

UZBEKISTAN'S PRESIDENTIAL ELECTIONS

Opportunities and risks for foreign investors

November 2021

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| Issues & Sectors | Foreign investment, Reforms, Privatization |
| Stakeholders | Shavkat Mirziyoyev, Russia, EAEU, China, Turkey |

On 24 October, Uzbekistan held Presidential elections won by the incumbent Shavkat Mirziyoyev with 80.12% of the vote. Five candidates had run in the elections, with Mirziyoyev's closest competitor, Maksuda Varisova of the People's Democratic Party of Uzbekistan, gaining less than 7% of the vote. Mirziyoyev was inaugurated on 6 November.

Shavkat Mirziyoyev's victory was predictable and there was little suspense in the campaign itself, which began only a month before election day and lacked substance. Even though OSCE observers noted that voting was peaceful and voter turnout high (80.5% against a mandatory minimum of 33%), they also pointed out drawbacks such as a lack of competition and no criticism of the incumbent President during the campaign.

Additionally, several candidates were barred from taking part in the elections¹ as those parties on whose tickets they ran were refused state registration. The US generally supported the OSCE's stance, while the missions of the Shanghai Cooperation Organization (SCO) and observers of the Commonwealth of Independent States (CIS) recognized the results of the election.

This memo will cover:

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¹ Famous Uzbekistani singer Jahongir Otajonov wanted to run on the Erk ("The Will") party ticket but the Ministry of Justice refused to register the party. Similarly, the "Khakikat va Tarakiet" ("Truth and Progress") and "Halk Manfaatlari" ("People's Interest") parties were denied registration.

PRINCIPAL IMPLICATIONS OF MR. MIRZIYOYEV'S ELECTION

Overall, the Presidential elections will not change Uzbekistan's political picture. The President is the decision-making centre; he relies on a Parliament that is loyal to him and there is only notional opposition. However, the outcome of the elections is likely to spark reshuffles both in the government and among heads of regions (khokims).

At the same time, Uzbekistan's Constitution does not mandate that the government resign before a newly-elected President, only before a newly-elected parliament, and reshuffles themselves are largely triggered by other factors (workforce shortages, inter-clan conflict in various economic segments, etc.).

By law, the President may be elected for no more than two five-year terms, so President Mirziyoyev's team is expected to resolve the issue of power transit (retention) before 2026, or seek ways to extend Mirziyoyev's tenure (either by changing the Constitution or by offering a special interpretation of it; following the election, the President already announced preparations for a constitutional reform).

These processes require voters to remain highly loyal to the President in consideration of society's greater demands on the authorities, due to the liberalization and democratization that have taken place over the last five years. Mirziyoyev's second-term win testifies that the reforms he launched are seen in a positive light and are expected to be continued.

The reforms (expectations) focus around the following areas:

- Further economic liberalization:
 - Increasing openness of Uzbekistan's economy (reduced import duties, deregulation of exports).
 - A privatization programme and reduced state involvement in the economy.
 - Target market expansion by means of international infrastructure projects (participating in the "One Belt, One Road" project, building the North-South transportation corridor, etc.) and participation in integration alliances (possible accession to the Eurasian Economic Union / EAEU).
 - Foreign debt increasing to nearly 57% of GDP (as of September 2021) will additionally stimulate the economy and maintain growth of at least 5% a year.
- Continuing democratization:
 - Greater role and freedom of the media.
 - Greater informational openness (unblocking of several social networks).

POLITICAL AND ECONOMIC CONTEXT

Mr. Mirziyoyev came to power in 2016 following the death of the First President of Uzbekistan Islam Karimov, who had been Uzbekistan's leader for over 27 years. Mirziyoyev had been Prime Minister under Karimov for a total of 13 years and had launched several liberal reforms perceived positively by Uzbek society and the West. In 2016, there was a complete change of government (only the

Minister of Foreign Affairs retained his office): Abdulla Aripov became Prime Minister and remains in office, whereas the government itself has undergone several reshuffles.

Economically, Mirziyoyev eased protectionist policies: he allowed currency exchange and streamlined exchange rates, implemented a tax reform (in particular, reduced VAT from 20% to 15% and maximum income tax from 22.5% to 12%), eliminated several administrative barriers to foreign investment (including a visa-free regime for citizens of 86 countries) and allowed profit repatriation. At the end of Mirziyoyev's first term, large-scale privatization of state assets was announced.

In the social area, Mirziyoyev somewhat eased the state's control over the media. Careful and limited criticism of the authorities was allowed, and the authorities became generally more open to the media. Political prisoners were released and the Jaslyk prison infamous for inmate torture was closed.

In foreign policy, tensions with Uzbekistan's closest neighbors were eased: talks were resumed with Kyrgyzstan and Tajikistan on border demarcation and on the use of cross-border rivers (in 2021, agreements were achieved on joint building of hydroelectric power stations in border districts).

Despite the limited nature of the reforms, they appear significant when compared to Islam Karimov's rule. In 2019, *The Economist* named Uzbekistan country of the year. In 2020, Uzbekistan resumed talks on acceding to the WTO; in 2021, the new GSP+ agreement was signed with the EU on duty-free imports of a large range of Uzbekistan's commodities.

The following remain the principal risks to implementation of reforms:

Domestic political factors

- Resistance by local elites (clans):
 - Recently, the clans' influence in Uzbekistan has been on the rise again; this is particularly obvious at regional levels (Uzbekistan has a complicated ethnic and religious structure of society). Several officials from the "Karimov era" have regained or consolidated their standing in power.²
 - The clan nature of Uzbek society hinders the implementation of reforms at the lower levels, where they meet resistance. The interests of Uzbek elites in controlling big monopolies create steady resistance to easing protectionism (reducing import duties, privatization), which curbs foreign investment.
- Managerial personnel shortages:
 - Personnel changes mostly affected the top echelons of the authorities and had less of an impact on local authorities owing to acute personnel shortages.
 - Uzbekistan relies on local graduates of foreign universities and those who have worked for foreign corporations and non-profit organizations. Mirziyoyev also appoints foreign citizens to top offices (up to deputy minister level).
- The country is closed off in information terms:

² A stark example is the 2020 appointment of Shukhrat Ganiyev, who formerly held the office of khokim (governor) of the Ferghana Region for eight years, to the office of Deputy Prime Minister for development of agriculture and food.

- Despite a certain easing of media restrictions, criticism of the authorities is limited (anti-corruption investigations into top-ranking government officials and criticism of the President and his closest entourage are virtually prohibited).
- Restricted functioning of social networks. In July 2021, as per the law “On Personal Data” mandating that social networks store personal information of Uzbekistani users in the country itself, Twitter, TikTok, VKontakte and Skype were all blocked. On 3 November 2021, Uzkomnadzor (Uzbekistan’s State Supervisory Inspectorate in the field of informatization and telecommunication) blocked Facebook, Odnoklassniki, YouTube and Telegram. Following mass protests, President Mirziyoyev cancelled Uzkomnadzor’s decision, fired its head Golibsher Ziyayev, Minister for Development of IT and Communications Shukhrat Sadykov and Olimjon Umarov, Head of the government department for developing IT-technologies, telecommunications and innovations.

Overall, Mr. Mirziyoyev’s first term demonstrated that Uzbekistan had chosen to follow the “Kazakhstan scenario”, combining trends toward democratization and liberalization with rigid control of the government system.

Foreign political factors

Currently, Uzbekistan is balancing between the interests of its biggest foreign investors: Russia, China and Turkey, and also the US, which has political and economic interests in Central Asia.

The “Taliban factor” remains the principal foreign risk for Uzbekistan. Owing to the change of power in Afghanistan and withdrawal of US troops earlier this year, the risk of refugees and militants pouring into Uzbekistan remains. This could become an additional factor in the Islamization of Uzbekistan’s southern regions and the Ferghana Region³, and in sparking new ethnic conflicts.

Social, religious and ethnic contradictions might escalate if economic growth slackens and the reforms fail. The “labor migrant factor” could play an important role in these processes. Owing to COVID-19 restrictions, the number of labor migrants working in neighboring states (mostly in Russia) has fallen sharply and the migrants were forced to return to Uzbekistan. Wire transfers made by labor migrants from abroad account for 12–15% of the GDP, and the return of millions of them from abroad is exacerbating the unemployment problem.

FOREIGN INVESTMENT AND PRIVATIZATION

Large-scale privatization should become the central element of the economic reforms in Shavkat Mirziyoyev’s second term, as well as a key tool for attracting foreign investment. So far, investment has consisted joint ventures set up by Uzbekistan and investors from Russia, China and Turkey.

These countries dominate the Uzbek market for historical and geographical reasons. Uzbekistan was a republic of the former USSR (Russia is still its biggest foreign trade partner), while geographical proximity to China and cultural proximity to Turkey (Turkic languages) trigger their interest in investing in Uzbekistan.

³ The 2005 unrest in Andijan (Ferghana Region) remains one of the most “explosive” subjects in Uzbek society. Dozens of people were killed during the suppression of an armed rebellion (sparked by the authorities investigating local businesspersons accused of religious extremism).

Official estimates put the state's share in the economy at about 50%. In October 2020, President Mirziyoyev signed an order on preparing 620 undertakings for sale and, in February 2021, he instructed the Agency for Management of State Assets to expedite privatization of state property.

In September 2021, the sale of the state's share in Coca-Cola Bottlers, Uzbekistan's biggest soft drink manufacturer, to Turkey's holding company Anadolu Group was completed. This sale was an example of successful privatization and is intended to attract foreign investors' attention to Uzbekistan.

Uzbekistan's economy is based on agriculture (horticultural goods, cotton), mining of precious, non-ferrous, and rare metals (gold, silver, copper, uranium), and natural gas production. Today, most items on the privatization list are small enterprises or minority shares in big companies. At the same time, the state still retains control over the biggest backbone companies (national and regional monopolies).

The authorities' immediate plans involve:

- Preparing for the sale of 10% of Navoiy Mining and Smelting Works, Uzbekistan's biggest manufacturer of gold and uranium (in 2020, gold accounted for nearly half of Uzbekistan's exports, and export of gold is regulated by the state).
- IPO of the Olmaliq Mining and Smelting Works (produces 90% of the silver and 20% of the gold). This is Uzbekistan's biggest enterprise by profit.
- Agreement has been reached on Hungary's OTP bank purchasing controlling stock in Uzbekistan's state-owned Ipoteka bank. There are plans to sell shares in other banks, too (overall, plans involve increasing the share of private capital in banks from 15% to 60%).

Large-scale privatization has triggered resistance by the Uzbek elite, however, meaning the reforms could be greatly protracted. This resistance is partially mitigated by the funds received from privatization being mostly distributed to the regions (70–80% of sales proceeds should go to regional and municipal treasuries).

RELATIONS WITH RUSSIA AND THE EAEU

Under Mirziyoyev, Tashkent-Moscow relations have improved significantly. Russia will be the first country the President visits after being re-elected (planned for the second half of November). Earlier this year, Russia granted amnesty to 158,000 Uzbek citizens who had been barred from entering Russia (the topic of labour migrants is highly sensitive for Uzbekistan). Uzbek authorities are also in talks on the subject of Uzbek companies and entrepreneurs renting 1 million of hectares of land in Russia to produce food in demand in Uzbekistan.

Uzbekistan's potential membership of the EAEU, to which it obtained observer status in 2020, could give new impetus to the rapprochement with Russia. A poll conducted by the Centre for Economic Research and Reform at the Executive Office of the President of Uzbekistan showed that 74% of Uzbekistan's citizens support full accession to the EAEU (which could greatly simplify the labour migrant situation and make Russian imports more accessible).

CONCLUSION

Uzbekistan remains both an attractive and a risky state for foreign investment. The economic liberalization impetus and large-scale privatization plans provide a good opportunity for entering Uzbekistan's market or for expanding a presence there. At the same time, in-depth reforms could be obstructed by resistance put up by local elites and by external factors capable of destabilizing the country (the Afghanistan factor and escalating religious and ethnic contradictions).

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