infrastructure in Developing Countries. Trends, Impacts, and Policy Lessons*. World Bank, 2003).

²⁵ Monitoring and support of PPP projects in developing countries are conducted with the Consultation center on private-public infrastructure projects (Public-Private Infrastructure Advisory Facility – PPIAF).

²⁶ Kerf M., and A. Izaguirre, *Revival of private participation in developing country infrastructure. A look at recent trends and their policy implications*. PPIAF Note 16, 2007.

In general, PPP idea has justified expectations²⁷. Private providers have managed to expand accessibility of infrastructure (in Latin America access to water and sewer system after PPP introduction has increased in a range from 5 up to 30 %, and electric systems - from 15 up to 40 %), achieve more effective utilization of resources, reduce losses and radically raise quality and reliability of services. Successfully realized PPP projects had favorable effect on public finance, having allowed lowering budgetary costs on infrastructure, including at the expense of refusal of subsidies, and, in addition, filling up the budget with taxes, paid by private providers. As for the tariffs on services, they grew as a rule in case liquidation of deep subsidies; if subsidies before privatization were not too large, then, providing economy of costs from 10 up to 30 %, PPP in some cases has allowed achieving reduction of prices, especially at a competitive choice of the private operator. Benefit from PPP realization has touched everything, including needy layers of the population.

At the same time, in implementing PPP model in developing countries, there also appeared serious obstacles, as a result private investments into infrastructure has decreased that substituted "boom" in the beginning of 90-ies. Revision of PPP contracts in 2-3 years after their conclusion accepted wide scales. Partly such instability was explained by excessive specification of the concluded agreements. Distrusting state regulation bodies and dispute settlement institutions in developing countries, investors aspired to stipulate all project details in contracts²⁸. Such agreements, designed for ten-year period and longer terms appeared to be too strict and cumbersome that was revealed already in the first years of their implementation. As a result, trust of investors to PPP idea was shaken. Nevertheless, projects already started with rare exception have not come to a stop. For the period of 1990-2001 only 48 out of almost 2 500 PPP projects or about 3 % of investments have been stopped or renationalized²⁹.

There are also examples when mass protests against increase of prices for infrastructure services became obstacles for PPP projects. A number of projects with foreign investments have been put under threat caused by falls in national currency exchange, that resulted in compensating by investors the incurred expenses; attempts in raising tariffs for maintaining

Box 8. PPP in combating poverty

There is a widespread opinion that infrastructure privatization may affect the status of low-income people. Meanwhile, there are numerous examples of obvious gain for low-income layers of population out of PPP projects implementation. So, in Chile for the last 10 years after privatization of electric and telephone systems the share of those, who had no access to electricity among the poorest 10% of households, has decreased from 30 up to 7%, and families without telephone - from 99 to 69%. Privatization of public utilities sector in Bolivia has led to increase of HCS accessibility for 20 % of the poorest families. After privatization of infrastructure in a number of cities of Columbia, from 60 up to 80% of new connections fell to the share of one third of the low-income population. Privatization of water-pipes in the capital of Senegal, Dakar, has led to increase of connections of the poorest households to the network. Alternative sources of clean water have cost 10-30 times more expensive than the value of water-pipes.

Based on materials of Estache, A., A. Gomez-Lobo, and D. Leipziger. Utility Privatization and the Needs of the Poor in Latin America: Have We Learned Enough To Get it Right? World Bank Policy Research Working Paper 2407. World Bank, 2000; C. Harris, Private Participation in Infrastructure in Developing Countries. Trends, Impacts, and Policy Lessons. World Bank, 2003).

²⁷ Harris, C.

²⁸ Harris, C., cit.

²⁹ Harris C., J. Hodges, and M. Schur. *Infrastructure Projects. A Review of Canceled Private Projects. Public Policy for the Private Sector Note 252. World Bank, 2003.*

project profitability in hard currency have faced all those social and political restrictions.

Learning lessons from the problems, which PPP projects have faced earlier, investors pay special attention to decrease of financial and other risks, and aspire to invest in projects that can yield more return with higher guarantee. Characteristics of risk protection have been discovered in structural changes in HCS sphere outlined in the last years. So, up to 60% of new PPP projects are being realized in telecommunication sector, where it is easier to establish market tariffs that completely compensate costs. The second strategy of risk minimization suggests that private operators prefer contracts, in which state, not consumers, pays for infrastructure services. Finally, popularity of PPP projects on the basis of rent increases, where investment component plays rather modest role or is absent at all³⁰.

More sober and conservative approach to PPP in developing countries, which substituted boom of the 90-ies, assumes intensive project appraisal and careful selection of private partner, contract types and financing methods. The problems, which have arisen during PPP project implementation in the developing world, are being overcome by encouraging competition among potential partners of government, granting target subsidies for low-income people, improving legal PPP regime and ensuring participation of society in discussing PPP projects and controlling their implementation. Of great importance are acquiring of experience in infrastructure privatization, both at government and private sector, and development of PPP strategies and tools, adapted to local conditions.

³⁰ *Cit.*

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