**A *Country Report and Profile***

Presented By:

Alfiya G. Mirzagalamova amirz@indiana.edu

Jason C. Holman jholman@indinanaedu

# Dmitri Maslitchenko dmitri@mailroom.com

**The concept of transition of the Republic of Uzbekistan to the market economy consists of five principles formulated by its President Islam Karimov:**

*1. Economy should have priority over politics. Economic reforms should not follow the lead of political processes.*

*2. The State is the main reformer. The representatives of legally elected authorities have to determine priorities and pursue balanced policy of no social shocks.*

*3. Along with economic reforms it is necessary to create a system of social protection of the Republic population especially of most vulnerable groups.*

*4. Superiority of Law and Constitution.*

*5. Stage by stage movement to the market economy. The transition to next stage only after the current stage targets have been met..*

***[[1]](#footnote-1)I. Political and Economic Background***

*Politics*

To understand the politics of Uzbekistan it is important to delve into its most recent history. The leader from 1959-1983 was Sharaf Rashidov, who ruled in a quasi-feudal fashion, much like the newly elected leader. Rashidov kept the USSR content through a combination of patronage, corruption, and repressive behavior. Once Mikhail Gorbachev was elected, Rashidov was the prime target for his drive to eliminate corruption. Although there was an upsurge of national identity among the Uzbeks and a feeling of victimization by the thousands of corrupt officials who where soon imprisoned, incredibly through more repression the elections for new leaders would go unopposed. The Republic of Uzbekistan declared its independence from the former Soviet Union on August 31, 1991. Although it was not recognized by the United States until December 25, 1992. Uzbekistan is a member of the United Nations and the Commonwealth of Independent States (CIS). Although Glasnost led to many open media discussions of the environment and ethnic issues, the elections held in 1990 were one-sided. The main opposition party was not allowed to stand, therefore leaving many communist candidates to be elected. Islam Karimov was first elected President in 1990 by the Supreme Soviet and later was reelected by a popular vote in 1991.

In 1995 Karimov held a national referendum which would extend his term into the year 2000. He had 99% of the electorates support. Karimov proclaims he is a supporter of Eastern Democracy. He stresses the importance of stability of eastern democracy over its western counterpart. The stability that Karimov suggests many believe is just a ploy for Karimov to use his dictatorship power to cling to the old world status. Karimov is one of the strongest supporters of continued cooperation among the Soviet Republics. Karimov supported the new Union Treaty in spring of 1991 and did not oppose the August 1991 coup in Moscow. Once the coup collapsed Uzbekistan declared independence. Karimov proclaims Uzbekistan is a multiparty system, yet the Erk (Freedom) Democratic Party, the Birlik (Unity) Peoples Movement (BPM) and the Islamic rebirth Party (IRP) have been banned.

[[2]](#footnote-2)Policy makers still remain suspicious of unregulated market mechanisms, although Karimov officially commits to a market-oriented reform. Prices were slowly liberalized and the new trade policies are less harmful toward exports. The import tariffs proposed in 1993 are preferential toward CIS communities and extra low tariffs toward Central Asian countries. It is going to be very difficult for him to explain why many of the neighboring Central Asian countries are becoming richer through liberalization and privatization while Uzbekistan continues to stay stable, but poorer then the other nations. Karimov stresses stability as a reason why Uzbekistan has not seen the high inflation rates characteristic to other CIS communities in transition.

[[3]](#footnote-3)2Karimov gives little mention to human rights. He believes that economic stability is necessary for socio-political stability. In his new book, Along the Road of Deepening Economic Reform, Karimov states, preparation, discussion and adoption of fundamental laws regulating and providing guarantees of human rights and freedoms, rights and freedoms of public organizations and freedom of conscience and religion have been something principally new in practical law making in this country. He also briefly mentions the womens rights and acknowledges their special role as women-mothers and presses for better child care provisions.

*Economy*

[[4]](#footnote-4)3At independence, the economy was dominated by cotton production. Uzbekistan hoped to benefit from this by selling the cotton on the international market, but the early 1990s were a time of depressed prices on world cotton markets. This created a dispute with Russia, which responded by seeking to purchase cotton on the world market. Uzbekistan lost a considerable amount of revenue due to this conflict with Russia. Eventually the two countries reached an agreement to barter Uzbek cotton for Russian petroleum products.

Other important agricultural products include grain, fruit, vegetables and natural silk from cocoons. The main problem of Uzbekistan is that about three-fifths of the country is desert or semi-arid desert: almost all cultivated land must be irrigated. This has resulted in the gradual drying up of the Aral Sea. By the 90's the available water supply had been exhausted to the point that there was no possibility of increasing the amount of land used for agricultural purposes. Grain production only covers a quarter of Uzbekistans total consumption. Therefore Uzbekistan relies heavily on imports from countries such as the United States to support their supply of grain. Uzbekistan complains that the USSR destroyed its grain-growing capacity in order to create the cotton monoculture. This has remained a very difficult obstacle for Uzbekistan and grain continues to be a major import.

[[5]](#footnote-5)4Uzbekistans other primary product exports include gas and minerals. Uzbekistan has few energy sources besides gas and untapped hydro power. Although a major oil field was recently discovered in the Fergana Valley in 1992. Uzbekistan is the largest importer of oil by all the CARs. The most accessible mineral export is gold, of which Uzbekistan was the USSRs second-largest producer. Joint ventures are bringing foreign technology to exploit Uzbekistan gold mines. Other mineral deposits include silver, lead, copper, zinc, and tungsten. Uzbekistans minerals have a low ore content, which suggests that it would not be as valuable on the world market.

[[6]](#footnote-6)5After World War II, Soviet resources were concentrated on rebuilding industrial enterprises in European areas. With less investment the growth rate of Uzbekistans industry declined. There was a long trend of falling industrial growth rates. Manufacturing industry in Uzbekistan was originally developed in close relation to its primary product base which of course was cotton and fruits and vegetables. Machinery for the cotton sector was a major output and food processing industries were also important. These are the only two substantial forms of manufacturing in Uzbekistan. This is somewhat disturbing considering the large amounts of resources that are available.

[[7]](#footnote-7)6The general problem was of lack technical ability and low standards of quality. The main approach to correct this problem was to encourage joint ventures. Many joint venture agreements were signed in 1992 and 1993, but there was little actual foreign investment. There was also a problem with Uzbekistans communication capabilities. In 1993 a joint venture was formed with the Turkish company, Teletas,to install seventy thousand lines.

Uzbekistan also would like to become the hub of Central Asia. When the Aeroflot fleet was shared out after the dismemberment of the USSR, Uzbekistan utilized its share of the planes productively to earn vast amounts of hard currency. It created an international network in the spring of 1993 with the goal of making Tashkent a hub for budget and travel between Europe and Asia. Flights would be established to Karachi, Delhi, Kuala, Lumpur, Bangkok, Beijing, Frankfort, and London. Israel provided training assistance to Uzbekistan Airways, and the airline raised its credibility by purchasing several Airbuses.

Economic reform in Uzbekistan has been very slow. Until 1994 Mr. Karimov opposed reform. Since then he has had to start some reforms to obtain IMF backing for his stabilization program and to get World Bank financing. Uzbekistan has been officially committed to economic reform since independence. The government has favored gradual change, and the pace has become increasingly slower as the years have went on. Labor market and enterprise reform have been limited, and indeed the ultimate reason behind Uzbekistans slow price liberalization has been to maintain the value of real wages and subsidies. The government has promised to keep wage and benefit increases ahead of future price rises.

[[8]](#footnote-8)7Privatization in Uzbekistan has progressed extremely slow. Karimov dominates economic policy; he has issued a raft of decrees that are on occasion contradictory, but aim to convince the multilateral institutions that reform is taking place. The first form of privatization took place in 1994. The process lacked transparency, was corrupt and resulted in Mr Karimovs allies owning the viable firms. Other obstacles are that land liberalization ahead of establishing a guaranteed water supply would be meaningless for the irrigation-based agricultural sector. In industry, not only has privatization of state enterprises been slow but there was also very little privatization created from many small-scale entrepreneurs.

***[[9]](#footnote-9)8II. Budgetary and Monetary Conditions***

Uzbekistans statistics are notoriously inaccurate and in small quantities. The government views economic data as a state secret, and circulation of the more informative data is restricted. All figures from Uzbekistan must be treated with a degree of caution as the government is trying show that the country is handling the post Soviet government better then its neighbors. The country is attempting to switch from the old communist national accounting method using National material product (NMP), which excludes most services and depreciation, to the standard System of National Accounts (SNA).

What is clear is that Uzbekistans economy has been in decline since the collapse of the Soviet Union. After a 3.7 % fall in 1991 National material product declined by 14.4% in 1992. GDP in those two years has dropped by 0.5% and 11.1%. In 1993 the fall in GDP was 2.4 % according to IMF estimates, with national material product down by 3.5% mainly due to continued government subsidies. The IMP initially estimated that, due to tighter policies, GDP contracted by 10.1% in 1994. However, the Uzbek authorities claim that despite a severe credit crunch and a confiscatory change of currency, GDP shrank by only 2.6%, the figure that the IMF now accepts.

**[[10]](#footnote-10)9Net Material Product**

**1989 1990 1991 1992 1993**

Total(Rb m)

At current prices 21,588 23,402 49,636 386,071 3,686,800

Real Change ( %) 3.1 11.3 -3.7 -14.4 -3.5

Per Head (Rb)

At current prices 1,091 1,157 2,407 18,287 170,622

Real change (%) 0.8 8.9 -5.5 -16.4 -5.7

\*Derived from the World Bank mid-year population estimates.

*Budget Deficit*

Uzbekistans government budget has suffered from large deficits since the collapse of the Soviet Union. The IMF has put the 1993 fiscal deficit at 12% of GDP, while the governments figure released through the World Bank was 2.5%. The main reason for the deficits is lost revenue subsidies from the Soviet Union. Uzbekistan had one of the largest subsidy share of revenue compared to many of the other (CIS) countries. During the 1980s the proportion of revenue actually increased form 20.8% in 1987 to 43.2% in 1990. Soviet grants which has once accounted for 7% of GDP in 1987 rose to 19.5% of GDP by 1991.

***1[[11]](#footnote-11)0III. Expenditure Policies and Assignments***

Although Uzbekistan is now engaged in the necessary fiscal and revenue-raising reforms demanded by multilateral institutions, very little revenue is received from taxes. Corruption, weak institutions, economic recession and poor tax compliance have hindered revenue collection severely. The government claims that actual revenue to GDP has risen in recent years from 26.4% to 41%in 1993. Given continued state control of the economy, tax compliance among state enterprises would tend to be greater than in countries with a growing private sector, although figures may be overstated. On the expenditure side, increased outlays on defense and security, welfare payments, and subsidies to industry have been the most important developments since 1991. Increased expenditure was financed through huge expansion of domestic credit, montised by courtesy of the Russian Central Bank until 1993 when this tactical trend was eliminated once it was found to be unsustainable. The government then went to the IMF. The figures on the preceding page show this information

**1[[12]](#footnote-12)1State Budget** (Rb bn)

**1988 1989 1990 1991 1992 1993**

**Revenue 9.7 11.8 15.1 30.2 139.8 1,814.5**

of which:

Turnover Tax 3.3 3.8 4.0 6.1 3.3 n/a

VAT 0.0 0.0 0.0 0.0 38.4 477.1

Excises 0.0 0.0 0.0 0.0 9.5 44.9

Company income Tax 1.7 1.3 1.5 3.8 23.9 382.9

Personal Income tax 1.1 1.5 1.3 1.8 11.4 145.3

Grants from Union Budget 2.3 3.6 6.4 11.4 0.0 0.0

**Expenditure 10.1 11.0 14.9 32.4 193.9 1,923.4**

of which:

Economy 4.6 5.0 8.1 5.9 20.9 392.7

Defense and Public Order n/a n/a n/a 0.2 11.7 n/a

Social and Cultural 5.2 5.5 6.2 9.2 70.8 n/a

**Balance -0.4 -0.8 -0.2 -2.4 -54.1 -108.9**

% of GDP -1.4 -1.0 -1.2 -3.6 -12.1 -2.5

\* 1993 data are from the World Bank. They exclude non-budgetary accounts.

Sources: IMF, Economic Review: Uzbekistan; World Bank, Statistical Handbook: States of the Former USSR, 1994

**IV. *Tax Structure and Administration1[[13]](#footnote-13)2***

*Corporate Taxation*

*Profit Tax*

Uzbek entities ‑ taxed on their profits from all sources worldwide.

Foreign Entities ‑ taxed on profits from the entrepreneurial activities of their establishments in Uzbekistan.

Foreign entities receiving income from Uzbek sources other than through Permanent Establishments are subject to withholding tax on the gross amounts of the income without reduction for any expenses.

The general profit tax rate is 37%. This rate is reduced to 25% for entities with foreign investment of 30% or greater.

A tax return and activity report should be filed with the tax authorities by February 15. An audit opinion or an agreement for audit services should also be submitted by the appropriate deadline.

*Social charges*

Employers must make social insurance and employment fund contributions, as well as contributions to a trade union if applicable. The total amount payable, which is deductible for profits tax purposes, is 38% to 40% of each employee's gross salary, made up as follows:

Fund Rate

Social insurance 36%

employment 2%

Trade union (if applicable) 2%

**Individual Taxation**

A resident is defined as an individual who is physically present in Uzbekistan for 183 days or more in a calendar year. Residents are taxed on their worldwide income, while non‑residents are taxed only on their Uzbek sources income.

Taxable income for 1995 and 1996 is taxed at the following rates:

Taxable income (less annual non‑taxable minimum)

Up to 2 annual minimum wage 15%

2 to 5 annual minimum wage 25%

5 to 10 annual minimum wage 35%

Over 10 times annual minimum wage 40%

*Social security contributions*

1% of the gross salary to the Social Insurance Fund.

*Deductions and Exemptions*

All income is taxable in Uzbekistan unless it is specifically exempt. The list of specifically exempt income includes alimony, gift, severance and pension income.

*Capital gains*

Capital gains in the disposal of shares are exempt for taxation. Capital losses are not deductible.

**Other taxes and fees**

*Value Added Tax ("VAT")*

VAT was introduced in Uzbekistan on February 15, 1991. The current rate is 17%.

VAT is levied on turnover from the supply of all goods and services (including barter transactions), unless they are specifically exempt. Imports are exempt. Though, VAT is levied on the Uzbek seller's markup of imported goods. Exported goods and services are specifically exempt from VAT. Exported goods are defined as having cleared customs. Exported services are defined as being supplied to a "foreign person". For the determination of whether services are exported, neither the place of providing the services not the place where the benefits are used are considered, only that the purchaser is a foreign person (entity). It could be argued that Uzbek VAT legislation allows representative offices of foreign legal entities (which are non‑resident), paying for services in foreign currency through authorized Uzbek banks to also be classified as "foreign person".

Effective January 1 1996, the exemption on exported goods and services is only applicable if the importing country does not impose VAT on exports to Uzbekistan. This restriction is especially important with respect to some members of the CIS as VAT is charged on exports to member states.

The VAT legislation of Uzbekistan allows a credit for VAT incurred, when such goods or services are "charged to the cost of production".

*Excise taxes*

Excise taxes are payable by domestic producers and importers of excised goods. The list of excised goods is determined by the Cabinet of Ministers and includes tobacco, jewelry, gasoline, liquor and other goods. Exported goods are exempt. Tax rate vary from 5% to 75%. The amount of excise tax is determined by the taxpayer, based on the volume of goods sold and established tax rates on such goods.

*Property tax*

The 2% rate tax is based on the historical cost of fixed assets used in production. Legislation specifically includes buildings, machinery, equipment and vehicles. Accumulated depreciation does not reduce the taxable base. The following assets are specifically excluded from he taxable base for property tax purposes:

‑ housing, social and cultural facilities;

‑ environmental protection assets;

‑ agricultural equipment;

‑ transportation networks (including roads and pipeline);

‑ communication and power transmission lines (including

‑ maintenance structures);

‑ communication satellites; and

‑ automobiles.

Profit tax is deductible for profits tax purposes.

*Subsurface use tax*

Taxes on the mining, and oil and gas industries. Subsurface uses tax is deductible for profits tax purposes.

*Land tax*

A fee on land owners is imposed at a fixed rate per hectare.

*Vehicle fees*

A minimal fee on motor vehicle owners is imposed at a fixed rate per horsepower. Individuals must also pay this fee, though only at half the corporate rate. Only vehicles registered for road use are subject to this tax (e.g. not those used for production which would be subject to property tax).

In addition there is a fee on the purchase of vehicles, defined as a percentage of the purchase price of the vehicle excluding VAT or duties, 5% for cars and 10% for trucks, buses, trailers and semi‑trailers.

*Road use tax*

All entities are subject to road use tax which is applied to gross sales, excluding VAT and excises. For transportation companies a rate of 2% and for all other companies a rate of 1% applies. The tax is deductible for profits tax purposes.

*Water use fee*

There is a nominal charge for the use of water resources at a fixed rate per cubic meter of water consumed. For most companies, the rate is 0.09 soum per cubic meter. The fee is deductible for profits tax purposes within statutory water use limits.

*Local taxes*

There are numerous different taxes, though most are insignificant except for the administrative burden. Example of more significant local taxes include:

1. Tax on advertising costs. In Tashkent the rate is 5% of total expense.
2. Fee for cleaning the local territory, payable by entities and individuals conducting entrepreneurial activities. In Tashkent the rate is 0.5% of gross receipts.
3. Fee for the right to trade, payable by entities and individuals conducting retail trade. In Tashkent the rate is two minimum monthly wages per month.

**Revenue collection problems**1[[14]](#footnote-14)3

1. High tax rates on modest tax bases reduced not only by economic contraction but also by various exemptions.
2. Weak tax administration compounded by corruption.
3. The effective tax burden on those who comply with the tax code is increased since large numbers of taxpayers successfully evade taxes ‑ equity and efficiency problems.
4. Corruption and abuse of authority by poorly paid tax administrators are serious problems.
5. Another major cause of poor tax revenues is dollarization and the continued use of barter, payment in kind.

**The Investment Policy of Uzbekistan**

**Priority areas**1[[15]](#footnote-15)4

1. Gold‑mining and non‑ferrous (Uzbekistan ranks 4th in the world in terms of gold reserves).

2. Power engineering.

3. Processing of cotton (40% of the gross agricultural production is cotton, however only 10% of produced raw cotton is processes in Uzbekistan, the rest is exported as raw material. The existing textile industry is obsolete).

4. Processing of vegetables and fruits (The production makes up 60% of the total fruit and vegetables production of the former USSR; agricultural infrastructure development needed ‑ processing, transportation, storage facilities, packing).

5. Transport and communication.

6. Tourism (4000 architectural monuments, many of them are under the protection of UNESCO;. world famous cities Samarkand, Bukhara, Khiva; tourism infrastructure is a potential area of investment).

7. Financial and monetary. Create a network of banks and insurance institution.

8. Environmental Protection (degradation of the ecosystem of the Aral Sea, irrational use of water resources).

**Guarantees and privileges granted to foreign investors1[[16]](#footnote-16)5**

1. If subsequent legislation of the republic of Uzbekistan impairs investment conditions, then the legislation which was valid at the time of making the investment shall apply for a period of time not exceeding 10 years.

2. Companies profit tax shall be reduced by:

1. 20%, for an export share of 5-10% of the total production;
2. 30%, for an export share of 10-20% of the total production;
3. 40%, for an export share of 20 to 30% of the total production;
4. 50%, for an export share of 30% or above of the total production.

The purpose here is encourage export oriented manufactures and producers. "The great success stories of economic development in the last decade have been the newly industrialized countries of East Asia, especially the so-called "Four Tigers" (South Korea, Taiwan, Hong Kong, Singapore) and, increasingly, Thailand and China. In these countries, rapid growth of manufactured exports has produced dramatic increase in income. NICs have undertaken a host of interventionist measures to create incentives for export-oriented manufacturing firms, often in particular targeted industries at particular stage of development."1[[17]](#footnote-17)6

The heritage of the old socialist system - exports of primary commodities and raw materials (cotton and cotton products in case of Uzbekistan)- has to be gradually replaced by exports of manufactured goods. "It makes a difference not only because of the recurring problem of gluts resulting in falling process in commodity markets but also because of the greater potential for raising technological capabilities".1[[18]](#footnote-18)7

3. Receipts in hard currency earned by a company due to increase in export production (product, jobs, services) shall be exempt from profit tax.

4. A 25% profit tax shall apply to the profits of Joint Ventures with a foreign capital of above 30%.

5. Joint Ventures with a foreign capital investing into projects in priority industries included in the Investment Program of Uzbekistan shall be exempt form taxation for the first five years of operations.

6. Joint Ventures which specialize in agricultural products and the processing thereof (except for wines and strong alcoholic beverages), consumer products, and construction materials, medical equipment, machines and equipment for agriculture, light and food industries, recycling of waste materials are exempt from taxation for two years from the date of registration.

7. The profit tax base is decrease by 30% of the expenses for environmental protection.

8. Dividend on governmental bonds are exempt from taxation;

9. Joint Ventures in which the foreign investors share accounts for a least 50% shall be exempt of profit tax provided that whole tax amount is re-invested into the development and expansion of production of consumer goods.

10. Exporting companies are exempt of VAT for materials resources used in the production of exported goods (jobs, services)

11. Beginning July 1994 through December 31, 1997 all commercial banks including those with foreign capital, as well as the branches and subsidiaries of foreign banks operating in Uzbekistan are exempt from profits, property, land and vehicle taxes.

**V*. Intergovernmental Financial Relationship***

The Statute of the Republic of Uzbekistan "About Taxes on Enterprises and Entities" establishes revenue sources of the State budget of the Republic of Uzbekistan, State budget of the Republic of Karakalpakstan1[[19]](#footnote-19)8 and local budgets for the following expenditures:

1. Social Security Payments;
2. Businesses regulation;
3. International payments;
4. Stabilization of the foreign currency circulation;
5. Stimulation of extraction of mineral resources; and
6. Environmental protection.

Uzbekistan has a unified statewide tax policy for all layers of government. Local governments are entitled to levy taxes within the format of the state wide tax policy.

Tax revenue is transferred to the budget of Uzbekistan, budgets of the Republic of Karakalpakstan, regions, Tashkent city (the capital) and local budgets according to the norms established annually during the process of budget approval for the respective fiscal year.

Local governments impose local taxes in their jurisdictions in full accordance with the Uzbek laws and based on the general tax policy of Uzbekistan.

The authorities levying a specific type of tax establish:

1. the taxpayer;
2. the tax base;
3. the tax rate;
4. the procedure of calculation and payment;
5. exemptions and privileges;
6. life time of the tax.

**IV*. Social Insurance***

In most transition countries proposals to reform social security have included the establishment of minimum retirement benefits, compulsory employment‑related benefits, unification of treatment across occupations, increases in the retirement age, and steps to reduce access to benefits by younger working pensioners. It is important that pension and social security reforms help to insure adequate levels of protection without overburdening contributors to the system. This will require better collection of private sector contributions and improved targeting of benefits, including tying future eligibility of pension benefits to past contributions.

As a part of the transformation process, most transition countries have introduced unemployment insurance schemes. In Uzbekistan unemployment benefits were roughly 80 percent of the average wage in 1993, although the generosity of the scheme was matched by onerous administrative procedures, which ensured that few individuals qualified.1[[20]](#footnote-20)9

***Uzbekistan:***

**A *Country Report and Profile***

Presented By:

Alfiya G. Mirzagalamova amirz@indiana.edu

Jason C. Holman jholman@indinanaedu

Dmitri Maslitchenko dmitri@mailroom.com

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