O’ZBEKISTONDA SHAXSLARARO MUNOSABATLAR VA RASMiy MABLAG’LARDAN NOTEKIS FOYDALANISH

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INTERPERSONAL RELATIONSHIPS AND UNEQUAL ACCESSIBILITY TO OFFICIAL FUNDING IN UZBEKISTAN

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Abstract. While a centralized system is wasteful, a market system allocates resources efficiently. Research citing market failures and information gaps as the main culprits highlights the important influence of institutional and political factors on resource allocation. These include formal channels such as order and rules, as well as informal channels such as political connections and personal relationships. Often, exclusive and personal political affiliations play a special role in the decline of profits from formal funding distribution. This article studies the influence of interpersonal relations on the uneven distribution of official funds in Uzbekistan.

Key words: banking sector, finance, economic growth, risk management, investment, liquidity.

Introduction. Uzbekistan has maintained steady economic growth, ranging from 5% to 8% since the early 2000s. This seemingly supports the government’s approach of gradual market-oriented reforms to safeguard living standards and bolster industry. Surprisingly, despite an abundance of skilled, affordable labor, the growth model focused on capital-intensive sectors, especially natural resources, with preferential treatment like direct credit from the banking sector. Consequently, the increase in per capita income was primarily due to capital-to-labor ratio improvements, while the employment rate dropped from 71% to 63% (Trushin 2018).

The lack of institutional reforms restricted economic opportunities, particularly for the labor-intensive private sector. The government’s failure to uphold the rule of law and protect private property hindered the efficient allocation of resources. However, here we should mention about socio-economic reforms accelerated in the sphere after leadership changes in the country, which cause favorable conditions and supportive hands for entrepreneurs lacking for a long period of time. Implementing reforms in these areas encourages private sector involvement in wealth creation, leading to sustainable capital accumulation, enhanced economic growth, and greater inclusivity.
This chapter emphasizes the significance of an equitable distribution of bank financing for enterprise and overall economic growth. Achieving this goal hinges on the government’s credible commitment to improving institutions that facilitate market-based access to formal financing.

The following sections provide an overview of mainstream economic theories on the importance of enterprise access to bank financing. While recognizing unequal distribution, mainstream views attribute it primarily to market and information imperfections. Institutional economists, however, propose an alternative explanation, emphasizing the crucial roles of social and political factors alongside information gaps. These insights inform the subsequent discussion on the interplay between institutions, informality, and bank financing allocation in Uzbekistan. Additional factors specific to Uzbekistan’s context exacerbating formal financing allocation are briefly addressed. The chapter concludes with a summary of key findings.

The Significance of Enterprise Access to Bank Financing for Growth

Banks are fundamental to modern economies, but understanding how they drive economic activity and growth requires a nuanced discussion. The emergence of private property and money facilitates trade, leading to economic efficiency. However, without banks, funding projects relies solely on entrepreneurs’ resources due to high information costs. Savers lack the means and expertise for comprehensive project assessment. Consequently, not all available savings are utilized for investment.

Banks act as vital financial intermediaries, addressing information and incentive challenges. They accept short-term deposits and provide long-term loans, encouraging saving and reducing credit costs for businesses. This ‘maturity transformation’ is a key growth-facilitating function. Additionally, by pooling risks and diversifying resources, intermediaries enhance savings rates, resource allocation, and long-term economic growth. Banks also spur financial development, enabling international market participation, and streamline the payment system, expediting transactions and trade.

Adam Smith attributed Scotland’s eighteenth-century trade and industry growth in part to the establishment of public banks in Edinburgh. Coase’s work on firms applies to banks as specialized financial intermediaries, efficiently coordinating information gathering and assessment. This economizes on aggregate information costs, benefiting borrowers. By concentrating deposits and loans, banks achieve economies of scale and reduce transaction costs.

Access to formal finance is crucial for investment and growth. A lack thereof hampers profitable entrepreneurial ventures, leading to suboptimal operations despite high capital productivity. Studies show that financial development helps firms overcome liquidity constraints, fostering growth potential. Furthermore, financing from formal sources correlates with faster firm growth.

In summary, financial intermediaries drive economic growth through information generation and evaluation, risk management, savings mobilization, efficient resource allocation, liquidity provision, and managing payment systems. While historic instances exist where growth occurred without extensive financial development, the prevailing theoretical and empirical support for the link between financial development and economic growth remains robust. As Levine aptly stated, there’s a fundamental relationship between financial development and economic growth.

Factors Influencing Unequal Bank Financing Distribution

Modigliani and Miller (1958; Miller and Modigliani 1961) proposed that, in ideal market conditions, enterprises should be indifferent to funding sources. Yet, in less developed financial systems of emerging economies, bank loans are the primary external financing option (Cressy and Olofsson 1997). Research shows that due to incomplete information, financial intermediaries often allocate formal credit more favorably to larger, established enterprises, disadvantaging smaller and younger firms (de la Torre et al. 2010; Demetriades and Andrianova 2004). This unequal distribution hampers investments and growth, as some profitable initiatives lack funding (Claessens and Perotti 2007).

Conventional explanations focus on information gaps causing the inequitable allocation of bank credit. Smaller and younger enterprises, seen as higher risk, often lack acceptable collateral and face competition, making cash-flow prediction less reliable (Mina et al. 2013). Despite their significant presence, banks struggle to benefit from economies of scale when lending to them (Beck 2013), resulting in higher costs for these businesses (Berger et al. 2001).

Recent institutional economic perspectives highlight the role of social and political factors alongside information gaps. They argue that business decisions respond not only to market forces but also to rules and regulations that shape behavior. Bureaucratic organizations under the rule of law facilitate exchange and investment, influencing economic outcomes (Acemoglu et al. 2005; Goldsmith 1995; North 1990; Weber 1968). Economic structures, including networks and bureaucratic institutions, evolve with economic development (Stiglitz 2001). In underdeveloped markets, credibility-lacking bureaucratic institutions can be partially replaced by interpersonal networks to address allocation questions, including financing (Stiglitz 2001).
Political connections are increasingly recognized as influential in accessing formal financing (Boubakri et al. 2013; Bartlett 2023; Cull et al. 2015; Faccio 2006; Faccio et al. 2006; La Porta et al. 2002; Li et al. 2008). Entrenched elites can create unfavorable operational constraints, fostering favoritism, corruption, and bribery, further hindering market-based exchange (Fedderke et al. 1999).

Competing views exist on the impact of corruption and rent-seeking behavior on social welfare. While some argue that productive firms can benefit from bribe-giving, this relies on specific assumptions and ignores the enduring, interpersonal nature of corrupt relationships (Blackburn et al. 2009; Duvanova 2014; Li 1998; Manion 1996).

Additionally, not all entrepreneurs have economically valuable networks, and valuable networks can be exclusive. Access to certain networks may grant access to others, creating further inefficiencies (McKeen 1992). Corruption and rent-seeking practices, therefore, not only come at an economic cost but also challenge equality of opportunities (Bowles and Gintis 2002).

Institutions, Informality, and Bank Financing in Uzbekistan

The fall of Communist regimes in Eastern Europe and the former Soviet Union triggered significant changes in the 1980s and 1990s. This period, known as the 'transition', aimed to establish a society guided by democratic values and market-driven economic relations. Uzbekistan, upon gaining independence in 1991, also embarked on this transition, though it adopted a more gradual and cautious approach to economic reforms compared to its counterparts (Ruziev 2021), which were justified due to caring population from shocking consequences observed in some countries some years ago.

While market-oriented factors gained strength and bureaucratic organizations became more established, they still operate with biases and legal shortcomings in Uzbekistan. Socio-economic reforms accelerated after a leadership change in 2016, but the country remains one of the least reformed among transition economies. The European Bank for Reconstruction and Development's (EBRD) assessment of transition quality (ATQ) indices offer a useful measure to evaluate Uzbekistan’s progress in building credible institutions and a functioning economy guided by market signals and competition (EBRD 2023).

Figures 10.1 and 10.2 depict two pertinent ATQ indices - 'well-governed' and 'competition' – comparing Uzbekistan's progress with other transition countries in 2016 and 2022. These indices gauge the quality of institutions, integrity standards, rule of law, and control of corruption, as well as efforts to shift decision-making from state-driven to market-driven mechanisms. These factors significantly influence the allocation of bank financing based on risk and return principles. The figures indicate some progress for Uzbekistan between 2016 and 2022 in both indicators.

However, the country still lags behind most transition economies in the sample.

The literature reveals that in such conditions, entrepreneurs and bureaucrats often rely on personal networks to allocate resources related to financing, investment, and production. Bureaucratic organizations tend to personalize positions, using rigid rules and regulations for rent-seeking. This leads to a misallocation of resources, as entrepreneurs turn to interpersonal networks rather than market signals. This organizational failure has been observed in Uzbekistan, according to various empirical studies.
These networks play a significant role in resource allocation, from water management to access to bank financing. However, their exclusive nature often benefits members at the expense of broader society. Furthermore, informal norms and practices can hinder innovation and risk-taking, crucial factors for economic growth.

Studies in the sociology of law also confirm the prevalence of informal transactions in Uzbek society. Some of these, while legally deemed corrupt, are socially accepted as gifts. This dual legal and informal institutional landscape creates alternative norms and orders regulating transactions. Notably, the state in Uzbekistan is powerful in maintaining security and preventing instability, but weaker in enforcing the rule of law and service delivery.

Finally, empirical literature highlights the negative impact of informality and corruption on firms’ access to formal financing and their subsequent performance. While market and information imperfections are recognized causes, connectedness to exclusive networks significantly influences the chances of receiving bank credit. However, receiving bank financing does not necessarily lead to enterprise growth, as shown in studies for Uzbekistan (Ruziev and Midmore 2015).

Overall, this comprehensive analysis underscores the intricate relationship between institutions, informality, and the allocation of bank financing in Uzbekistan’s evolving economic landscape.

**Additional Factors Impacting Enterprise Access to Formal Financing**

In previous sections, we discussed information imperfections and institutional quality as key contributors to the uneven distribution of formal financing for enterprises. Now, we’ll explore additional factors related to financial underdevelopment.

One crucial factor exacerbating access to bank loans in countries with underdeveloped financial systems is credit rationing. Banks often require collateral to mitigate risks associated with default. However, raising interest rates or collateral requirements can lead to adverse selection or moral hazard issues. Thus, banks may opt to ration loans rather than impose higher costs on borrowers.

Financial underdevelopment in emerging economies, where bank loans are a primary source of external financing, limits enterprise access to bank financing. This may stem from high fixed costs for financial services and strict entry regulations. Additionally, these economies often lack a sufficiently large pool of domestic savings, hindering efficient mobilization for financing demands.

During the transition period in Uzbekistan, both per capita income and financial development were considerably lower than in advanced economies. While market-oriented reforms were adopted, progress in Uzbekistan was notably slower until 2016. Despite recent reforms, Uzbekistan remains economically and financially underdeveloped compared to its post-Communist counterparts.

The banking sector in Uzbekistan is one of the least reformed and underdeveloped. It heavily relies on government deposits and loans, leaving a significant portion of enterprises credit-starved. The country’s foreign exchange market also showed signs of financial repression before its liberalization in 2017.

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**Figure 2. The assessment of transition qualities: the competitive index in selected transition economies, 2016 and 2022**
Figures 3 and 4 illustrate Uzbekistan’s progress in per capita income and financial development compared to other post-Communist economies between 2011 and 2021. While there have been improvements, Uzbekistan’s relative position still indicates its lag in these aspects.

Despite the importance of bank loans for investments in Uzbekistan, only a small fraction of enterprises reported access to bank credit. Banks also show limited engagement in intermediating private sector savings, further constraining access to financing.

While direct evidence is scarce, research in post-Communist economies suggests that in regions with limited resources, interpersonal networks can exacerbate resource misallocation. This implies that in economies like Uzbekistan, with constrained formal credit supply, those leveraging bureaucratic connections may gain disproportionate access, contributing to resource misallocation.

**Conclusion.** While speaking about economic growth of the Republic of Uzbekistan, it would be reasonable to divide into three periods: as a part of former USSR, post-Communist and after 2016. All of them differs due to the socio economic and political atmosphere in the country which mostly has closed been related to the outlook of the leaders and mentality of the nation.

The idea that transitioning from centrally planned to market-based systems would lead to efficient resource allocation was a central theme for post-Communist economies. However, empirical research reveals that inefficiencies persist, particularly in providing financial services to businesses. It’s evident that formal financing tends to favor larger enterprises over smaller, younger ones in market-based economies.

Traditional explanations attribute this inefficiency to market and information flaws. Nevertheless, recent literature highlights the significant role
of institutional and political factors in resource allocation, including bank financing. In countries with weak market mechanisms and institutions lacking credibility, a select group of well-connected entrepreneurs can monopolize resources, leading to further inefficiencies. This stands in contrast to anonymous market exchanges, which are more efficient because the best buyers or sellers aren’t tied to exclusive networks. Corruption and rent-seeking practices not only harm the economy but also undermine equal opportunities.

Growing empirical evidence from transition economies shows that well-connected enterprises, despite lower capital productivity, receive a disproportional share of formal financing, resulting in resource misallocation. Uzbekistan is no exception, facing even more challenges due to credit rationing and poor financial intermediation.

To move forward, policymakers must implement credible reforms aimed at enhancing institutions that promote market-based incentives. This will foster a fairer distribution of financing, particularly in labor-intensive sectors, ultimately spurring job creation and inclusive, sustainable economic growth.

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Kutil so‘zlar: kredit, kreditga layoqatlilik, tijorat banki, qarz oluvchi, moliyaviy barqarorlik, to‘lov qobiliyati, raqamli banking, bank faoliyatini raqamlashtirish.