

THE ROAD TO INTERNATIONAL BANKING: UZBEKISTAN'S EFFORTS AND ACHIEVEMENTS

Proposed By

Otajanova Shakhnoza

Supervisor

Denny Andriana, SE., MBA., Ak., CMA., CA., Ph.D

1.1 Research Background

Uzbekistan is a landlocked country in Central Asia that has undergone significant economic and political reforms since the early 1990s. One of the critical areas of reform has been the banking sector, which has seen significant growth in recent years. Despite this progress, the country's banking system remains largely isolated from the global financial system. As a result, Uzbekistan's banks have limited access to international capital markets, which limits their ability to finance large-scale projects and expand their operations.

To address this issue, the Uzbek government has been working to integrate the country's commercial banks into the world banking system. This effort has involved a range of measures, including regulatory reforms, changes to banking laws, and the introduction of new financial instruments. The goal is to improve the efficiency and competitiveness of Uzbekistan's banking sector, enhance financial stability, and attract foreign investment.

One of the key steps taken by the Uzbek government was the adoption of the Law on Banks and Banking Activities in 1996, which established the legal framework for the banking sector. The law created the Central Bank of Uzbekistan, which is responsible for regulating and supervising the country's banking system. The government has also implemented a range of other reforms, including the introduction of new financial instruments such as bonds, the establishment of credit bureaus, and the implementation of international accounting standards.

Despite these efforts, however, Uzbekistan's banking sector still faces significant challenges in integrating into the global financial system. The country's banking sector remains relatively underdeveloped compared to its regional neighbors, and the lack of transparency and weak corporate governance in some banks have limited their ability to attract foreign investment.

"Foreign Banks: Trends, Impact and Financial Stability" by Claessens and van Horen (2014): Claessens and van Horen analyze the trends, impact, and implications of foreign banks in the global banking system. The authors examine how the presence of foreign banks in a country's banking sector affects financial stability, efficiency, competition, and economic growth. They delve into various aspects of foreign bank

operations, including their lending behavior, risk-taking, and the transmission of shocks across borders.

"Commercial Bank Management" by Peter S. Rose is a comprehensive textbook that provides an in-depth overview of various aspects of commercial banking and bank management. The book is designed to give readers a solid understanding of the principles, practices, and challenges involved in effectively managing a commercial bank.

"Banking Globalization, Transmission, and Monetary Policy Autonomy" is a chapter written by Linda Goldberg, which is part of the book "Globalization in an Age of Crisis: Multilateral Economic Cooperation in the Twenty-First Century." The chapter focuses on the challenges and implications of banking globalization for the ability of individual countries to conduct independent monetary policy and manage their economies.

Integrating commercial banks of Uzbekistan into the world banking system can be a complex process that involves several strategies and measures. Here are some ways this integration can be achieved:

1. Adopting International Standards: Commercial banks in Uzbekistan should align their practices with international banking standards and regulations, such as the Basel Accords, to ensure compatibility with global banking norms. This step is crucial for gaining the confidence of foreign investors and institutions.

2. Enhancing Technology Infrastructure: Upgrading technological capabilities is essential for seamless integration into the world banking system. Implementing modern banking software, security measures, and electronic payment systems will facilitate cross-border transactions and connectivity.

3. Foreign Correspondent Relationships: Building strong relationships with foreign correspondent banks is vital for international transactions and access to global financial networks. It enables Uzbekistani banks to provide services to their customers for international trade and remittances.

4. Regulatory Reforms: Uzbekistan should continue reforming its banking regulations to align with international best practices. This includes improving transparency, risk management, and anti-money laundering measures.

5. Capital Adequacy and Risk Management: Strengthening capital adequacy and risk management frameworks will enhance the stability and credibility of Uzbekistani banks in the eyes of global investors.

6. Financial Inclusion Initiatives: Expanding financial inclusion efforts can improve the accessibility of banking services to the unbanked population. This not

only supports the country's economic growth but also increases the potential customer base for Uzbekistan's banks.

7. Capacity Building and Training: Developing the skills and knowledge of bank employees is essential for adapting to global banking practices and technologies.

Differences in Previous Research and This Research:

There are a few potential differences that can be considered:

1. **Timeliness:** The information provided here is up-to-date only until September 2021. If there have been significant developments or changes in the banking sector in Uzbekistan or globally after that date, this research may lack the most recent insights.

2. **In-depth Analysis:** Previous research may have conducted in-depth studies specific to Uzbekistan's banking system, whereas the information provided here is more of a general guideline for integrating into the world banking system.

3. **Data Sources:** The information presented here is based on my training data up to September 2021 and general knowledge. Previous research might have relied on more extensive and specialized data sources, interviews, and empirical studies.

4. **Scope:** The scope of previous research might have been broader or more focused on particular aspects of integrating commercial banks into the world banking system, which may not be fully covered here.

In any case, it is always recommended to supplement research with multiple sources and conduct specific studies tailored to the unique circumstances of Uzbekistan's banking sector for a comprehensive understanding.

To address these challenges, the Uzbek government has focused on improving the regulatory environment, enhancing the transparency and accountability of banks, and encouraging foreign investment. In recent years, the government has established its road map to reform banking system of the government to implement a range of measures to strengthen the banking sector, including the adoption of new laws and regulations, the introduction of international accounting standards, and the establishment of a credit registry meanwhile to modernize local banking system with international banking experience (Decree of the President of the Republic of Uzbekistan, 2016).

During the consistent reform of the financial sector, a number of measures were implemented, and as a result, the necessary legal conditions were created for conducting advanced banking business and strengthening the competitive environment in this sector.

In particular, the Laws of the Republic of Uzbekistan "On the Central Bank of the Republic of Uzbekistan", "On Banks and Banking Activities", which conform to international standards and create an attractive legal environment for foreign

investments in the financial sector. Updated laws "On regulation of currency" and "On payments and payment systems" were adopted (Decree of the President of the Republic of Uzbekistan, 2016).

At the same time, the analysis of the current situation in the banking sector reveals a number of systemic problems that prevent the development of the banking sector in accordance with economic reforms and the needs of society, such as the high level of state intervention in the banking sector, the insufficient quality of management and risk management in state-owned banks, the low level of financial intermediation in the economy indicating its existence.

It is required to take prompt measures to introduce information technologies and financial technologies to the banking system on the basis of modern service solutions, to ensure adequate information security, and also to reduce the influence of the human factor in the provision of financial services.

PF-5953 dated March 2, 2020 of the President of the Republic of Uzbekistan approved the Strategy of Actions on the five priority areas of development of the Republic of Uzbekistan in 2017-2021 as "Development of Science, Enlightenment and Digital Economy" based on the tasks defined in the State program on implementation, as well as to stimulate the development of the private sector, to increase the investment attractiveness of banks, the popularity and quality of banking services, a program of radical transformation of the banking sector was developed (Decree of the court of Ministers of the Republic of Uzbekistan, 2023).

The recent economic and financial reforms to enhance local banking system of the Uzbekistan initiated to pay off but it has still multiple issues in the system.

In December 2022, the Business Activity Index (BAI), calculated by the Center for Economic Research and Reforms, amounted to **1,054** points, and, compared with the previous month, increased by **5.4%**. And there is also a **3%** increase in the BAI compared to the same period last year.

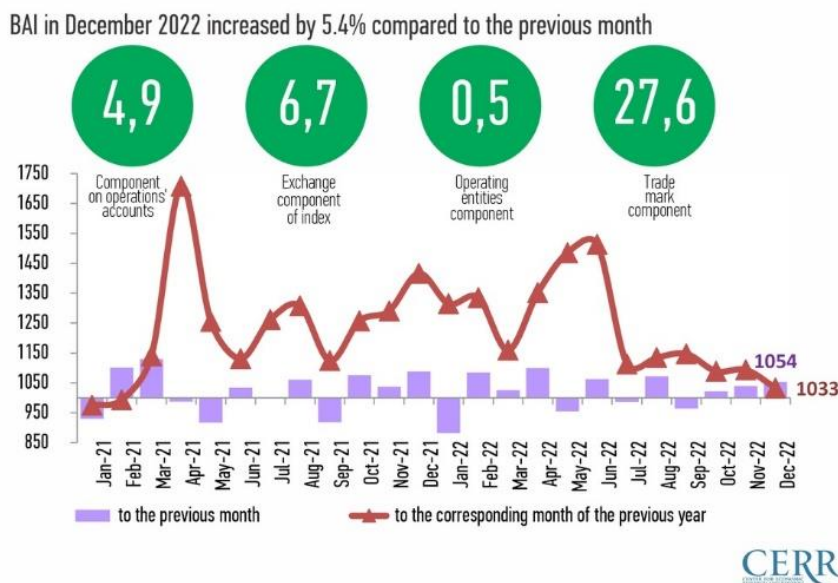


Figure 1: Business Activity Index report on commercial banks of Uzbekistan

Source: Center for Economic Research and Reforms (CERR), 2023

The BAI in December 2022 (Table 1) increased by 5.4% compared to the previous month and amounted to 1,054 points, due to changes in the following components:

- the number of transactions on bank accounts of business entities increased by **4.9%**;
- the component of operating business entities increased by **0.5%**;
- the intensity of the purchase of raw materials on the commodity exchange increased by **6.7%**;
- the component of trademarks increased by **27.6%** (Table 2).

Overall, the integration of Uzbekistan's commercial banks into the world banking system remains a work in progress, but significant progress has been made in recent years. With continued efforts to improve the regulatory environment, enhance transparency and accountability, and encourage foreign investment, Uzbekistan's banking sector is poised to become more competitive and better integrated into the global financial system.

The Government of Uzbekistan is attracting international loans to reform and integrate commercial banks affairs into global banking system. Thus, 21.1 trillion in January-December 2022 at the expense of commercial bank loans and debt funds of other organizations. Uzbek soums of fixed capital investments were absorbed, and their share in total investments was 7.8%. 18.6 trillion in January-September 2022 at

the expense of commercial bank loans and debt funds of other organizations (Statistics Agency of the President of the Republic of Uzbekistan, 2023). Uzbek soums of investments in the fixed capital were absorbed and amounted to 130.2% compared to the corresponding period of 2021.

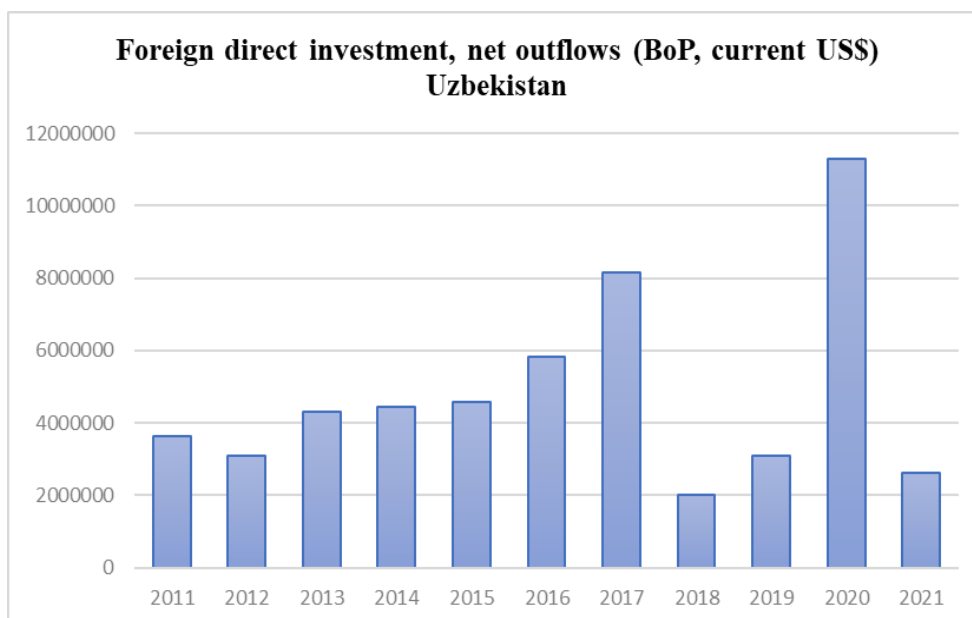


Figure 2: Foreign direct investment, net outflows, Uzbekistan

Source: The author's development based on the results of empirical research

The share of investments made from commercial bank loans and debt funds of other organizations in the total capital investments in the republic increased by 1.9% compared to the corresponding period of 2021 and reached 9.8%. organized (Statistics Agency of the President of the Republic of Uzbekistan, 2023).

These investments were directed to modernize banking affairs and integrating into international banking system. The services of local commercial banks have been improved. The types of services provided by commercial banks are expanding day by day.

However, loan allocation remains one of the most demanded services. In January-June 2022, their share in the total volume of financial services was more than 55%.

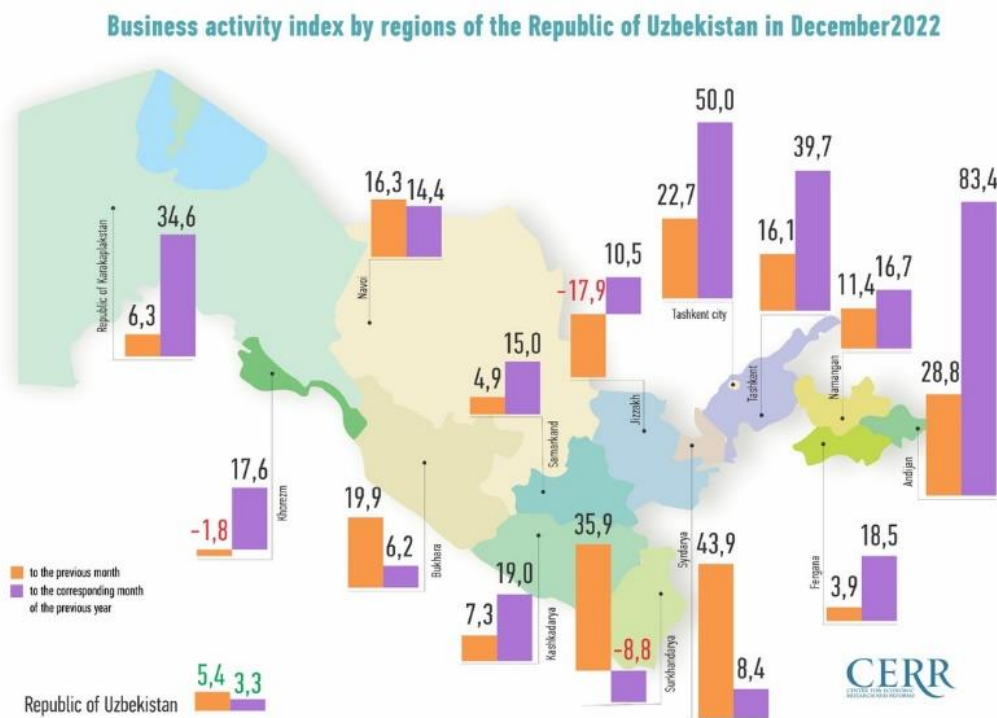


Figure 3: Business activity index by regions of Uzbekistan

Source: CERR, 2023

A high demand for lending services was noted in Tashkent. The share of the city in the total volume of credit services was more than 38 percent. In the Syrdaryya region, this indicator was only more than 3% (Statistics Agency of the President of the Republic of Uzbekistan, 2023). In the months of January-March 2022, the largest share of investments in the fixed capital, which was absorbed at the expense of bank loans and debt funds of other organizations, was observed in Samarkand region. 25.5% of the total investments in this area were absorbed from this source of financing. The smallest share according to this indicator was observed in the Syrdaryya region and made up 5.5% of the total investments.

Source: CERR, 2023.

In December 2022, the number of banking transactions between legal entities increased in 7 regions compared to the previous month. In particular, the most significant growth was observed in Andijan (55.0%), Kashkadarya (14.3%),

Namangan (9.0%) regions and in Tashkent, however, as a capital city, this rate consists (4.9%) respectively.

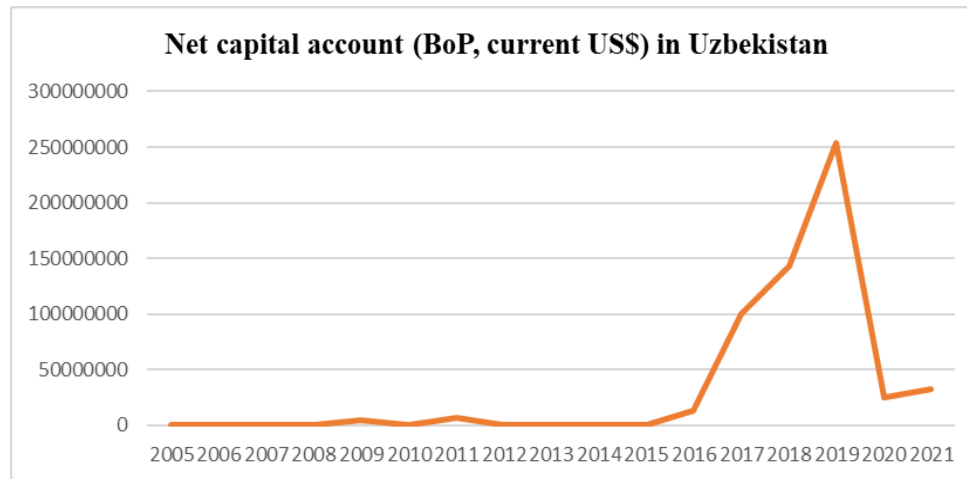


Figure 4: Net capital account in Uzbekistan

Source: The author's development based on the results of empirical research

At the same time, there was a decline in the Samarkand (-10.5%), Navoi (-4.5%), Jizzakh (-1.7%), Khorezm (-3.9%), Surkhandarya (-3.3%), Tashkent (-3.0%) and Fergana (-2.1%) regions. The exchange component of the BAI was 1.0675. This means an increase in the component level by 6.7% compared to the previous month, which is due to an increase in the average physical volume of goods purchased in each transaction by 10.6%, as well as an increase in the number of transactions by 2.9%. At the UzEx, the total turnover in December 2022 amounted to 6,822.1 billion sums, which is 7.3% less than in the previous month. The component of operating business entities in December 2022 amounted to 1.0051, which means an increase of the component by 0.5% compared to the level of the previous month. This indicator also has a positive value in relation to the same period last year with an increase of 12.9%.

The number of operating business entities in December 2022 increased by 3,683 units compared to the previous month of 2022 (633,734 units) and amounted to 636,734 units. During the reporting period, the number of small enterprises increased from 520,199 to 523,556 units (an increase of 3,357 units). Also, the number of farms increased from 109,199 to 109,512 units (an increase of 313 units). The number of operating large enterprises amounted to 3,666 units, which is an increase of 13 units compared to December 2022.