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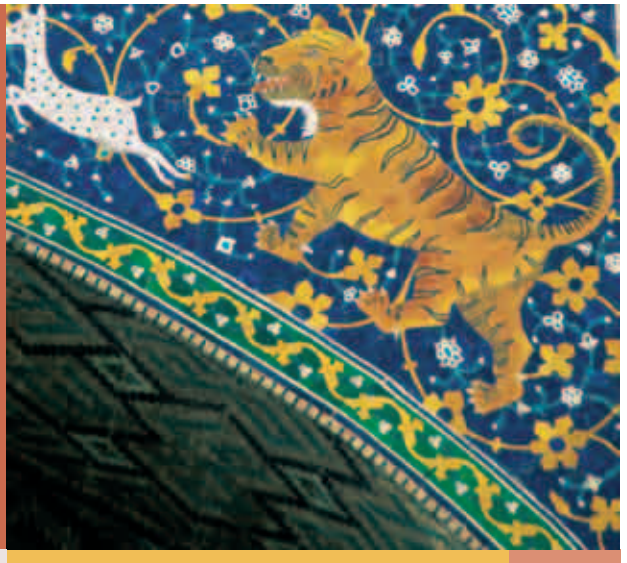

BUSINESS ENVIRONMENT IN UZBEKISTAN AS SEEN BY SMALL AND MEDIUM ENTERPRISES

Survey results based on **2004**

Государственный Секретариат
Швейцарии по Экономике
Secrétariat d'Etat à l'économie
State Secretariat for Economic Affairs
SWITZERLAND seco

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Survey results based on

2004

Tashkent, 2005

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GLOSSARY

CBU - *Central Bank of the Republic of Uzbekistan*
CM - *Cabinet of Ministers*
CSREO - *Consolidated State Register of Enterprises and Organizations*
CTI - *Chamber of Trade and Industry*
FDI - *Foreign Direct Investment*
GDP - *Gross Domestic Product*
Goskompriroda - *State Committee for Nature Protection*
Goskomstat - *State Statistics Committee*
Goskomzem - *State Committee for Land Resources, Geodesy, Cartography, and Surveying*
ICC - *Inspections Coordination Council*
IFC - *International Finance Corporation*
LLC - *Limited Liability Company*
MFER - *Ministry for Foreign Economic Relations, Investment and Trade*
MIA - *Ministry of Internal Affairs*
MJ - *Ministry of Justice*
NAS - *National Accounting Standards*
PIN - *Taxpayer's Personal Identification Number*
RU - *Republic of Uzbekistan*
SES - *Center for State Sanitary-Epidemiological Surveillance under the Ministry of Health*
SME - *Small and Medium Enterprises*
STC - *State Tax Committee*
STI - *State Tax Inspectorate*
VAT - *Value-Added Tax*

Soum to US dollar exchange rates applied herein (CBU rates):

Average 2003 exchange rate: $1=971.33 soums
Average 2004 exchange rate: $1=1,020 soums
January 1, 2005 exchange rate: $1=1,058 soums

The 2004 per capita Gross National Income (World Bank assessment): US $460.

PREFACE

This Report, presented by the International Finance Corporation (IFC), is the result of IFC's fourth annual survey of the SME sector in Uzbekistan. The aim of the survey was to discover entrepreneurs' attitudes to prevailing business conditions and to government reforms in this area. Implementation of the project was made possible through the financial support of the State Secretariat for Economic Affairs of Switzerland **(seco).**

For the 2004 survey, the number of participating SME representatives was increased to 3,000. The number was augmented over previous years by including individual entrepreneurs in the sample and by an additional survey of enterprises engaging in foreign trade. Legal regulation of the activities of individual entrepreneurs and agricultural enterprises sometimes differs from that of the other SMEs. Where this is the case, the differences are explained in the relevant chapters of the Report.

The quantitative and qualitative characteristics of the sample and the survey methodology made possible a comparison of the results to the results of similar surveys conducted by IFC in the Republic of Uzbekistan in the past, thus tracking the dynamics of key processes in the business environment in the country.

This Report is not intended to be an exhaustive account or analysis of all the problems facing SMEs in Uzbekistan, nor does it reflect the opinions of IFC or **seco** about them. The survey provided a look at the situation through the eyes of entrepreneurs and revealed their opinions on the most important processes influencing the development of this economic sector. Based on analysis of the data, IFC has made recommendations for improving the business environment in Uzbekistan.

Responding to suggestions by the Government of Uzbekistan, the format of the Report was somewhat changed for this year. Taking into consideration requests from our target readership, the present Report focuses on recommendations to address specific issues constraining SME growth in the country and on assessment of the impact expected from implementing the proposed measures.

This survey reflects the business environment in Uzbekistan up to the end of 2004. Since then, the Government of Uzbekistan has taken a number of decisions aimed at improving the business climate in the country, including addressing problems highlighted by the survey. These solutions are reviewed in this Report; however, the effects can only be assessed comprehensively based on the results of the next survey.

This Report consists of an overview, two main parts, and annexes. "Overview of the Business Environment" summarizes the main issues facing SMEs. Part I deals in detail with the areas in which IFC assists state agencies in improving procedures and removing obstacles to private enterprise ("Inspections," "Reporting," and "Permits") and also with the areas where IFC assistance is expected ("Registration" and "Taxes and Tax Administration.") Survey data on other aspects of entrepreneurial activity (foreign trade, financial institutions, licensing, standards, and certification) and additional data on the issues described in Part I are presented in the form of charts and diagrams in Part II of the Report. Should any questions arise, IFC is prepared to elaborate on the statistical data presented herein. The annexes contain the survey methodology and additional analysis of the legal and regulatory framework and international experience in addressing the issues reviewed in the main chapters of the Report.

The results of the survey were discussed at round table meetings and in focus groups. Participants included representatives of the Ministry of Economics, the Ministry for Foreign Economic Relations, Investment, and Trade, the Ministry of Justice, the Ministry of Finance, the State Tax Committee, and the State Customs Committee, as well as entrepreneurs and representatives of the Chamber of Trade and Industry. In this way, IFC obtained expert assessment of the results and main conclusions of the survey.

The IFC SME Policy Project is grateful for the valuable contribution of the following agencies and organizations in the preparation of this Report: the SME Coordination Council, the Inspections Coordination Council, the Ministry of Economics, the Ministry of Justice, the Ministry for Foreign Economic Relations, Investment, and Trade, the State Committee for Demonopolization and Support of Competition and Entrepreneurship, the State Statistics Committee, the State Customs Committee, the State Tax Committee, the State Committee for State Property Management, the Joint Information and Analysis Department for Economics and Foreign Economic Relations under the Cabinet of Ministers, the Chamber of Trade and Industry of Uzbekistan, and the Association of Dehkan and Private Farms. The Project team also thanks our colleagues at the World Bank Resident Mission in Uzbekistan, the IFC Southern Europe and Central Asia Department, and the IFC Private Enterprise Partnership.

This Report has been published in the Uzbek, Russian, and English languages. Electronic versions of this Report, as well as the 2001-2003 reports, are available at the IFC site http://www2.ifc.org/centralasia/sme/uzsurvey.htm. Additional hard copies can be obtained at:

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Overview of the Business Environment in Uzbekistan

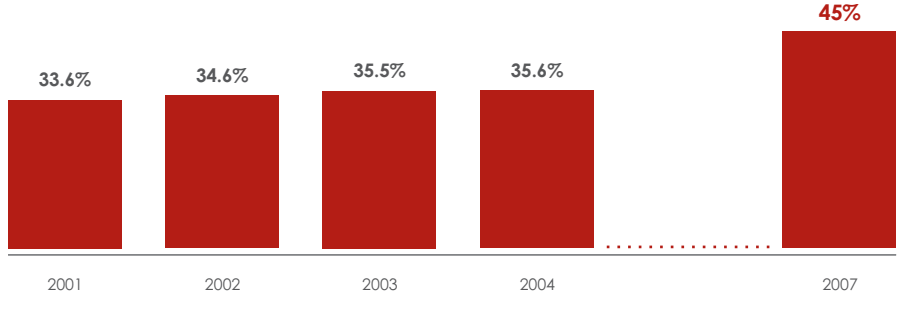
The importance of small and medium enterprises (SMEs) to the economic development of any country can hardly be overestimated. International experience has shown that this sector provides the flexibility an economy requires in order to respond to changes in business conditions. Since SMEs are less capital-intensive than large companies are, they are easier to establish and to reorient to other activities. Under normal business conditions, they can invest funds in the development of new areas of activity and build production capacity, thereby creating opportunities for economic growth, employment, and higher living standards. SMEs respond quickly to changes in the business climate of a country and can thus serve as an indicator of economic development and the effectiveness of government reforms.

The SME sector plays an increasingly important role in Uzbekistan. According to the State Statistics Committee, it currently accounts for approximately 36% of GDP and 61% of total employment.

In 2005, the Government of Uzbekistan set the ambitious goal of raising the share of the GDP contributed by SMEs to 45% by 2007. Analysis of recent economic trends in the country shows, however, that the current rate of SME development does not point to achieving that objective.

Chart 1.1
SME SHARE AS A PERCENTAGE OF GDP IS NOT SUFFICIENT TO REACH THE SET OBJECTIVE

Source: Goskomstat



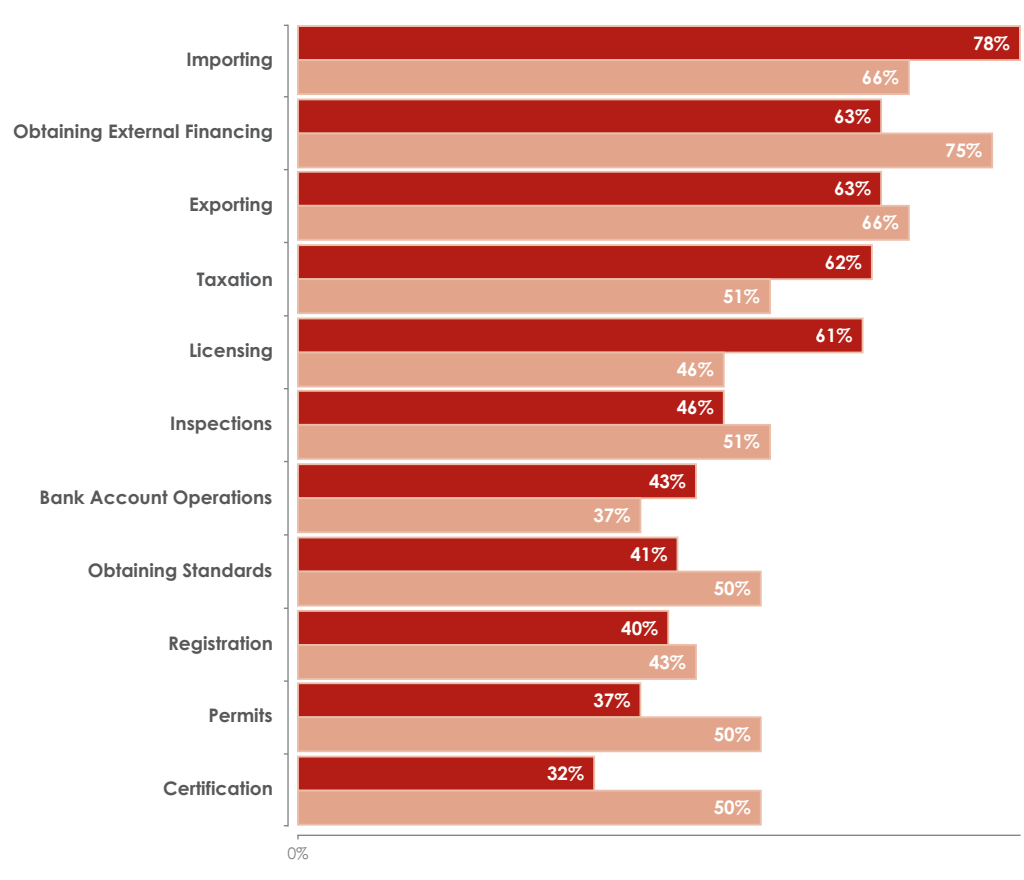
The increase in share of SMEs as a percentage of GDP can be promoted in two complimentary ways – by making it easier to start new businesses, thus sharply increasing the number of SMEs, and through measures designed to support existing SMEs in improving their performance.

The surveys IFC has conducted since 2001 have provided the means to track trends in the development of the business environment in Uzbekistan. The results have shown that a substantial percentage of entrepreneurs consider business conditions (related to both start-up and development) "problematic" or "very problematic."

Chart 1.2

ENTREPRENEURS SEE MANY ADMINISTRATIVE PROCEDURES AS PROBLEMATIC

% of respondents classifying the procedures in the given area as "problematic" or "very problematic"



ENTREPRENEURS SPEND SUBSTANTIAL TIME AND FINANCIAL RESOURCES ON STARTING A BUSINESS

The state regulates the establishment of businesses through registering these entities and issuing the required permits and approvals and through licensing, certification, and standards. The purposes of state regulation are:

- protecting consumer rights and interests;
- averting potential hazards to the public and the state;
- distributing limited resources;
- obtaining data on business activity for effective management and economic development.

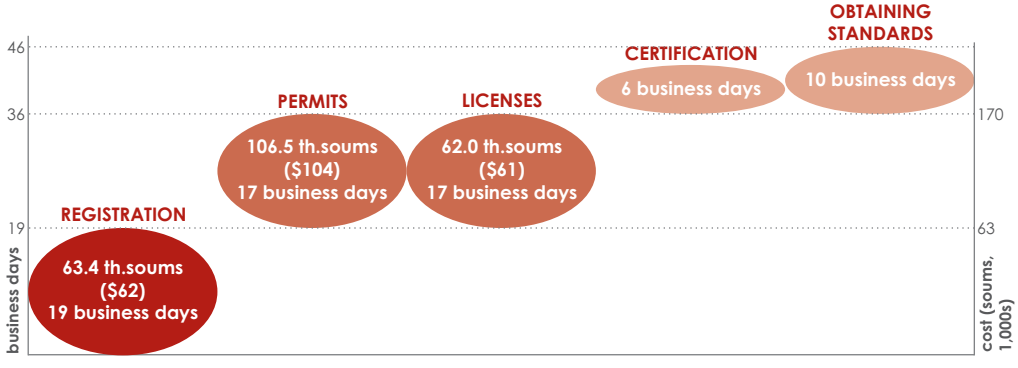
Regulatory procedures are also intended to be transparent, sufficiently simple to apply, and have no negative impact on the entrepreneur's motivation to do business.

In 2001, the government began implementing some targeted measures to facilitate the start-up of businesses. It introduced the "one window" registration procedure,[1] applied "one window" principle to issuing several types of permits,[2] reduced the number of activities requiring licensing,[3] and introduced a system of product certification based on declaration.[4]

Nevertheless, the survey results have shown that starting a business still involves certain problems. Establishing an entrepreneurial entity takes more than a month. Registration, for instance, takes on average 19 business days. According to the survey results, a business must obtain on average three permits and approvals, which takes another 17 days. Where applicable to the business activity, it takes on average 17 business days to obtain a licence, 10 business days to obtain a standard, and 6 business days for certification.

Entrepreneurs also spend substantial financial resources on these procedures. (See the chapters on Registration and Permits, as well as the Annexes.)

Chart 1.3
STARTING A BUSINESS INVOLVES SUBSTANTIAL TIME AND EXPENSE[5]



Sixty-one percent of respondents who underwent the licensing procedure in 2004 described it as "problematic" or "very problematic" (almost one and a half times more than in the previous year). The survey showed that the average validity period for licences issued in 2004 was three years, while the law stipulated a minimum period of five years. The percentage of respondents who had to make unofficial payments to obtain licences increased from 24% in 2003 to 31% in 2004. By contrast, only 17% of respondents mentioned the need to make such payments during the certification procedure – considerably fewer than in 2003, when 46% of entrepreneurs mentioned such need.

1 Resolution 347 of the Cabinet of Ministers of the Republic of Uzbekistan "On Improving the System of State Registration of Entrepreneurial Agents," August 22, 2001.

2 Resolution 357 of the Cabinet of Ministers of the Republic of Uzbekistan "On Radical Improvement of Registration Procedures for Establishing Businesses," August 20, 2003.

3 Resolution 222-II of the Oliy Majlis of the Republic of Uzbekistan "On the List of Types of Activity Requiring Licensing," May 12, 2001.

4 i.e. produce, which is not subject to mandatory certification, may be certified by submitting declaration stating that the produce conforms with safety requirements. Resolution 318 of the Cabinet of Ministers of the Republic of Uzbekistan "On Additional Measures of Simplifying the Certification Procedure," July 6, 2004.

5 The 2004 average soum to US dollar exchange rate set by the CBU was 1,020.

Box 1.1

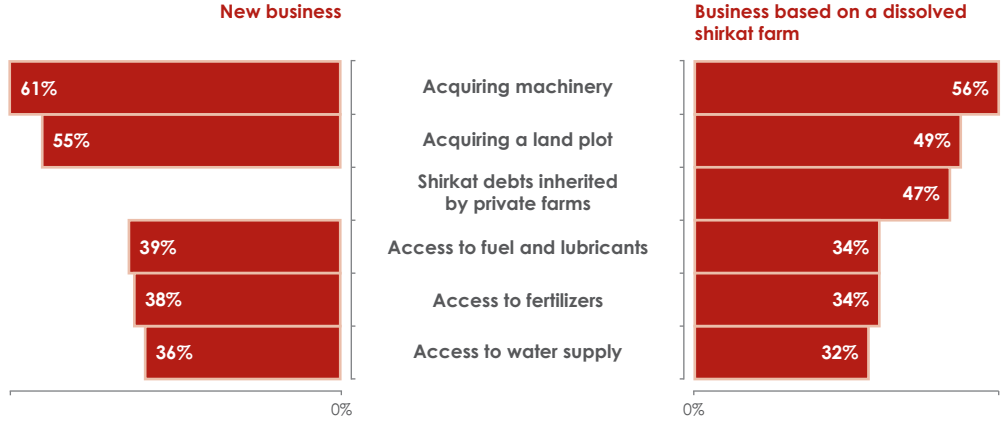
Resolution PP-186 of the President of the Republic of Uzbekistan[6] was introduced on September 21, 2005. Accordingly, as of October 1, 2005:

- Licences for all types of activity requiring licensing are issued for a period of at least five years;
- For 13 types of activity, licences are issued without time limit;
- The function of licensing six types of activity was transferred from commissions of the Cabinet of Ministers to state authorities.

This Resolution also introduced a number of changes to the procedures for issuing permits, as described in the relevant chapter.

Establishing agricultural enterprises involves additional difficulties related to land plot allocation and acquiring machinery and supplies of fuel, lubricants, fertilizers, and water. These problems apply to both newly-established businesses and those established in place of the former shirkat farms (agricultural cooperatives). In the latter case, the problems for entrepreneurs are aggravated by debts inherited from the dissolved shirkat farms.

Chart 1.4
ESTABLISHING AGRICULTURAL ENTERPRISES IS HIGHLY PROBLEMATIC
% of respondents engaged in agriculture who described the given area as "problematic"



To solve these problems, a substantial number of respondents engaged in agriculture had to make unofficial payments (see Statistical Results of the Survey).

Since entrepreneurs generally cannot start operations until they have obtained all registration papers and permits, administrative delays resulted in lost profits. According to estimates, the economy lost profits of 1.4 billion soums (approximately US$1.4 million) for each day that over 51.7 thousand new SMEs established in 2004 were idle.[7]

[6] Resolution PP-186 of the President of the Republic of Uzbekistan "On Reducing the Types of and Simplifying Procedures for Issuing Permits to Engage in Entrepreneurial Activity," September 21, 2005.

[7] Based on 51,728 SMEs undergoing registration in 2004, average annual sales per SME of 36 million soums, and percentage profit for new businesses of 20.6%.

Growth in the number of SMEs is also affected by the complexity of the procedures for liquidating a business. Studies in a number of countries have shown a direct correlation between the number of liquidated businesses and the number of new ones.[8] Practical liquidation procedures allow entrepreneurs to more readily enter the business arena, apply their abilities appropriately, react more flexibly to changes in the market, and use limited material and labor resources more effectively. Moreover, efficient liquidation procedures serve the interests of investors and lenders by making more funds available to finance new investment opportunities.

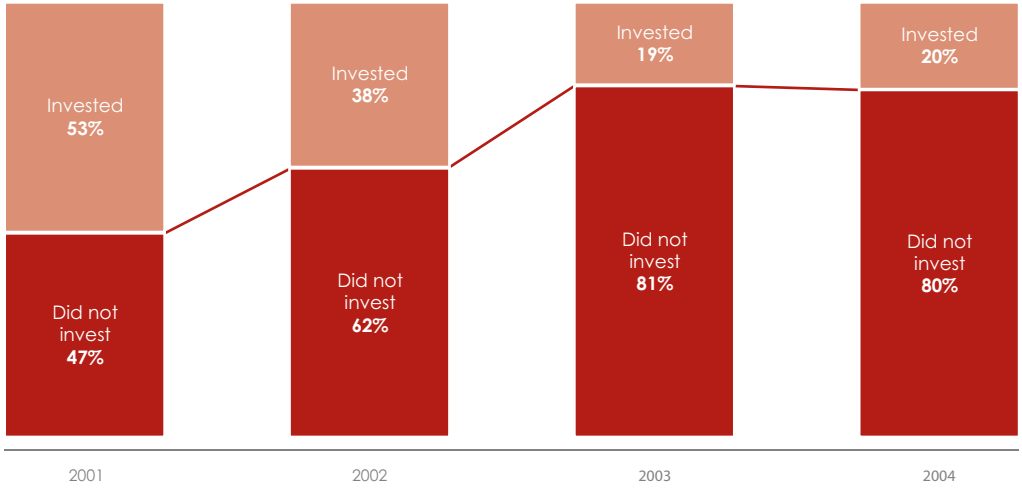
The survey showed that more than two-thirds of respondents who had to liquidate a business at one time or other found the procedure "very problematic" or "rather complicated" (see Statistical Results of the Survey for more detail). This assessment can be attributed to the extremely complex regulatory framework (see Annex 1 for more detail).

THE BUSINESS ENVIRONMENT IS NOT CONDUCIVE TO ENCOURAGING ENTREPRENEURSHIP

A business environment favorable to entrepreneurs promotes economic development. Reducing unwarranted costs and risks spurs entrepreneurs to expand their businesses and make additional investment and creates employment opportunities.

The survey results showed that in 2004, the alarming trend toward a diminishing number of enterprises investing in fixed assets had been halted in Uzbekistan. (In 2001–2003, the percentage had decreased almost threefold.) However, there was no significant increase in this indicator: Only one-fifth of respondents made investments in 2004.

Chart 1.5
PERCENTAGE OF RESPONDENTS INVESTING IN FIXED ASSETS IS NOT GROWING
% of respondents



[8] Doing Business in 2005: Removing Obstacles to Growth. 2005. A copublication of the World Bank, the International Finance Corporation and Oxford University Press.

The volume of capital investment is important to economic growth, but so is the accompanying (and largely consequent) increase in productivity. The government of Uzbekistan can do nothing (or very little) to mitigate such factors as the high costs associated with the country's remoteness from the markets of industrialized countries, lack of direct access to sea ports, and regional instability. These are consequences of the country's geographical location – including its proximity to countries where military action took place not so long ago.

Nevertheless, the government does have a direct impact on a number of other factors, such as an enabling environment, a well-developed infrastructure, access to financing, the business tax burden and tax administration, openness to foreign partners, stability and transparency of laws, protection of property rights, and the level of corruption.

Uncertainty about the further course of economic reforms, an excessive tax and customs burden, the instability of regulatory measures and the potential for arbitrary interpretation of them, excessively complicated rules for doing business, and rigid control of state agencies reduces investment potential and motivation. Entrepreneurs bear additional expenses in overcoming complicated administrative barriers. Added to standard expenses (wages, transportation, raw materials, etc.) these costs can render many investment propositions unprofitable and reduce productivity.

The survey revealed certain problems in the systems of taxation, inspections, reporting, financial intermediation, and foreign trade activity. A detailed analysis of the survey with respect to some of these factors in the entrepreneurship climate is presented in the following chapters. Additional information on other issues can be found in the statistics section.

The 2004 survey results showed a heavy tax burden on SMEs, with a tax rate averaging 20% of revenue. Entrepreneurs felt that this was double the rate that would allow some potential for enterprise development. In 2004, the simplified tax system had not been fully implemented and enterprises in most sectors had to pay more than five types of taxes and fees. Further, tax law was unstable, controversial, difficult to understand and adhere to, and allowed for individual tax privileges and preferential treatment.

Box 1.2

The World Bank Project "Business in 2005"[9] conducted a study on the impact of high tax rates on business activity in various countries and based on the results, concluded that "international experience shows that a 1% reduction in taxes leads to a 3.7% increase in the number of firms, a 0.9% increase in sales, and a 1.1% increase in employment."

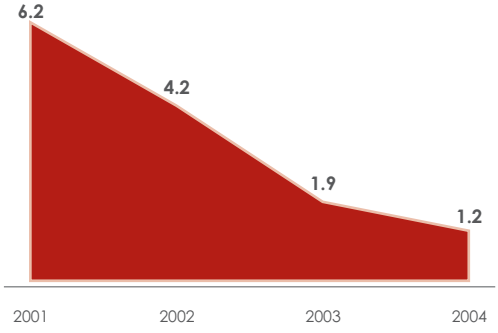
The survey results showed a positive trend toward a decrease in the average number of inspections in the country and an increase in the number of enterprises undergoing no inspections in the course of a year.

[9] Doing Business in 2005: Removing Obstacles to Growth. 2005. A copublication of the World Bank, the International Finance Corporation and Oxford University Press.

Chart 1.6

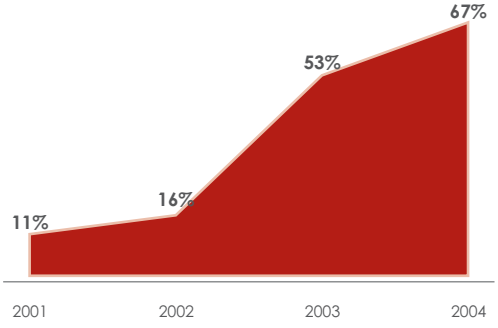
THE AVERAGE NUMBER OF INSPECTIONS AT THE SINGLE ENTERPRISE HAS DECREASED

# of inspections



THE SHARE OF ENTERPRISES UNDERGOING NO INSPECTIONS ANNUALLY HAS INCREASED

% of respondents



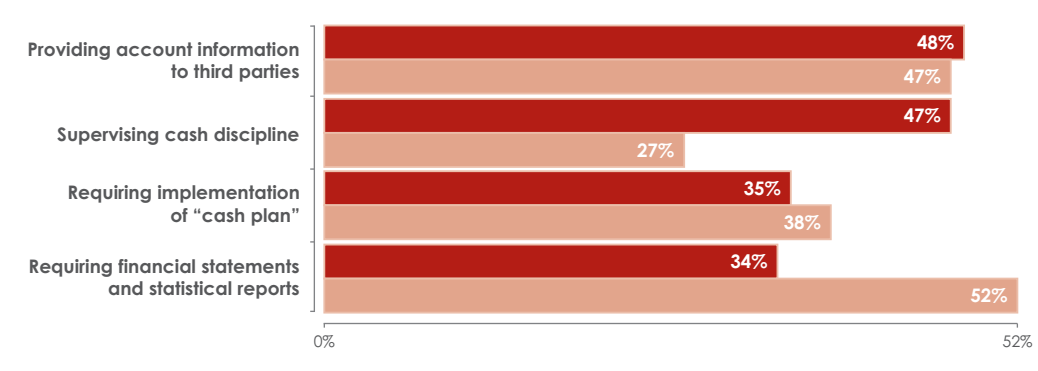
Despite government measures to cut the number of inspections, the emphasis is still on exposing violations and imposing penalties rather than on assisting entrepreneurs in avoiding violations and addressing shortcomings. The system of choosing companies for inspection and carrying out inspections is still not transparent. As a result, businesses with higher sales are inspected more frequently and the number of entrepreneurs who have to make unofficial payments is growing.

Respondents pointed out that some banks continue to perform functions inappropriate for financial institutions. These functions include supervising the activities of businesses and submitting information on their clients to third parties such as taxation agencies, the prosecutor's office, and local authorities.

Chart 1.7

BANKS CONTINUE TO PERFORM FUNCTIONS INAPPROPRIATE FOR FINANCIAL INSTITUTIONS

% of respondents



One-third of respondents pointed out that, despite the official cancellation of the "cash plan," banks continue to require their clients to adhere to such plan. The survey showed that, starting in 2004, local authorities were getting actively involved in cash collection (see Annex 2).

Like the previous year (see IFC's 2003 report, Business Environment in Uzbekistan as Seen by Small and Medium Enterprises), in 2004 the problem of access to cash was especially acute for enterprises in the real sector of economy (agriculture, industry, and construction).

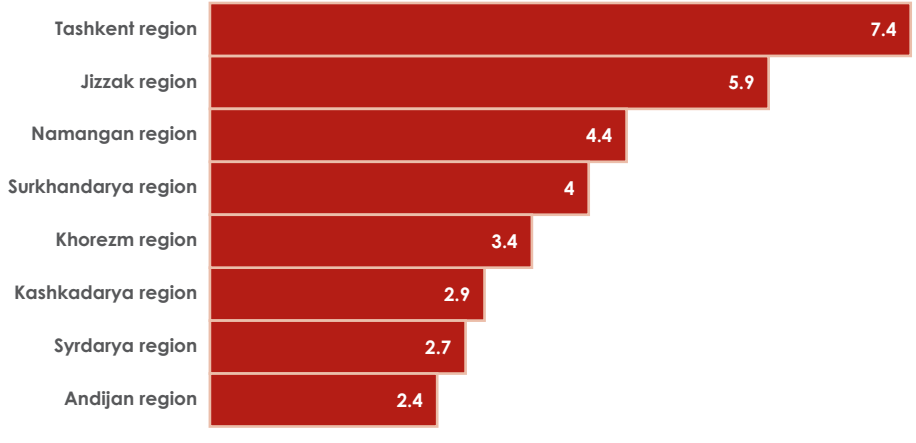
"The "cash plan" is no longer set by the bank. Now, our tax inspector officially brings it to us on the Khokimiyat's instruction. If you fail to submit the amount of cash planned, you are first summoned to the Khokimiyat, and then all kinds of unpleasant things begin – such as revocation of permits and visits from tax inspectors for ad hoc inspections".

Focus group participant

Chart 1.8
THE PROBLEM OF ACCESS TO CASH WAS MOST ACUTE FOR ENTERPRISES IN THE REAL SECTOR OF ECONOMY
% of respondents

By law in Uzbekistan, on a client's instructions banks must transfer funds from the client's account no later than the day following the day of receipt of a payment order.[10] However, because commercial banks expended their efforts and funds performing functions not appropriate for them, and because of problems with liquidity in some regions, it took more than two business days to transfer funds from one account to another.

Chart 1.9
COMMERCIAL BANKS TOOK AN EXCESSIVELY LONG TIME TO PROCESS SETTLEMENTS
business days



"I wanted to transfer some funds from my business account in Jizzak Region to Tashkent, but the bank transferred only a quarter of the amount. For the second week running, I have been trying to get them to transfer the rest of the money".

Focus group participant

In some regions, settlement took five to seven days. Since there is no other way to effect settlements, such delay often ties up funds of enterprises and affects their performance.

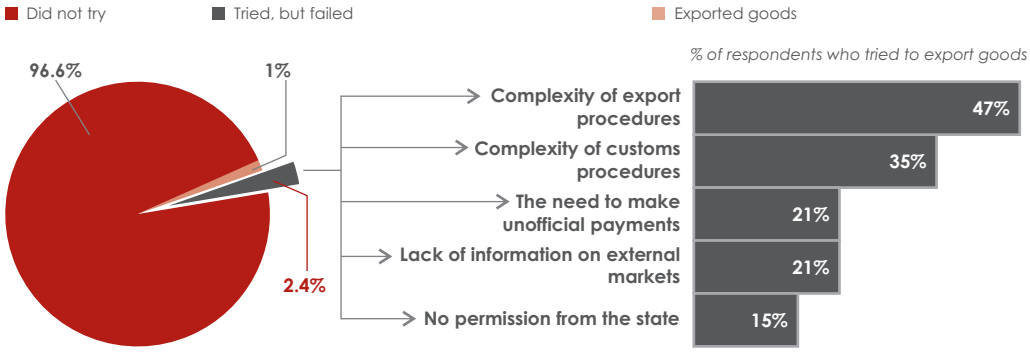
Further information on typical problems in the relationship between SMEs and financial institutions is presented in Statistical Results of the Survey, and in IFC's 2001-2003 reports "Business Environment in Uzbekistan as Seen by Small and Medium Enterprises."[11]

The government of Uzbekistan provides support for exports. For example, exported goods have been exempted from customs duties and a number of other privileges have been granted to manufacturers of export-oriented goods. Despite these measures, exporters face numerous constraints. The survey showed that only one-third of respondents who tried to export their goods succeeded in doing so. The others failed to overcome a variety of administrative barriers.

[10] Regulations for non-cash settlements were approved by Resolution 60 (№¼) of the Central Bank on January 12, 2002 and registered (1122) at the Ministry of Justice on April 15, 2002.

[11] The electronic versions are available at http://www2.ifc.org/centralasia/sme/uzsurvey.htm.

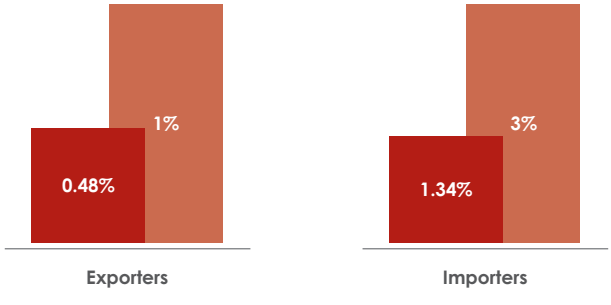
Chart 1.10
ONLY ONE-THIRD OF BUSINESSES WHO TRIED TO EXPORT THEIR GOODS SUCCEEDED IN DOING SO
% of respondents



Agriculture accounts for 61% of businesses in Uzbekistan, and the state is obliged to provide support to them. However, the analysis showed that a wide array of constraints prevented 90% of potential exporters representing this sector from exporting goods. More detailed information on SME export and import transactions is presented in Statistical Results of the Survey, as well as in the 2003 IFC Report Business Environment in Uzbekistan as Seen by Small and Medium Enterprises.

IFC compared the survey results with data from the State Committee on Statistics.[12] The percentage of respondents who indicated in the IFC survey that they carried out export and import transactions in 2004 was more than double the figures in the official data.

Chart 1.11
SURVEY RESULTS POINTED TO A SIGNIFICANT PERCENTAGE OF UNOFFICIAL FOREIGN TRADE TRANSACTIONS
Goskomstat (% of operating SMEs) *IFC data (% of respondents)*



It seems that a substantial number of businesses, having failed to overcome administrative obstacles, engaged in unofficial trade in various ways. This was so for both export and import transactions.

To address these issues, the Government of Uzbekistan passed a package of legal and regulatory measures in 2005 in which it outlined a two-year action program aimed at improving the business environment:

"For instance, all of our farm produce is smuggled into Kazakhstan, and from there it is transported to Russia as if it had been produced in Kazakhstan. The government has made the export procedure so complicated and expensive that practically two-thirds of participants in foreign trade now operate in the shadow market. And those who operate officially are unable to compete with them."

Focus group participant

[12] Letter 18-15-05 of the State Statistics Committee of the Republic of Uzbekistan dated March 09, 2005.

- January 2005 – decision to draft a new Tax Code;[13]
- March 2005 – approval of a program for implementing the objectives and tasks of reforming and modernizing the country;[14]
- April 2005 – further reform and liberalization of the banking system;[15]
- June 2005 – improvement to legal protection for businesses;[16]
- June 2005 – introduction of a unified tax payment for SMEs, instead of the unified tax and multiple payments;[17]
- June 2005 – reduction of the amounts of financial penalties and exemption for minor, unintentional, first-time violations;[18]
- June 2005 – improvements to the system for submitting reports and calculating tax for SMEs;[19]
- August 2005 – guarantees of unimpeded access to cash held in bank settlement accounts;[20]
- September 2005 – cancellation of some types of procedures for obtaining permits and introduction of unlimited-duration licences for some types of activity;[21]
- October 2005 – further reduction in the number of inspections.[22]

To the business community, the announcement of these intentions and some practical moves in this direction signalled further economic reforms. Improving the business environment through collaboration of the country's government with the business community, with support from donor organizations and international financial institutions, will help ensure stable development of Uzbekistan's economy.

This Report presents an overview of the main problems entrepreneurs faced in undergoing inspections, obtaining all kinds of permits and approvals, reporting, registering businesses, and taxation in 2004. The summary tables that follow give a brief analysis of the main sources of these problems and detailed short-term and long-term recommendations on how to overcome them. The recommendations on the removal of barriers facing entrepreneurs, as revealed in the course of the survey, are intended to assist the government in its decision-making process in the course of reforming the business environment.

Part II of this Report (Statistical Results of the Survey) contains detailed data obtained from respondents with respect to questions concerning the entire range of their operations, from registration and obtaining the necessary permits and licences, through the processes for certificates and standards, settlement transactions, calculation and payment of taxes and other compulsory fees, to foreign business transactions, and business liquidation. It also contains detailed demographic information on the respondents and their assessment of the business environment overall. The data on agricultural businesses and self-employed entrepreneurs not operating through a legal entity are presented separately.

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[13] Order R-2108 of the President of the Republic of Uzbekistan, "On Drafting a New Edition of the Tax Code of the Republic of Uzbekistan," January 07, 2005.

[14] Resolution PP-24 of the President of the Republic of Uzbekistan, "On the Program for Implementing the Objectives and Tasks of Democratizing and Renewing Society, and Reforming and Modernizing the Country," March 10, 2005.

[15] Resolution PP-56 of the President of the Republic of Uzbekistan, "On Further Reforming and Liberalizing the Banking System," April 15, 2005.

[16] Decree UP-3619 of the President of the Republic of Uzbekistan, "On Further Improving the System of Legal Protection of Businesses," June 14, 2005.

[17] Decree UP-3620 of the President of the Republic of Uzbekistan, "On Additional Incentives for the Development of Micro-Firms and Small Businesses," June 20, 2005.

[18] Decree UP-3622 of the President of the Republic of Uzbekistan, "On Liberalizing Financial Liability of Businesses for Economic Violations," June 24, 2005.

[19] Resolution PP-100 of the President of the Republic of Uzbekistan, "On Improving the System of Business Reporting and Raising the Penalty for Illegal Demands," June 15, 2005.

[20] Resolution PP-147 of the President of the Republic of Uzbekistan, "On Guarantees of Unimpeded Provision of Cash Payments from Bank Deposits," August 05, 2005.

[21] Resolution PP-186 of the President of the Republic of Uzbekistan, "On Reducing the Types and Simplifying Permit Procedures for Entrepreneurial Activity," September 21, 2005.

[22] Decree UP-3665 of the President of the Republic of Uzbekistan, "On Further Reducing and Improving the System of Inspections of Businesses," October 05, 2005.

KEY PROBLEMS IN THE INSPECTION SYSTEM, THEIR MAIN SOURCES, AND RECOMMENDATIONS TO ADDRESS THEM

PROBLEMS	SOURCES OF PROBLEMS	SHORT-TERM RECOMMENDATIONS TO ADDRESS PROBLEMS	EXPECTED IMPACT	LONG-TERM REC-OMMENDATIONS
The enterprises operating most effectively are subject to inspections more frequently	A system of selecting enterprises for inspections is not put in place along with the administrative decrease in their number	Introduce a risk-based inspections system	1. Distribute inspectorate resources more efficiently 2. Reduce the burden on law-abiding enterprises and provide incentive to enterprises to comply with legal requirements 3. Reduce the number of inspections 4. Establish a system that encourages enterprises that comply with legal requirements voluntarily and penalizes those that violate them 5. Eliminate the potential for abuse of power by officials 6. Increase efficiency in business management	
	Fines as the objective of inspections			Liquidate the non-budgetary funds of inspectorates accumulated from penalties
Most inspections end in penalties, both official and unofficial	A system of selecting enterprises for inspections is not put in place along with the administrative decrease in their number	Introduce a risk-based inspections system		
	Lack of transparency in conducting inspections and the decisions of inspectors	1. Standardize and improve the procedure for directing inspections through introducing: • Checklists; • Regulations for conducting inspections (codes of conduct). 2. Simplify the standards applied to entrepreneurs by technical services	1. Prevent unlawful interference by inspectors in business activities and reduce the potential for abuse of power 2. Increase compliance with rules by entrepreneurs by making the rules clear, and raise the level of legal awareness of entrepreneurs 3. Standardize the procedure for directing inspections 4. Improve entrepreneurs' access to appeal of the actions of inspectors	Liquidate the non-budgetary funds of inspectorates accumulated from penalties
	Low level of legal awareness among entrepreneurs	1. Introduce checklists 2. Raise the level of legal awareness among entrepreneurs and the inspectors		Arrange workshops on interpersonal psychology, conflict management, strategic planning and risk-management for entrepreneurs and inspectors
Entrepreneurs preferred not to appeal inspectors' decisions	Poor functioning of the mechanism for appealing unlawful actions by inspectors	1. Establish the "presumption of innocence" principle 2. Raise the level of legal awareness of entrepreneurs	1. Change the perceptions preventing entrepreneurs from appealing decisions of state agencies, and improve entrepreneurs' access to appeal of the actions of inspectors 2. Increase compliance with legal requirements by entrepreneurs and inspectors, and raise their awareness of the law 3. Increase the accountability of inspectors for imposing legal enforcement measures 4. Prevent unlawful interference by inspectors in business activities and reduce the potential for abuse of power	
	Low level of legal awareness among entrepreneurs	1. Introduce checklists 2. Raise the level of legal awareness among entrepreneurs and the inspectors		

KEY PROBLEMS IN THE REPORTING SYSTEM, THEIR MAIN SOURCES, AND RECOMMENDATIONS TO ADDRESS THEM

PROBLEMS	SOURCES OF PROBLEMS	SHORT-TERM RECOMMENDATIONS TO ADDRESS PROBLEMS	EXPECTED IMPACT	LONG-TERM RECOMMENDATIONS
Preparing and submitting reports remains highly problematic for entrepreneurs	Requests for additional reports not required by law	1. Exercise stronger control over compliance with legislation at all levels 2. Raise the level of legal awareness among entrepreneurs and officials by publishing a series of information materials and arranging workshops	1. Eliminate the practice of demanding reports not stipulated by legislation 2. Raise the level of legal awareness among entrepreneurs and officials	Further simplify reporting formats Bring reporting formats closer to international standards
	Requests for additional information	Eliminate the power of state tax agencies to demand additional information from entrepreneurs outside the framework of the current inspection	1. Reduce the administrative burden on SMEs 2. Reduce contacts between entrepreneurs and officials and thus reduce the potential for abuse of power	
	Monthly submission of calculations of taxes and other compulsory fees	Limit the frequency for submitting calculation of taxes and mandatory contributions	1. Reduce the administrative burden on SMEs 2. Leave tax officials more time to do analytical work 3. Reduce contacts between entrepreneurs and officials and thus reduce the potential for abuse of power	
State tax agencies have no conditions for receiving reports	Lack of legislation to establish procedures for receiving reports	1. Formulate regulations to govern the procedure for receiving reports 2. Grant entrepreneurs the right to submit reports in electronic format	1. Reduce the number of problems involved in submitting reports 2. Reduce costs for entrepreneurs 3. Leave tax officials more time to do analytical work 4. Reduce contacts between entrepreneurs and officials and thus reduce the potential for abuse of power 5. Increase the level of legal awareness among entrepreneurs and officials	
	The right of entrepreneurs to submit reports by mail is not respected at the regional level	1. Strengthen control over compliance with legislation at all levels 2. Raise awareness of the law among entrepreneurs and officials by publishing a series of information materials and arranging workshops		

KEY PROBLEMS IN THE PERMIT SYSTEM, THEIR MAIN SOURCES, AND RECOMMENDATIONS TO ADDRESS THEM

PROBLEMS	SOURCES OF PROBLEMS	SHORT-TERM RECOMMENDATIONS TO ADDRESS PROBLEMS	EXPECTED IMPACT	LONG-TERM REC-OMMENDATIONS
The number of entrepreneurs who must obtain permits after registration is growing	Unrestricted introduction of permits	1. Reduce the number of permits 2. Draft a law regulating permit issuance and defining state policies in this area 3. Raise the level of legal awareness among entrepreneurs and officials by publishing a series of information materials and arranging workshops	1. End the practice of introducing through regulatory acts procedures restricting entrepreneurial activity 2. Reduce the number of contacts between entrepreneurs and officials and thereby reduce the potential for abuse of power 3. Allow entrepreneurs equitable competitive opportunities for access to and operation in the market	Introduce the principle of limiting the period for which permits will be in effective – "sunset clause"
	Non-compliance with legislation at the regional level		1. End the practice of introducing through regulatory acts procedures restricting entrepreneurial activity 2. Increase the accountability of public servants 3. Allow entrepreneurs equitable competitive opportunities for access to and operation in the market	
	Low level of legal awareness among entrepreneurs		1. Guarantee the transparency of permit issuance procedures: entrepreneurs aware of the requirements for permits will meet them 2. Ensure public control over compliance with legislation by officials	
Obtaining permits is problematic for more than one-third of enterprises	Shortcomings of the regulatory framework	1. Draft a law regulating permit issuance and defining state policies in this area 2. Monitor compliance with legislation in the field and establish accountability of officials for non-performance of their functions 3. Raise the level of legal awareness among entrepreneurs and officials by publishing a series of information materials and arranging workshops	1. Reduce the time required to obtain decisions, because the law would set a maximum period for reviewing documents 2. Guarantee the transparency of permit issuance procedures: entrepreneurs aware of the requirements for permits will meet them 3. Allow entrepreneurs equitable competitive opportunities for access to and operation in the market	1. Introduce the declaratory principle for permit issuance[1] 2. Introduce the "silence is consent" principle[2]
	Non-compliance with legislation at the regional level		1. Guarantee the transparency of permit issuance procedures: entrepreneurs aware of requirements for permits will meet them 2. Increase the accountability of public servants 3. Standardize permit-issuance procedures throughout the country, thus reducing corruption	
	Low level of legal awareness among entrepreneurs		1. Guarantee the transparency of permit issuance procedures: entrepreneurs aware of the requirements for permits will meet them 2 Ensure public control over compliance with legislation by officials	

[1] For permits, the declaratory principle means that the entrepreneur determines independently whether he meets all requirements and standards as clearly defined in legislation, and assumes responsibility for complying with them; therefore, he can take the actions/engage in the activity immediately upon notifying the relevant state agencies.

[2] The "silence is consent" principle means that public servants must, within a strictly limited period, review and reply to the entrepreneur's application, or ask for some additional time for the review. If they do not reply in time, the entrepreneur has the right to perform the actions or engage in the activity requested.

KEY PROBLEMS IN THE REGISTRATION SYSTEM, THEIR MAIN SOURCES, AND RECOMMENDATIONS TO ADDRESS THEM

PROBLEMS	SOURCES OF PROBLEMS	SHORT-TERM RECOMMENDATIONS TO ADDRESS PROBLEMS	EXPECTED IMPACT	LONG-TERM RECOMMENDATIONS
Contrary to legislation, most entrepreneurs carry out registration procedures themselves	Lack of an effective mechanism for collaboration between state agencies	1. Introduce the declaratory principle 2. Develop a mechanism for collaboration between state agencies 3. Monitor compliance with legislation at the regional level	1. Increase the accountability of officials 2. Standardize registration procedures throughout the regions 3. Reduce contacts between entrepreneurs and officials and thus reduce the potential for abuse of power 4. Ensure public control over the actions of official	1. Introduce on-line registration for SMEs 2. Study the effectiveness of the minimum capital requirements
	Non-compliance with legislation at the regional level	1. Monitor compliance with legislation at the regional level 2. Impose sanctions on officials for non-performance of their duties		
	Inaccessibility/incomprehensibility of information to/by entrepreneurs	Undertake a wide-scale information campaign and facilitate access to information: • arrange workshops and conferences • issue current and easy-to-understand information materials • publish information in newspapers, and make it available in registration inspectorates, CTI, etc.		
	Low level of legal awareness among entrepreneurs			
Registration time limits are not met	Lack of an effective mechanism for collaboration between state agencies	1. Introduce the declaratory principle 2. Develop a mechanism for collaboration between state agencies 3. Monitor compliance with legislation at the regional level 4. Impose sanctions on officials for non-performance of their duties 5. Undertake a wide-scale information campaign and facilitate access to information: • arrange workshops and conferences • issue current and easy-to-understand information materials • publish information in newspapers, and make it available in registration inspectorates, CTI, etc.	1. Eliminate unjustified extension of registration time limits: speeding up the start-up of businesses by just one day could increase the volume of sales in this sector by 1.4 billion soums per year 2. Increase the accountability of officials 3. Standardize registration procedures throughout the regions 4. Reduce contacts between entrepreneurs and officials and thus reduce the potential for abuse of power 5. Ensure public control over the actions of official	
	Lack of effective mechanism for imposing sanctions on officials for delays and unjustified denial of registration			
	Non-compliance with legislation at the regional level			
	Low level of legal awareness among entrepreneurs			
Registration costs have not gone down	The need to make unofficial payments		1. Reduce the expenses involved in registration for entrepreneurs 2. Increase the accountability of officials 3. Standardize registration procedures throughout the regions 4. Reduce contacts between entrepreneurs and officials and thus reduce the potential for abuse of power 5. Ensure public control over the actions of officials	
	The need to have contact with officials in various agencies			
	Low level of awareness of the law among entrepreneurs			

KEY PROBLEMS IN THE TAXATION SYSTEM, THEIR MAIN SOURCES, AND RECOMMENDATIONS TO ADDRESS THEM

PROBLEMS	SOURCES OF PROBLEMS	SHORT-TERM RECOMMENDATIONS TO ADDRESS PROBLEMS	EXPECTED IMPACT	LONG-TERM RECOMMEN-DATIONS
The tax burden is excessive	High tax rates	Reduce tax rates and simultaneously strengthen tax administration with the aim of increasing tax collection	1. Increase sales for businesses 2. Increase the number of new companies established 3. Reduce the shadow sector 4. Increase revenue to the public budget 5. Reduce corruption among pubic servants	Further reducing the tax burden
	High tax on investment expenses	1. Allow deduction of the interest on long-term credit from the basis for calculating profit tax 2. Allow accelerated depreciation rates to be applied to purchased equipment 3. Allow VAT input credits for capital purchases		
	Double taxation, "tax on tax" and taxation of sales	Reduce double taxation, eliminate "tax on tax," and end the practice of calculating taxes and fees based on sales		
	Some business expenses are included in the basis for calculating profit tax	Change the basis for calculating profit tax by excluding legitimate business expenses from taxable income		
	High social security contribu-tions and progressive income tax rate schedule	Analyze personal incomes with a view to finding ways to optimize the tax burden and social security contributions for individuals	1. Increase personal income 2. Reduce the shadow sector	
	Numerous individual tax concessions	Eliminate individual tax concessions	1. Make tax administration more effective 2. Reduce potential for corruption and abuse of power by officials	
	Tax treatment of local companies is worse than that of enterprises with foreign investment	Create equitable conditions for both local and foreign investors		

PROBLEMS	SOURCES OF PROBLEMS	SHORT-TERM RECOMMENDATIONS TO ADDRESS PROBLEMS	EXPECTED IMPACT	LONG-TERM RECOMMENDATIONS
Tax legislation is complicated	Large number of taxes and fees	Consolidate taxes levied on the same basis but administered separately	1. Reduce tax administration costs for both the state and businesses 2. Make tax administration more effective 3. Reduce unofficial business transactions 4. Reduce potential for corruption and abuse of power by officials	Further reduce the number of taxes and contributions
	Instability of tax system	1. Change the tax system only through amendment to the Tax Code 2. Regulate the effective dates of amendments to the tax system such that they come into effect only at the beginning of a new taxation year and provide for a mandatory period (of at least one quarter) after an amendment is passed before it comes into effect 3. Guarantee a stable tax system for newly established enterprises (for at least 12 months)		
	Large number of documents regulating taxation	1. Introduce a direct-action Tax Code 2. Change the tax system only through amendments to the Tax Code		
	Contradictory laws and regulations and ambiguity in interpretation	1. Simplify the calculation of some taxes (especially profit tax and VAT) 2. Interpret ambiguous regulatory provisions in the taxpayer's favor 3. Improve entrepreneurs' skills in dealing with tax issues 4. Improve the professional skills of tax officials		Raise salaries of tax officials and introduce financial incentives based on increased tax collection and advisory services to taxpayers
	Low level of legal awareness among entrepreneurs and tax officials	1. Introduce a direct-action Tax Code 2. Simplifying the calculation of some taxes 3. Improving entrepreneurs' skills in dealing with taxation issues 4. Improving professional skills of tax officials		

INSPECTIONS

MAIN FINDINGS

- Lack of transparent criteria in selecting businesses for inspection has led to a situation where the enterprises operating most effectively are subject to inspection most frequently.
- Inspections continue to have a punitive nature; most of them result in penalties, both official and unofficial.
- Entrepreneurs prefer not to appeal inspectors' decisions. Only 3% of respondents had appealed the actions of inspectorates in court, and only 39% of appeals were successful.

Internationally, business inspections are instruments for ensuring that businesses comply with legal requirements such as full and timely payment of taxes, environmental protection, health and labor safety, protection of consumer rights, and compliance with registration, licensing, certification, and other applicable standards.

However, this instrument of state control should not be an obstacle to conducting and developing business. Over the past few years, the government has implemented measures to reduce the number of business inspections carried out by inspectorates. (For more detail, please refer to the 2002-2003 IFC reports "Business Environment in Uzbekistan as Seen by Small and Medium Enterprises.")

The results of the 2004 survey show that the trend toward reducing the number of SME inspections has continued. Since 2001, the number of inspections at any one enterprise has decreased five fold on average. In 2004, SMEs were inspected an average of 1.2 times. Inspections lasted an average of 1.4 days and diverted two employees from their principal occupation. By comparison, in 2003 the average results were 1.9 inspections lasting 4.4 days and diverting 1.9 employees.

Box 2.1

Inspections of individual entrepreneurs:

The survey showed that the average number of inspections of individual entrepreneurs was also falling. In 2001, the average was 8 inspections, falling to 4.1 in 2004. However, it should be noted that individual entrepreneurs are inspected four times more frequently than legal entities. This may be because the law does not, in practice, regulate the procedure for directing and carrying out inspections of individual entrepreneurs operating as full-fledged businesses.[1]

However, the ultimate objective of inspections in Uzbekistan continued to be to expose violations and apply penalties, rather than preventing violations and/or helping entrepreneurs to remedy them. For this reason, the government's measures aimed at reducing the pressure of inspections on businesses produced ambiguous results. On the one hand, the number of enterprises undergoing no inspections increased six fold (from 11% to 67%). On the other hand, for the enterprises inspected, the inspections became even more problematic.

[1] See Annex 3.

Box 2.2

Before the large-scale administrative reforms in the Republic of Latvia, the main objective of inspections had been to expose violations and impose penalties. In the period 1999-2003, the government of Latvia undertook reforms, and one of the main areas for improvement was situation with respect to penalties. To address this issue, the principle "orientation toward compliance with regulatory requirements" was introduced into the work of inspectorates. Thus, imposing penalties ceased to be the ultimate objective, instead becoming just one way of ensuring compliance with safety requirements, and was to be applied only after considering alternatives.

A 2003 survey of the business environment in Latvia showed that, as a result of the reforms, the incidence of penalties decreased:

– fire-prevention and rescue service – by 87%

– labor inspectorates – by 84%

– sanitary inspection – by 82%

– municipal police – by 73%.

Moreover, in the period 1999–2003, in the fire-prevention and rescue service alone, the incidence of the following decreased:

– administrative sanctions – by 12%

– warnings to suspend activity/use of equipment – by 52%

– amount of administrative financial penalties – by 3%.

The survey also showed that, in the case of minor errors, inspectorates began to give written or verbal warnings about the need to prevent recurrence instead of imposing penalties.

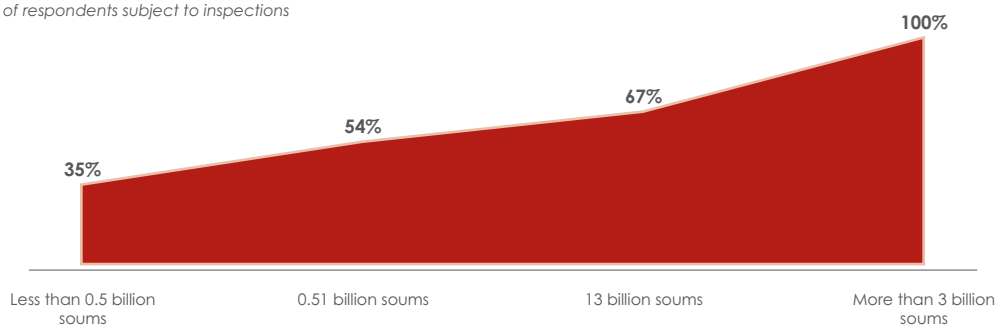
Through discussions about the results of the reform, the heads of inspectorates universally reached the understanding that changes in the frequency and duration of field inspections and the introduction of the "orientation toward compliance with regulatory requirements" principle did not lead to deterioration in public health or labor safety.[2]

THE ENTERPRISES OPERATING MOST EFFECTIVELY ARE SUBJECT TO INSPECTIONS MOST FREQUENTLY

The survey shows that, in practice, there is a direct correlation between the frequency of inspections and the scope of activity of the enterprise. Most inspections are carried out at enterprises with high annual sales. This applies equally to audits and to technical inspections, even though the latter should not be related to sales volume.

[2] Case Study: Inspectorate Reform in Latvia 1999-2003 FIAS. Jacqueline Coolidge, Lars Grava, Sanda Putnina.

Chart 2.1
INSPECTIONS ARE MOSTLY CONDUCTED AT ENTERPRISES WITH HIGH SALES
% of respondents subject to inspections



"The higher the sales I disclose, the more I attract the attention of inspectors. Inconsistency in selecting enterprises for inspections has led to a situation where tax inspectors come to me three times a year, while a neighbor opposite me has not been inspected for four years so far – only because his official sales are lower."

Focus group participant

This state of affairs resulted from the following factors:

A system of selecting enterprises for inspections was not put in place along with the administrative decrease in their number

As already pointed out, the government's measures to reduce the number of inspections have been successful to a certain extent (see Statistical Results of the Survey). However, the system lacks principles to be applied to directing inspections and criteria for selecting enterprises for inspections at the level of local inspectorate offices. This permits some officials to select based on their own interests.

"How do we select them? We receive a list of enterprises from the Inspections Coordination Council, compiled based on the list made by Tax Inspectorate. In the past, we tried to select those that were, in our view, most dangerous, but now we simply write applications for the whole list."

Focus group participant, inspector

"We are still entirely subject to the authorities. Despite all these resolutions, officials will always be able to turn everything in such a way that, if you "quarrel" with them, inspections at your enterprise will follow, one after the other."

Focus group participant, entrepreneur

Fines as the objective of inspections?

In the opinion of focus group participants, inspectors were not guided by the need to monitor, objectively, the entrepreneur's compliance with legislation when conducting an inspection; rather, they were deliberately looking for violations that could provide the basis for a fine.

A legal analysis has shown that the major inspectorates (Tax and SES inspectorates and the State Inspectorate for Oversight of the Electric Power Industry) have extra-budgetary funds accumulated through retaining a portion of the penalties imposed on businesses found in violation of the rules.

Box 2.3

The State Tax Committee of the Republic of Uzbekistan[3]:

Resolve that the **Social Development and Material Support Fund of the state taxation agencies shall be formed of the following deductions:**

- 10% of the amounts additionally collected by the state taxation agencies as a result of inspections (including fines) and the amounts of financial sanctions for abusing tax legislation (minus the amounts to be contributed to the extra-budgetary fund of the Tax and Currency Crimes Department under the Public Prosecutor's Office of the Republic of Uzbekistan);
- 10% of the amount of penalties for administrative violations;
- 10% of the amounts obtained from the sale of the property seized by the state taxation agencies and devolved to the state revenue.

The State Inspectorate for Oversight of the Electric Power Industry[4]:

Amounts collected for violations in the use of fuel and energy resources, oil products, gas, electricity and thermal energy shall, within a month, be transferred by enterprises, amalgamations, institutions and organizations to the settlement account of the State Inspectorate of the Republic of Uzbekistan for Control of the Use of Petroleum Products and Gas (Uzgosneftegazinspektsia) and

[3] Paragraph 5, Resolution 14 of the Cabinet of Ministers, "On Issues of Organizing the Activity of the State Taxation Committee of the Republic of Uzbekistan," January 12, 1998.

[4] Resolution 124 of the Cabinet of Ministers, "On Applying Economic Sanctions for Violations in the Use of Fuel and Energy Resources," March 9, 1994.

the State Inspectorate of the Republic of Uzbekistan for Oversight of the Electric Power Industry (Uzgosenergonadzor). Of these amounts, 90% is to be transferred to a special national intersectoral power supply account, while **10% is to remain at the disposal of Uzneftegazinspectsia and Uzgosenergonadzor without any subsequent taxation.**

The State Sanitary-Epidemiological Surveillance of the Republic of Uzbekistan[5]:

Sanitary-epidemiological stations of all levels shall open a special account in a bank to hold all funds obtained from penalties paid for abusing sanitary legislation, sanitary norms and rules, and hygienic standards, as well as mandatory rules established with the aim of preventing the emergence and spread of quarantined and other infections dangerous to the public. Of the total amount of the funds collected:

- 85% is to be allocated for epidemiological control and sanitary programs;
- **15% is to be allocated for providing material incentives to the staff of sanitary-epidemiological stations.** The amounts of bonuses are to be determined depending on the personal contribution of the staff member to the common work results. The total amount of bonuses shall not exceed three salaries per year.

"A tax inspector comes and says, "Your sales this year have reached 100 million!" I say, 'That's good – I paid more taxes!" To this, the tax inspector says, 'No – now I must find 10 million worth of violations at your enterprise; otherwise I will be punished."

"We don't let the SES into our restaurant. Right at the entrance, we agree to the maximum fine and pay it. It is simpler for us to pay at once than it is to distract our staff from work and cause inconvenience to guests."

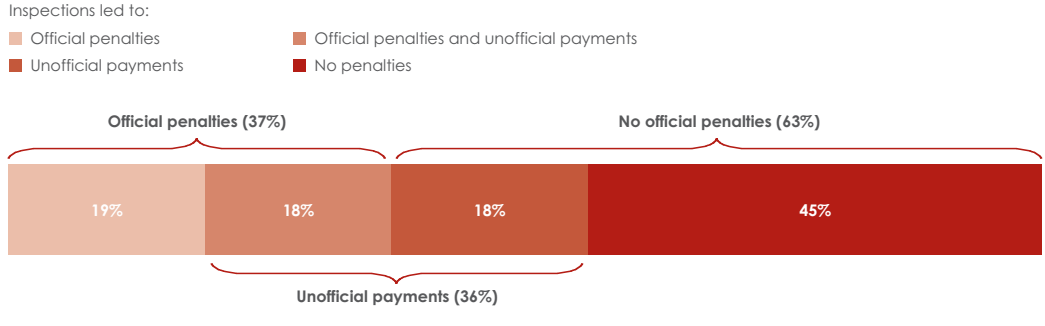
Focus group participants

This approach has led to an entrenched system of planned penalty collection. It explains, in part, the inspectors' desire to inspect primarily those enterprises with high annual sales, while the total number of inspections is decreasing.

MOST INSPECTIONS END IN PENALTIES, BOTH OFFICIAL AND UNOFFICIAL

More than half of inspections resulted in penalties, either official (in the form of fines, follow-up inspections, suspension of banking transactions, administrative or criminal liability, etc.) or unofficial (in the form of unofficial payments.) In 2004, inspections of 37% of respondents ended in official sanctions. Half of them paid fines of an average of 230,000 soums (approximately US $225). Thirty-six per cent of respondents, including half of those who were fined officially and one-third of those who were not, made unofficial payments.

Chart 2.2
MOST INSPECTIONS LED TO NEGATIVE CONSEQUENCES
% of respondents subject to inspections



This problem is attributable to the following factors:

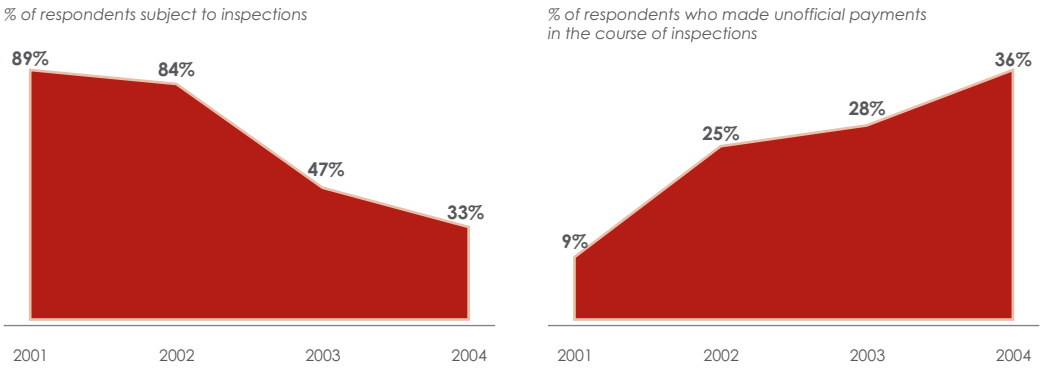
A system of selecting enterprises for inspections was not put in place along with the administrative decrease in their number

As in the case of the first problem, the large number of sanctions applied to the enterprises inspected reflected the fact that the number of inspections was falling, while inspectorates continued to be motivated to reach the "planned target" for penalties collected.

[5] Regulation, "On the Procedure for Using Funds Obtained From Penalties Paid for Violating Sanitary Legislation," approved by Resolution 147 of the Cabinet of Ministers, April 8, 1998.

In addition, inspectors were often guided by personal interests. The survey results led to this conclusion: Concurrent with the general trend toward a decrease in the number of inspections, the percentage of respondents who made unofficial payments in the course of inspections increased four fold since 2001.

Chart 2.3
THE PERCENTAGE OF ENTERPRISES INSPECTED FELL, BUT THE PERCENTAGE OF THOSE INSPECTED WHO MADE UNOFFICIAL PAYMENTS ROSE



Lack of transparency in conducting inspections and the decisions of inspectors

During inspections, entrepreneurs deal directly with the inspectors with respect to the firm's compliance with legal requirements. However, since the inspection procedure is poorly regulated, entrepreneurs do not always have a clear idea of which specific items the inspectors are required to check or entitled to check.

Lack of transparency in the criteria for conducting inspections make it possible for officials to impose penalties for any violation, even the slightest. Making things worse, half of the survey respondents are of the opinion that it is "rather difficult" to meet the requirements for which compliance is checked by inspectorates. As a result, inspectors can easily find faults and collect fines and unofficial payments. Inspectors are not at all interested in informing entrepreneurs about how to avoid future violations.

> "I have no notion of what an inspector must check. I know he will come and find some violations, no matter what. So, I have to give him whatever money I have left from my income to get rid of him."
>
> *Focus group participant*

Chart 2.4
IT WAS VERY DIFFICULT TO COMPLY WITH THE STANDARDS AND RULES OF VARIOUS INSPECTORATES

% of respondents who indicated that it was very problematic and difficult to comply with the standards and rules of the given authority

The focus group survey results, as well as an analysis of regulatory documents, showed that many complications could be attributed to the fact that the requirements of many technical services are based on regulatory documents dating back to the Soviet era. These requirements do not always reflect today's market-oriented conditions and/or current technology.

Box 2.4

The provisions of the sanitary standards for enterprises trading in foodstuffs, dated September 10, 1996, serve as an example of requirements which have become outdated or unnecessary under market-oriented conditions:

Para 45. …chambers for storing foodstuffs should be fitted with lamps permitted for use in premises with low temperatures. The lamps should have protective bowls with a metallic wire mesh to prevent breakage and protect foodstuffs from glass fragments.

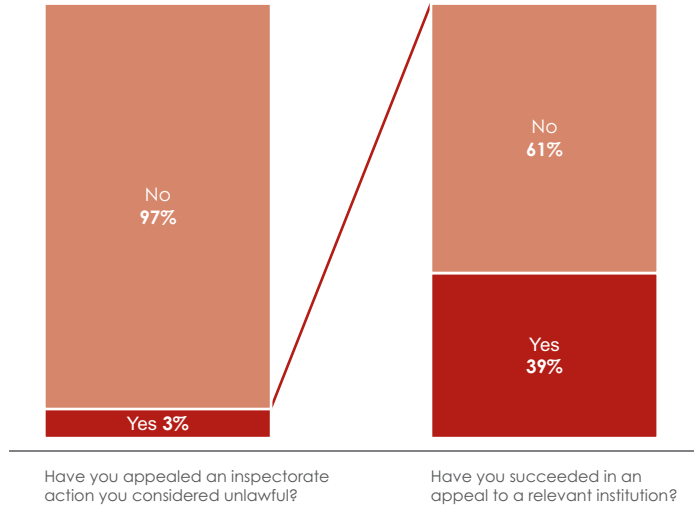
Para 61. …enterprises trading in foodstuffs shall have separate, isolated premises for accepting and storing glassware from the public, with an area of at least 18 m^2, and at least 36 m^2 in supermarkets.

Para 123. …before offering canned foods for sale, the stock-keeper or goods manager shall inspect them on a mandatory basis. For each lot of canned foods found unfit for consumption, a checklist shall be compiled in conformity with the applicable instruction, "On the Procedure of Quality-Based Acceptance of Industrial and Technical Products and Consumer Goods," dated June 15, 1965, with subsequent submission to a commission approved by a higher trade organization.

ENTREPRENEURS PREFER NOT TO APPEAL INSPECTORS' DECISIONS

The survey has found that the mechanism for appealing inspectors' unlawful actions or decisions, intended to ensure effective protection of entrepreneurs' rights and legal interests and to reduce the abuse of power by officials, is not functioning properly in Uzbekistan. For instance, only 3% of respondents had ever appealed an inspectorate action when they disagreed with its lawfulness. Only 39% of those who sought recourse at the relevant institutions were successful.

Chart 2.5
ONLY A HANDFUL OF ENTREPRENEURS APPEALED THE ACTIONS OF INSPECTORATES
% of respondents subject to inspections



That only an insignificant fraction of entrepreneurs appealed the actions of inspectorate officials is explained by the following:

Poor functioning of the mechanism for appealing unlawful actions

One reason for the small percentage of respondents who appealed inspectors' questionable decisions is the poor functioning of the appeal mechanism itself. Focus group participants said that entrepreneurs preferred to forgo a judicial inquiry into their case because examination of claims took a long time, the costs were high, and it was difficult to induce inspectorates to enforce court decisions.

Moreover, focus group participants feel that appeals are complicated by bias against entrepreneurs, as undoubtedly guilty of violations, on the part of both inspectorates and the courts.

"Our case was tried twice. It took half a year. We won in the end, but the money collected from us was never returned; it was set off against future payments. This is wrong, because we could have put it into circulation right away. We effectively extended credit to the state. But when we get a bank loan, we pay a high interest. On top of that, we had to cover the costs – even though the court assigned the costs to the defendant, a state agency."

Focus group participant

LOW LEVEL OF LEGAL AWARENESS OF ENTREPRENEURS

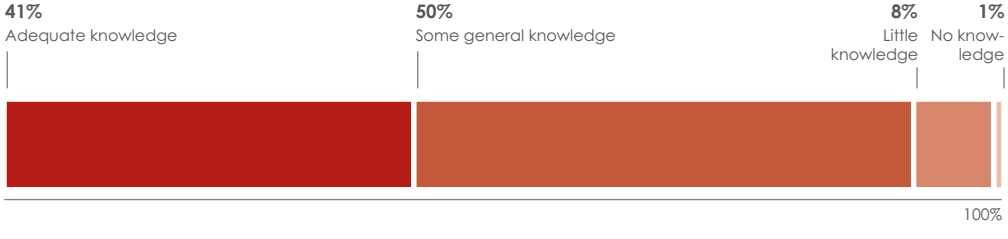
The survey showed that, in 2004, about 60% of respondents were only vaguely familiar with the legislation regulating the inspection process.

"Undoubtedly, courts are deliberately on the side of state authorities, not entrepreneurs. This is obvious during court proceedings."

Focus group participant

Chart 2.6
LESS THAN HALF OF ENTREPRENEURS HAVE ADEQUATE KNOWLEDGE OF THE LEGISLATION REGULATING INSPECTIONS

% of respondents



It is largely due to this lack of awareness on the part of entrepreneurs that most inspections end in penalties. With inadequate knowledge of their rights and duties, entrepreneurs cannot prevent unauthorized inspections[6] or defend their own interests. For instance, some focus group participants did not know they could demand that the inspection be carried out in the presence of a representative of the Chamber of Trade and Industry, whose function is to protect entrepreneurs' rights.

Because of their low level of legal awareness, entrepreneurs rarely appeal against inspectors' decisions even if they regard them as unlawful. In addition, fearing possible repercussions, they are reluctant to act as the inspectorates' formal opponents. The prevailing attitudes among entrepreneurs in Uzbekistan include unwillingness to confront representatives of the authorities.

[6] Inspections carried out without the direction of the Inspections Coordination Council or its territorial commissions, or, in the event of a criminal case, without a ruling by the relevant law enforcement agency or prosecutor's office.

SHORT-TERM RECOMMENDATIONS TO ADDRESS ISSUES IN THE INSPECTION SYSTEM

The problems described herein reduced the significance of the results achieved by reducing the number of inspections. To improve the situation, radical changes to the entire system is required, throughout all its phases: selecting enterprises for inspections and conducting inspections, criteria for imposing penalties on entrepreneurs, and the appeal process.

Detailed recommendations for streamlining the process of selecting enterprises for inspections and conducting inspections and for establishing a partnership between entrepreneurs and inspectorates are presented below.

Establish a risk-based inspection system for enterprises selection

In order to address the issues related to selection of enterprises for inspections, it is necessary to eliminate the subjective selection by inspectorate employees of the enterprises to be inspected. To that end, each inspectorate should formulate clear-cut selection criteria. International experience has shown that the most effective method of selecting enterprises for inspection is based on an analysis by inspectorates of the potential risks involved in the business activity.[7] In other words, under this method, selection for inspection and frequency of inspection depends on the extent of potential danger the operation of a business may pose to public health, the environment, or the country's economy.

EXPECTED IMPACT

A risk-based inspection system will:

- improve the efficiency of resource distribution at inspectorates, because they would only inspect enterprises with activities that pose the greatest danger;
- reduce pressure on successful, law-abiding enterprises and create additional incentive for entrepreneurs to comply with legislated requirements, because the frequency of inspections will depend on their compliance with established rules and standards;
- reduce the number of inspections through more objectivity in selecting enterprises for inspection and through increased compliance with legislation by entrepreneurs;
- reduce the scope of unfair competition, because this system will encourage law-abiding enterprises and penalize the violators;

Box 2.5

In October 2005, the President passed Decree UP-3665,[8] which provided for the following:

1. It changed the frequency of standard inspections of entrepreneurs' financial and business activity:
   - Standard inspections of the financial and business activity of micro-firms, small enterprises, and private farms will be conducted no more than once every four years, and of other businesses, no more than once every three years;
   - The financial and business activity of newly-established micro-firms, small enterprises, and private farms may not be subject to standard inspections for the first two years after their state registration.

(Before the Decree came into effect, all standard inspections could be conducted no more than once a year, and inspections of private enterprises and firms that paid taxes and other mandatory fees on time and in full, complied with other standards and rules, and had relevant annual audit reports could be carried out no more than once every two years.)

2. It abolished financial penalties for businesses that complied with the injunctions of inspectorates resulting from inspections and covered damages voluntarily, within the prescribed deadlines and in full measure, including the payment of the penalty interest.
3. It eliminated the possibility of duplicate inspections by tax agencies. Territorial tax agencies will inspect the financial and business activity of SMEs registered in other districts/towns, regardless of the actual location of their production premises, trade outlets, or premises from which they provide services/work, simultaneously with the relevant tax agencies in the locations of businesses registration.

In addition, a new roster of members of the Inspections Coordination Council was approved. The Council was instructed to formulate, jointly with the Ministry of Justice, the State Taxation Committee, and other ministries and departments, well-founded criteria for annual and quarterly businesses inspection schedules. And, by December 1, 2005, the Council was to set and approve an inspection schedule for 2006, including the list of businesses to be subject to inspection based on those criteria, and including the frequency for conducting complex inspections.

[7] For more detail see Annex 4.

[8] Decree UP-3665 of the President of the Republic of Uzbekistan, "On Further Reducing and Improving the System of Inspections of Businesses," October 5, 2005.

Box 2.6

To establish transparent and simplified inspection procedures, many countries have introduced checklists to be used in the course of inspections, as well as codes of conduct for inspectorates, which fully describe the procedure for directing and conducting inspections and for appealing the actions of inspectorates.

For instance, in the course of implementing full-scale regulatory reforms, in the area of surveillance Mexico introduced inspection checklists containing an exhaustive list of items to be checked. These were widely disseminated among entrepreneurs through the mass media.

To simplify procedures, some inspectorates in Latvia introduced inspection checklists with all issues to be checked and the inspectorates' instructions combined in one document. Moreover, all inspectorates in Latvia have their own codes of conduct fully describing their inspecting functions, the rights and duties of inspectors and those inspected, and the procedures for directing and conducting inspections and for appealing inspectorates' actions. Inspectors must familiarize entrepreneurs undergoing inspections with the regulations.

In the course of administrative reform, Canada formulated the Compliance Inspection Policy, which regulates inspectors' activity.

Box 2.7

In June 2005, the President passed Decree UP-3619, which provided that the following legal sanctions were only to be applied to businesses by court order:

- termination of activity;
- suspension of activity, excepting cases of suspension for a period of no more than ten business days to prevent emergencies, epidemics, and any other real threat to public life and health;
- suspension of transactions on bank accounts, with the exception of exposed cases of money laundering and funding of terrorism;
- financial penalties, with the exception of fines for delinquency in paying taxes and fees or in cases where an entrepreneur pleads guilty to a violation and pays financial penalties voluntarily;
- transferring items involved in a violation to the state;
- suspension for a period of more than ten days or invalidation or annulment of licences (permits) for certain types of entrepreneurial activity (with the exception of licenses issued by the commissions of the Cabinet of Ministers and the Central Bank.)

[10] Decree UP-3619 of the President of the Republic of Uzbekistan "On measures of improving further the system of SME legal protection" dated June 14, 2005.

- reduce the potential for officials at various levels to abuse their positions through using inspections to punish entrepreneurs;
- promote more effective business management, because entrepreneurs will have some idea, when they start a business, of which bodies will inspect the enterprise and when.

Put in order and improve the inspection process

Transparency in conducting inspections can be improved in the following two ways:

First, inspectorates carrying out inspections not related to financial and business activity of enterprises should introduce checklists for each type of entrepreneurial activity. They should contain lists of specific questions, as well as the inspectorate's instructions for remedying any shortcomings discovered. Checklists should also include a complete list of everything the inspector will check. The checklist should be made available to all entrepreneurs prior to inspection and be widely distributed among entrepreneurs.[9]

EXPECTED IMPACT

With the introduction of checklists into the inspection process, both entrepreneurs and inspectors will become familiar with the range of issues to be covered in the course of an inspection. This will have the following benefits:

- prevent inspectors from interfering in areas outside their competence, thus reducing opportunities for abuse of power;
- raise awareness of the law and compliance with legal requirements by entrepreneurs, first because they will know the exact range of issues to be checked, and second because records will be kept of violations found, on which the frequency of inspections will depend;
- standardize the process and raise the quality of inspections country wide, regardless of the level of the inspectors' proficiency;
- give entrepreneurs more scope to appeal questionable actions by inspectorate representatives and improve the effectiveness of their appeals.

Second, codes of conduct for inspectors should be prepared and put into practice. The codes of conduct should include detailed and clear-cut information on the powers granted to inspectors in carrying out inspections, the standard operating procedures of inspectorates, the rights and duties of inspectorate representatives and the businesses being inspected, the criteria for imposing penalties (based on the extent of the threat to the public posed by the violation,) the procedure for imposing and collecting penalties, and the procedure for appealing the inspectorates' decisions made based on inspection results.

[9] For more detail, refer to Annex 5.

Box 2.7 (continue)

In addition, the President's Decree UP-3622[11] of June 24, 2005 formalized the intention of introducing into the Tax Code an amendment stipulating that all unavoidable uncertainty, controversy, and vagueness in the laws and regulations on taxes, fees, and payments would be interpreted in favor of the taxpayer.

These measures were intended to create a more effective mechanism for protecting businesses and to reduce interference in their activities by inspectorates, with the aim of safeguarding entrepreneurs' legal interests and preventing unjustified restrictions on entrepreneurial activity.

EXPECTED IMPACT

With the rights and duties of each participant in the inspection process clearly defined, and regulations on the procedures to be followed put in place, the introduction of codes of conduct will:

- reduce opportunities for abuse of power by inspectors;
- create an additional mechanism for protecting the rights and interests of businesses;
- standardize the inspection process country wide;
- raise legal awareness among entrepreneurs.

Embed the "presumption of innocence" principle

Another measure to overcome the inefficiency of the mechanism for appealing inspectorates' decisions arising from entrepreneurs' attitudes is to introduce a law enforcement procedure requiring inspectorates to justify penalties based on inspection results in court before they can be imposed on businesses.

EXPECTED IMPACT

This measure would shift the burden of proof of the appropriateness of penalties from entrepreneurs to inspectorates in court. In addition, this approach would give inspectors increased responsibility for meting out penalties commensurate with the violations of entrepreneur. Being required to justify in court their decisions in imposing penalties based on inspection results would substantially reduce opportunities for abuse of power by inspectors.

Technical services: simplify the regulations for entrepreneurs

The regulations of technical services should be reviewed and simplified for entrepreneurs, to the maximum degree possible, in order to bring them closer to the current conditions brought on by a market-oriented economy and technological advancements, and to eliminate obsolete provisions.

EXPECTED IMPACT

Reviewing and simplifying the regulations for businesses would enhance the transparency of inspections substantially. Entrepreneurs would be better able to comply with fairer regulations, which would reduce the number of penalties imposed on them.

[11] Decree UP-3622 of the President of the Republic of Uzbekistan, "On Liberalizing Financial Liability of Businesses for Economic Violations," June 24, 2005.

Raising the level of legal awareness among entrepreneurs and inspectors

As both entrepreneurs and inspectors pointed out in focus groups, a partnership between inspectorates and SMEs is necessary in order to reduce the number of problems arising in the course of inspections. That aim would be advanced by raising awareness of the law among both entrepreneurs and inspectors. This could be achieved through joint round-table meetings, workshops, and publication and dissemination of information on the procedures for directing and conducting inspections, and so on.

Box 2.8

The IFC SME Policy Project and the Ministry of Justice have jointly taken steps to raise the level of legal awareness among SMEs. In December 2002, they published a brochure, What You Must Know About Inspections, describing the entire inspection process and containing contact information for inspectorates and the "hot line" for the Ministry of Justice. It was distributed among SMEs country wide through regional departments of the Ministry of Justice, Khokimiyats region, the Chamber of Trade and Industry, the Association of Businesswomen, and the Association of Dehkan and Private Farms. The full version of the brochure was also published in the weeklies Taxation and Customs Newsletter and Soliklar va Bojhona Habarlari. Approximately 34,000 copies were distributed in all.

The survey showed that 41% of respondents were familiar with the brochure, and 84% of them stated that they were satisfied with the information it contained. Almost half of entrepreneurs who used the brochure in the course of their entrepreneurial activity pointed out its usefulness.

EXPECTED IMPACT

This approach would raise the level of legal awareness among inspectors, top executives of inspectorates, and entrepreneurs. This increased awareness would lead to less abuse of the law by all parties involved in inspections and fewer problems arising from inspections for businesses. It would also improve compliance with regulations among businesses that are not inspected.

Box 2.9

Since 2003, the IFC SME Policy Project has been actively collaborating with a number of ministries and departments in Uzbekistan to improve the system for directing and conducting inspections:

- an international expert was invited to participate in a number of round-table meetings and focus groups comprised of entrepreneurs and employees of the inspectorates most frequently engaged in inspecting businesses (tax agencies, fire-prevention units and SES units);
- to draw on the latest international experience, a study tour was arranged for representatives of the above-mentioned agencies to Latvia, which has been most successful in reforming the Soviet era regulatory system to European standards;
- based on the results of the round-table meetings and the study tour, a joint plan for improving the process of SME inspections by inspectorates was formulated, agreed upon with the heads of the Inspections Coordination Council, and approved by the national SME Coordination Council;
- in accordance with the plan, checklists for the fire-prevention and SES bodies were compiled, and pilot inspections were carried out as a basis for discussing with entrepreneurs the effectiveness of these documents and the necessity of introducing them;
- jointly with the SES bodies, work has begun on formulating criteria for risk-based inspection system.

At the invitation of the Ministry of Justice, the Ministry of Economics, and the State Committee for Demonopolization and Support of Competition and Entrepreneurship, Project experts participated in drafting a number of government measures aimed at improving the system for directing and conducting inspections.

LONG-TERM RECOMMENDATIONS

Subsequent steps in reforming the inspection system should be aimed at further simplifying the process for entrepreneurs. That requires a radical change in the way inspectors view inspections – as a source of income. The practice of planning for the revenue from penalties imposed on entrepreneurs should be abolished. Among other things, measures should include liquidation of the inspectorates' extra-budgetary funds accumulated from penalties imposed on businesses. It would be advisable to introduce a system of material incentives for inspectorate employees funded solely from the state budget, and to study the possibility of raising inspectors' salaries. Simultaneously with these measures, regular staff appraisals and upgrading of inspectors' professional skills should be undertaken.

Box 2.10

In 2004, the World Bank studied the financial reporting system in Uzbekistan. The study showed that there were four large extra-budgetary funds in the country, and over twenty small ones. The latter were accumulated at budget-funded organizations that collected revenue in the course of their activities. The funds were spent on improving the operations of these organizations, as well as on bonuses and other remuneration for their employees.

In the opinion of the World Bank, the existence of such funds carries a number of risks for the country's budgetary system. They fragment and even usurp the budgetary process, thereby complicating planning and control over the effective and targeted use of funds.

In light of the problems involved in the existence of extra-budgetary funds, the World Bank recommends that the government of Uzbekistan abolish them in the medium term.

In addition, to aid in establishing the partnership between entrepreneurs and inspectorates required in order to minimize problems and improve the effectiveness of inspections, it is advisable to introduce training programs such as interpersonal psychology and conflict management, and strategic planning and risk management for top executives.

[12] The World Bank, Republic of Uzbekistan. 2004. Country Financial Accountability Assessment. Report N 31345-UZ, October, 2004.

REPORTING

MAIN FINDINGS

- Preparing and submitting reports remained highly problematic for entrepreneurs, as pointed out by 41% of respondents.
- State tax agencies have no conditions for receiving reports, as pointed out by 40% of respondents.

The state requires businesses to submit reports in order to monitor their activities and for statistical purposes stemming from the need for effective economic management and development. However, submitting reports costs entrepreneurs time and money and distracts them from their primary activity. Not surprisingly, reporting is sometimes called "the information tax on businesses."

A clearly defined and limited list of required reports, simplified to the extent possible to eliminate duplication, would serve the interests of both state agencies and entrepreneurs. The power of state agencies to demand reports should be strictly prescribed by law.

In Uzbekistan, SMEs are only required to submit reports to state statistical and tax agencies and in the form established by them.[1] In practice, however, this limitation is not always observed, and businesses must submit a variety of additional information to these and other agencies. For instance, one-third of respondents pointed out that the commercial banks demand various financial and statistical reports.

PREPARING AND SUBMITTING REPORTS REMAINS HIGHLY PROBLEMATIC FOR ENTREPRENEURS

The survey showed that, despite certain measures taken in Uzbekistan back in 2000 to simplify and put in order the SME reporting system, preparing and submitting reports continues to create many problems for entrepreneurs. Two out of five respondents pointed to the complexity of this process.

Box 3.1

According to Resolution 65 of the Cabinet of Ministers of February 23, 2000, SMEs were required to submit reports only to local state statistical and tax agencies in the forms established by them. These reports were to be submitted once per quarter, and was not permitted to demand monthly reports from them.

National accounting standard 20[2] established the list of financial reports to be submitted SMEs. They need only submit annual reports consisting of a balance-sheet, a financial statement, and information about accounts receivable and payable.

[1] Resolution 65 of the Cabinet of Ministers of the Republic of Uzbekistan, "On Measures to Reduce and Put in Order Reporting by Small Enterprises," February 23, 2000.

[2] NAS Para 5.9, "On the Procedure for Simplified Accounting and Reporting by SMEs (registered by the Ministry of Justice" on January 24, 2000, # 879).

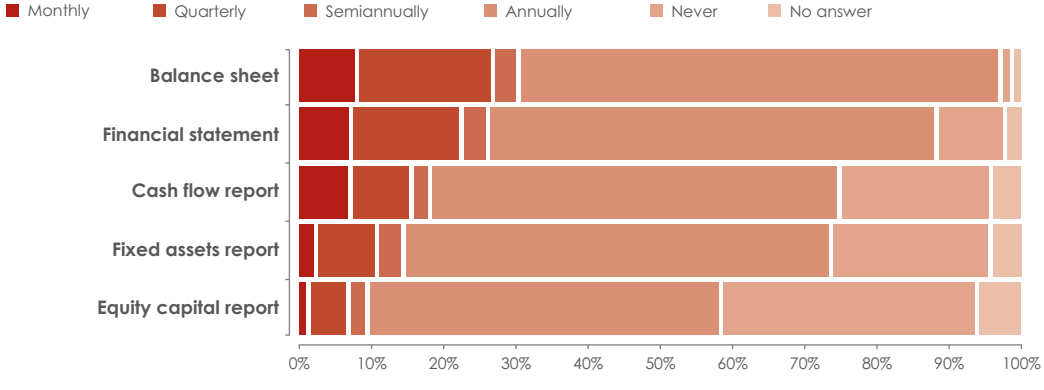
There are several factors in the degree of complexity in preparing and submitting reports.

Requests for additional reports not required by law

Despite the restriction on tax and statistical agencies that they may require financial reports from SMEs no more than once a year,[3] respondents said that they were required to submit them much more frequently. Moreover, respondents pointed out that they had to submit additional forms of financial reports (on fixed assets, cash flow, and equity capital) which SMEs are not obliged to submit.

Chart 3.1
SMEs SUBMITTED FINANCIAL REPORTS MORE OFTEN THAN REQUIRED BY LAW

% of respondents



> "A tax inspector may call any time and demand any information. It may take the accountant one week to do it, and making the same calculations as are required to prepare a balance sheet. What is the use of the requirement to submit a balance sheet once a year if similar information can be demanded from us on a weekly basis?"
>
> *Focus group participant*

These circumstances arise from the improper enforcement of reporting regulations at the regional level. The level of legal awareness among both entrepreneurs and officials is also an important factor. If officials knew the fundamental laws and regulations in this area, they would not accept reports more often than required by law or in forms not stipulated in the regulations, even if entrepreneurs submitted them. Similarly, if entrepreneurs knew the laws and regulations, they would not feel obliged to meet unlawful requests from officials.

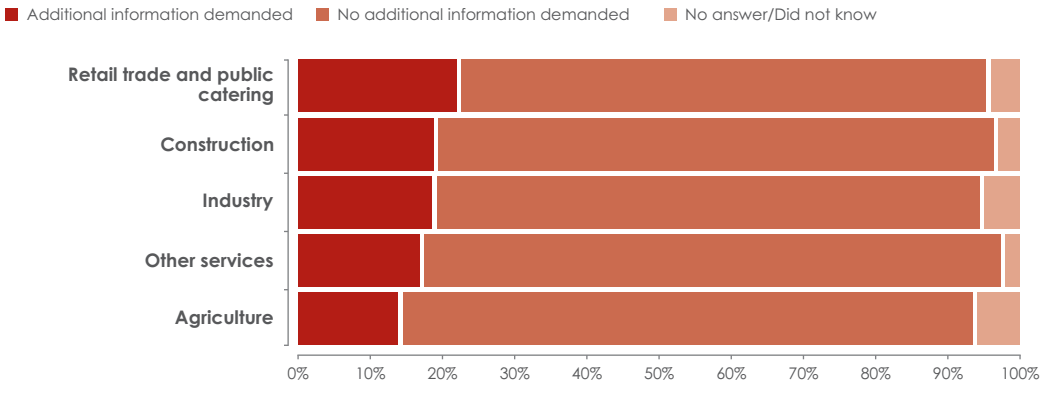
Requests for additional information

Two out of five respondents pointed out that tax agencies demanded additional information. Looking at this issue by economic sector shows that additional documents are most often requested from retail trade and public catering enterprises, and most rarely from agriculture businesses.

[3] Resolution 227 of the Cabinet of Ministers of the Republic of Uzbekistan, "On Measures to Further Improve Statistical and Financial Reporting," June 25, 2002.

Chart 3.2
TAX INSPECTORATES' DEMANDS FOR ADDITIONAL INFORMATION FROM SMEs

% of respondents



It should be pointed out that there are no restrictions on an agency's legal right to demand additional information.[4] This increases the administrative burden on the entrepreneurs who have to prepare and submit additional information to tax agencies.

Box 3.2

The right of tax agencies to demand additional information from entrepreneurs is stipulated by legislation in other countries as well. However, it is strictly regulated. In Latvia, for instance, if a tax inspector considers it necessary to obtain information other than the mandatory reporting forms, he must formalize each such demand as an inspection of the taxpayer's activity.

Monthly submission of calculations of taxes and other compulsory fees

Until recently, legal restrictions on the frequency of submitting reports did not apply to calculations of taxes, the unified social security fee, mandatory insurance payments, and deductions for extra-budgetary funds. Entrepreneurs had to submit these to tax agencies on a monthly basis, which reduced the significance and effectiveness of the government measures limiting financial reporting and distracted entrepreneurs from their primary activity. Thus, the establishment of a system under which SMEs would submit reports to tax agencies no more frequently than quarterly has not been completed.

STATE TAX AGENCIES HAVE NO CONDITIONS FOR RECEIVING REPORTS

The survey showed that 40% of respondents assessed the procedures for submitting financial reports and calculations (waiting on the premises, the schedule for accepting reports, etc.) as "problematic" and "rather complicated." Although the state allows for submission by mail, only 2% of respondents took advantage of that option.[5] More than half of respondents did not even know that it was possible, and 26% indicated that tax inspectors demanded their personal attendance at the tax inspectorates to submit reports and calculations.

There are several reasons for the organizational problems with receiving reports.

"In Samarkand City, division into districts has been abolished. Entrepreneurs used to submit reports to tax inspectorates in three districts, but now we all have to take them to the City Tax Inspectorate. On the days when reports are to be submitted, long queues are formed there because everyone comes to one place. We have to stand in the queue several times – first for the inspector, then for the computer operator, and so on. When will normal conditions for submitting reports be put in place?"

Focus group participant

[4] According to Article 5 of Law 474-I of the Republic of Uzbekistan, "On the State Taxation Service," August 29, 1997, tax agencies, within their competence, have the right to obtain from legal entities and individuals information, references, documents, and copies of documents relating to the taxpayer's activity.

[5] Article 122 of the Tax Code of the Republic of Uzbekistan grants taxpayers the right to submit financial reports and tax calculations through communication agencies, i.e., by mail.

"My firm provides accounting services to several enterprises. In my official capacity, I have to visit tax inspectorates in three districts. I have a feeling that each inspectorate makes its own rules. One of them accepts reports from morning until lunchtime, another after lunchtime for only one hour, and the third only every other day."

Focus group participant

Lack of legislation to establish procedures for receiving reports

The high degree of complexity in the process of receiving reports is primarily due to the lack of laws and regulations for state tax agencies with respect to standardized report receipt schedules, registration procedures, and report processing (including reports received by mail or e-mail).

Legal requirements are not observed at the regional level

The problems described above are largely caused by the lack of adherence to legal requirements at the regional level. One example has already been mentioned – that tax agencies refuse to accept reports from businesses by mail, even though this form of submission is legal. However, it should be noted that the legal and regulatory framework contains certain contradictions that prevent entrepreneurs from exercising the rights granted to them. For example, according to National Accounting Standard 1, the submission date of a financial report submitted by a company in the vicinity of the agency is the day the relevant agency acknowledges receipt. For that reason, entrepreneurs cannot send their reports by mail because receipt of their report must be confirmed by a stamp and a signature.[6] Also, demands for additional information forced entrepreneurs to visit state agencies more often than required by law.

SHORT-TERM RECOMMENDATIONS ON ADDRESSING REPORTING ISSUES

The reporting system requires further improvement. The problems with it increase the administrative burden and costs and distract entrepreneurs from entrepreneurial activity. This is especially critical for SMEs that often do not have sufficient financial and human resources.

Abolish the practice of requesting additional information

Tax agencies should no longer be empowered to demand additional information from businesses outside the framework of the inspections conducted by those agencies.

EXPECTED IMPACT

The administrative burden on businesses would be reduced by relieving them of the need to spend time and human resources on preparing additional information and documents. This measure would also reduce the possibility of abuse of power by officials who would rather demand additional information than analyze the reports available, thereby shifting part of their work onto entrepreneurs.

Extend restrictions on the frequency of submitting reports to the calculation of taxes and other compulsory fees

The existing legal restrictions on the frequency of submitting certain reports should be applied to the submission of tax calculations. It would be advisable to reduce the frequency with which SMEs are required to submit document to tax and statistical agencies to no more than quarterly.

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[6] According to Para 65 of NAS 1, Accounting Policy and Financial Reporting (registered by the Ministry of Justice on August 14, 1998, # 474), the submission date of a financial report submitted by a company in the vicinity of the agency is the date the relevant agency acknowledges receipt, and by entities situated outside the vicinity it is the date of its postmarked dispatch.

Box 3.3

The IFC SME Policy Project expressed the need to implement the above-mentioned measures back in 2004. It should be noted that in June 2005, the President's Resolution PP-100 was passed, which provided that:

- as of July 2005, the submission of calculations of taxes, fees, and other compulsory payments by SMEs to tax agencies was to be made quarterly rather than monthly;
- state tax and statistical agencies would no longer be permitted to demand from SMEs any information, references, or documents, other than the established financial and statistical reports, except in the course of inspections and in the manner specified by law;
- other agencies and organizations would no longer be permitted to demand from SMEs any information, including reports, data, references, and documents not stipulated by duly approved legislation.

These measures were intended to address the many problems existing in the reporting area. In order to make viable a system under which SMEs report on their activities no more than quarterly requires ensuring strict compliance with the requirements of this Resolution by state agencies at all levels.

EXPECTED IMPACT

The actual effect of applying these measures can only be analyzed based on the results of the next survey. It is expected that restrictions on the frequency of submitting calculations will substantially reduce the administrative burden on SMEs and allow them to manage their resources more effectively. For their part, tax agency employees will be able to concentrate on analytical work since they will spend less time on receiving and processing calculations. Personal contact between entrepreneurs and representatives of tax agencies will also be reduced, thus reducing the potential for abuse of power.

Regulate the procedure for receiving reports

Many of the problems with submitting reports stem from the lack of a standard working schedule for tax agencies and the lack of a standard process for receiving reports, including by mail and e-mail. Addressing those problems through legislation to regulate the process is necessary to creating an enabling business environment. Intensified control over compliance with legislation in the field is also necessary, along with permanent programs to raise legal awareness among entrepreneurs and officials.

EXPECTED IMPACT

These measures would reduce the problems with submitting reports, end the state agencies' practice of establishing arbitrary schedules for receiving reports, and raise legal awareness among entrepreneurs and officials.

Introduce electronic reporting

To further alleviate the problems with reporting, it is recommended that entrepreneurs be permitted to submit reports in electronic format via the Internet. A factor in favour of this measure in that tax agencies in Uzbekistan are well equipped with computers. The problem is that relatively few SMEs are equipped with computers and still fewer have access to the Internet (see Statistical Results of the Survey). Nonetheless, a pilot project can be implemented in Tashkent City, where 38% of respondents have Internet access. Positive results may encourage other entrepreneurs to use computer technology, and eventually this system could be implemented country wide.

[7] Resolution PP-100 of the President of the Republic of Uzbekistan, "On Improving the Business Reporting System and Enhancing Responsibility for Unlawful Demand," June 15, 2005.

EXPECTED IMPACT

Exercising the option of submitting reports in electronic format will relieve entrepreneurs of the need to attend in person, thus allowing them to use their working hours more effectively. Tax agencies will be able to process the information received more efficiently and thereby reduce administrative costs. The time saved will enable the staff of state agencies to perform analytical work. Personal contacts between entrepreneurs and representatives of tax agencies will be reduced, thereby reducing the potential for abuse of power.

Exercise stringent control over compliance with legislation at the regional level and raise legal awareness among entrepreneurs and officials

Stringent control over compliance with legislation in the field is required in order to end the practice of demanding extra reports and demanding reports more frequently than once a year. In addition, it is necessary to implement continual efforts to raise legal awareness among both entrepreneurs and officials through publishing a series of explanatory materials and by arranging workshops and round table meetings.

EXPECTED IMPACT

Control over compliance with legislation, along with efforts to promote better understanding of laws and regulations among entrepreneurs and officials, will allow entrepreneurs to use the opportunities granted to them more effectively and reduce the potential for abuse of power.

LONG-TERM RECOMMENDATIONS

In reforming the reporting system in Uzbekistan, simplifying financial and other reporting procedures for SMEs should go hand in hand with exercising effective control over compliance with legislation at the local level. The forms of reporting should be brought into compliance with international standards provided that this will contribute to stability in the reporting system, which is necessary for doing business and developing businesses successfully and will put no additional burden on SMEs.

Box 3.4

Pursuant to the President's Resolution PP-100, "On Acceptance and Registration by State Tax Agencies of Businesses' Financial Reports and Calculations of Taxes, Compulsory Fees and Income Statements, and Written Applications and Notices,"[8] regulations were formulated, providing for:

- the option of submitting financial reports, at the taxpayer's discretion, either directly to a state tax agency or by mail or e-mail;
- a procedure for receiving and processing reports and calculations, including those received by mail and e-mail;
- the possibility that taxpayers could submit reports to state tax agencies throughout the full business day;
- the conditions required to organize the receiving of reports by tax agencies, including standard requirements for the operation of offices where reports are received (such as availability of information boards and computers with regulatory and legal software, etc.)

Box 3.5

Reporting in electronic format via the Internet and other electronic means is used in many countries (including Germany, France, the Netherlands, and Australia) to simplify document circulation between entrepreneurs and state agencies. This makes submitting reports easier for entrepreneurs and data processing easier for agencies.

In Sweden, for example, all reporting is carried out electronically. Entrepreneurs send all tax statements to tax agencies via the Internet, attaching electronic seals. Personal contact between entrepreneurs and tax inspectors is practically eliminated. This practice primarily applies to small enterprises in Sweden, which submit reports only once a year[9].

[8] Registered by the Ministry of Justice of the Republic of Uzbekistan on July 29, 2005 (1500).

[9] Excise Taxes, the Swedish Way. Taxation and Customs Newsletter, August 1, 2005.

PERMITS

MAIN FINDINGS

- The number of entrepreneurs who must obtain permits within the first year of activity is growing. In 2002, it was 81%; in 2004 it was up to 97%.
- Obtaining permits is problematic for more than one-third of enterprises. Going through this procedure, they faced a shortage of information, a large number of required documents, ambiguity in the requirements, long waits for permits to be issued, and the need to make unofficial payments.

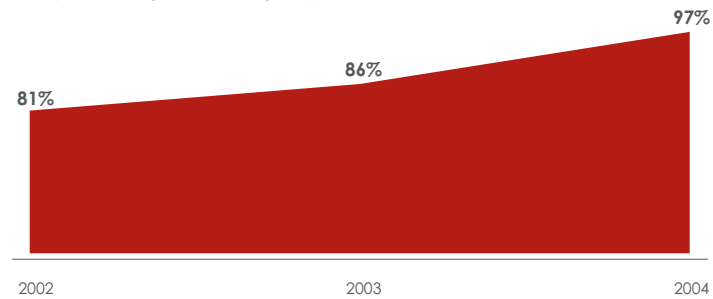
The issuing of permits is a mechanism in the state regulation of business activity intended to prevent harm to public interest, distribute limited resources, and monitor entrepreneurial activity. But the effectiveness of a country's business environment is partly determined by the quality, simplicity, accessibility, and transparency of its administrative procedures, including the issuing of permits.

In Uzbekistan, most entrepreneurs must obtain a variety of permits in the course of their activity. Along with the registration of a legal entity (or individual entrepreneurs), permits are mandatory for certain types of activity. (For instance, wholesale trade, apart from company registration, requires a special permit to engage in this activity.) Permits are also required for certain actions (such as changing the category of a property from living quarters to non-residential property.)

THE NUMBER OF ENTREPRENEURS WHO MUST OBTAIN PERMITS AFTER REGISTRATION IS GROWING

One of the problems in the existing permit system is the growing percentage of enterprises that have to apply to state agencies to obtain permits during the first year of their activity.

Chart 4.1
THE NUMBER OF ENTERPRISES REQUIRING ADDITIONAL PERMITS AFTER REGISTRATION HAS GROWN
% of respondents registered in the given year



In 2004, newly registered enterprises required an average of three permits. One-third of these new businesses had to obtain four permits or more.

Permit requirements exist in practically all areas of entrepreneurial activity in Uzbekistan.

Chart 4.2

MOST ENTERPRISES HAD TO OBTAIN SEVERAL PERMITS

% of respondents who obtained permits

Box 4.1

Examples of existing permits:

- in construction – a permit for construction of facilities;
- in trade – a permit to engage in wholesale and retail trade;
- in production – a permit to use certain materials and substances;
- in export – a permit to export fresh fruits and vegetables;
- in import – a permit to import high-frequency equipment and radio-electronic devices;
- in nature management – a permit to discharge wastewater;
- in investment – a permit to open accounts abroad;
- in advertising – a permit to put advertisements on mail;
- in customs clearance – a permit to place commodities under temporary import (export) administration.

A preliminary analysis by the Ministry of Justice and IFC revealed the existence of approximately 130 types of permits in the country. This may be attributed to the following factors.

Unrestricted introduction of permits

The large number of permits is due to the unrestricted introduction of new permits by various state agencies, which in turn is due to the shortcomings in the legal framework regulating this area.

Box 4.2

Resolution 236 of the Cabinet of Ministers, June 28, 2002,[1] provided that activities not included in the List of Activities Requiring Licensing (approved by Resolution 222-II of the Oliy Majlis, May 12, 2001) are not subject to licensing. However, permits are not licenses and can be introduced without limitation.

[1] Resolution 236 of the Cabinet of Ministers of the Republic of Uzbekistan, "On Measures for Implementing the Law of the Republic of Uzbekistan 'On Licensing Certain Types of Activity," June 28.2002.

The main cause of this problem is most probably the lack of a standard regulatory definition of terms such as "permit," "permission certificate," and "approval" in the laws applicable to all types of permits.

Box 4.3

In legal practice, a permit/approval is a document in the established format, or decision expressed in any other documentary form, granting the holder the right to perform a certain action or engage in a certain activity.

Another cause of the uncontrolled introduction of permits by various agencies is the lack of an exhaustive list of them in the applicable legislation. As a result, a number of obsolete permits are still applicable in the country, necessitated by the conditions prevailing at the time. A permit to export fresh fruits and vegetables, introduced because of the need to meet national requirements for produce at a time when prices in the domestic and external markets differed significantly, is an example.

There are also permits that substitute administrative regulation mechanisms for market-oriented ones. For instance, a permit for the use of natural gas by SMEs issued by Khokimiyats of Tashkent City, the regions, and the Council of Ministers of the Republic of Karakalpakstan is a method of regulating access to resources administratively, while a market-oriented mechanism would mean that the SME would buy the required amount of gas from a supplier at market prices.

Some permits duplicate or substitute for the functions of other state regulation instruments, such as certification and licensing. For example, permits granting the right to engage in wholesale and retail trade substitute for a license for these activities, although legislation does not refer to trade as a type of activity requiring licensing. An example of duplication is the permit for advertising certain types of products. The only criterion for issuing the relevant permit is submission of the conformity certificate for the product.

Non-compliance with legislated requirements at the regional level

An important factor in the large number of permits is non-compliance with applicable legislation at the regional level. The fact that permits are issued under regulations that have become invalid provides an example.

For instance, the Ministry of Health continues to issue sanitary permits to businesses, even though the regulations requiring that they be issued[2] have been invalidated, superseded by the adoption of another document[3] that does not contain that requirement.

MORE THAN ONE-THIRD OF RESPONDENTS EXPERIENCED DIFFICULTIES IN OBTAINING PERMITS

Thirty-seven percent of respondents who had to obtain permits in 2004 assessed the procedure as problematic (for more detail, see Statistical Results of the Survey and Annex 6). They identified the following difficulties most frequently: the large number of documents required, inaccessibility of information on the conditions for issuing the permit (the documents required, the processing time, costs, and so on), ambiguity in the requirements, and the long waiting time.

[2] Regulations "On the Procedure for State Registration of Entrepreneurial Entities" (Annex 1 to Resolution 347 of the Cabinet of Ministers of the Republic of Uzbekistan, August 22, 2001).

[3] Regulations "On the Procedure for State Registration of Entrepreneurial Entities and Permit Issuance" (Annex 1 to Resolution 357 of the Cabinet of Ministers of the Republic of Uzbekistan, August 20, 2003).

Chart 4.3
DIFFICULTIES ENCOUNTERED BY ENTREPRENEURS IN OBTAINING PERMITS

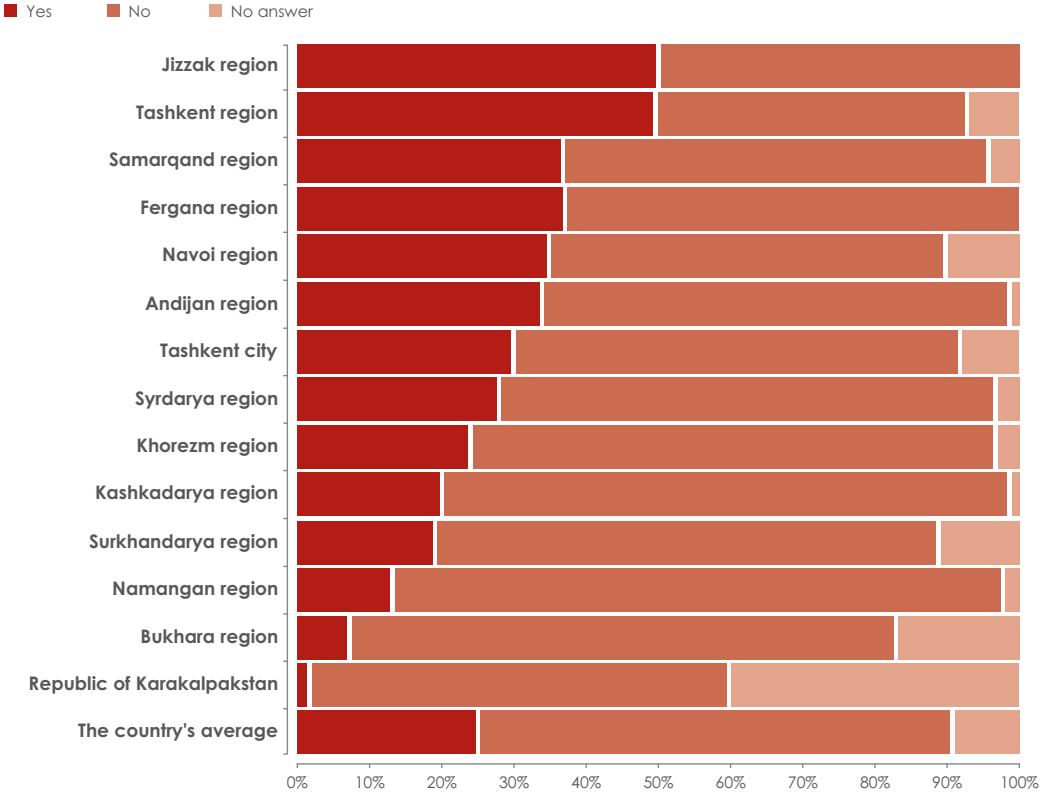
% of respondents who pointed out that compliance with rules and standards was "problematic" and "rather difficult"

The requirement to submit a great number of documents and lack of information on the terms and conditions for granting permits forces entrepreneurs to resort to unofficial payments to obtain the documents they need.

Of respondents who obtained permits in 2004, 25% admitted to making unofficial payments during the process. Considering the difficulties in this process, such as the long periods for reviewing applications and the large number of documents required, the need to make unofficial payments to obtain or speed up the issuance of a permit becomes obvious. The problem exists in all parts of the country.

Chart 4.4
IN THE PROCESS OF OBTAINING PERMITS, ENTREPRENEURS HAD TO RESORT TO UNOFFICIAL PAYMENTS

% of respondents



Shortcomings of the regulatory framework

As already mentioned, the applicable legislation not only allows state agencies to introduce all kinds of permits without any control but also fails to regulate the procedure for issuing permits.

Box 4.4

Legislation lacks the requirement to include regulations with respect to specific procedures for issuing permits. Therefore, entrepreneurs are unable to get a clear-cut and comprehensive idea of the phases in obtaining a particular permit, the agencies that issue it, the costs, the list of or requirements for documents to be submitted, etc. This leads to abuse of power by officials.

An analysis of applicable legislation shows that the problems in this area stem from the following:

- the conditions for issuing permits are unclear due to the lack of specific mechanisms for the interaction between state agencies and entrepreneurs;
- the issuing of permits is regulated by a large number of documents;
- entrepreneurs have difficulty accessing intradepartmental regulations governing the issuance of any specific permit and officials are unwilling to familiarize entrepreneurs with these documents;
- regulations are contradictory.

Box 4.5

An example of contradictory regulations is the regulations governing changing the category of a property from living quarters to non-residential property: Regulations "On the Procedure for Reclassifying Living Quarters as Non-Residential Property" (Annex 4 to Resolution 18 of the Cabinet of Ministers, January 20, 2000) and Regulations "On The Procedure for State Registration of Entrepreneurial Entities and Permit Issuance" (Annex 1 to Resolution 357 of the Cabinet of Ministers of the Republic of Uzbekistan, August 20, 2003). According to the former, a decision must be made within 30 days, while the latter stipulates two days. Both documents are currently in force, and officials are free to apply the provisions of either. Some regulations governing permits do not contain any specific processing periods at all[4].

Clearly, the present administrative procedure for obtaining permits does not have a standardized and integrated regulatory framework, nor does it have standardized principles, rules, and mechanisms. This leads to the conclusion that a system for issuing permits is effectively absent in Uzbekistan.

> "To obtain this permit, I have to submit 20 documents I've never heard of, and wait for three months. It is easier for me to work without a permit, bypassing the law."
>
> *Focus group participant*

Non-compliance with legislated requirements at the regional level

The many problems involved in obtaining permits are also caused by the lack of strict compliance with laws and regulations at the regional level.

For instance, the law specifies uniform processing periods country wide. However, the survey showed that the time required to obtain the same permits varied by region. This reveals a failure to comply with applicable legislation at the regional level.

[4] For example, Regulations "On the Procedure for Registration and Engagement in Wholesale and Retail Trade" (Annex to Resolution 407 of the Cabinet of Ministers of the Republic of Uzbekistan, November 26, 2002).

Chart 4.5

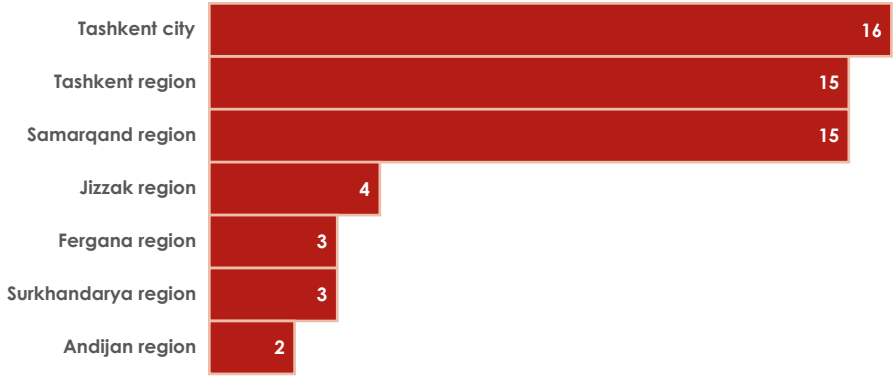
OBTAINING A PERMIT TO EXPORT FRESH FRUITS AND VEGETABLES TOOK TWICE AS LONG FROM ONE REGION TO ANOTHER

business days

Chart 4.6

OBTAINING A PERMIT TO RECLASSIFY LIVING QUARTERS AS NON-RESIDENTIAL PROPERTY TOOK EIGHT TIMES LONGER FROM ONE REGION TO ANOTHER

business days



"When I was trying to obtain a registration certificate, I was insistently advised to obtain this permit. I was told I could not operate without it. I spent a whole week, as well as my nerves and money, on collecting the documents. I later learned that this permit had been abolished long ago. But I had no strength to appeal it, so I gave up."

"I wanted to export tomatoes. You know yourselves that it is rather delicate produce. Every minute matters. I was told at the customs that I had to obtain a permit from the Khokimiyat. There, they demanded a large number of documents from me and told me to come a week later. I asked when I would get the permit, but was told they could deny me one if I got on their nerves. I waited for their decision for ten days and got a refusal. Later, knowledgeable people told me that they were obliged to review my application within 24 hours. If I had known that earlier, my tomatoes probably wouldn't have spoiled."

Focus-group participants

LOW LEVEL OF LEGAL AWARENESS OF ENTREPRENEURS

The above-mentioned problems in the permit system are largely attributable to the low level of legal awareness among entrepreneurs. Often, they do not know their rights, are not familiar with the main documents regulating their activity, and therefore can not appeal the actions of state agencies in an effective way.

SHORT-TERM RECOMMENDATIONS ON REFORMING THE PERMIT SYSTEM

Since permits are obtained in the initial phase of entrepreneurial activity, the problems with the process have a negative impact primarily on the entrepreneur's desire to do business, and therefore, on business development in general.

Box 4.6

Resolution PP-24 of the President, March 10, 2005[5] (Annex 6, Section III, Para 1.2), provides for the following:

- taking stock of all existing permits;
- abolishing a number of permits;
- simplifying permit procedures.

[5] Resolution PP-24 of the President of the Republic of Uzbekistan, "On the Program for Implementing the Objectives and Tasks of Democratizing and Renewing Society, and Reforming and Modernizing the Country," March 10, 2005.

Work on improving the system for issuing permits should proceed in the following three directions:

- reducing the number of permits;
- establishing a legal system aimed at reforming the issuing of permit in accordance with the principles of a market-oriented economy;
- raising the level of legal awareness among entrepreneurs and public servants by publishing a series of explanatory materials and arranging workshops.

Reduce the number of permits

To reduce the number of enterprises that have to obtain permits, it is necessary to abolish the following existing permits:

- permits introduced to deal with a situation that no longer exists;
- permits that are a substitute for market-oriented mechanisms and principles;
- permits that duplicate the functions of other state regulation instruments (certification and licensing).

Permit procedures restricting economic activity in some way should be introduced solely by acts of the country's parliament – the Oliy Majlis. This would reliably protect businesses from legislation prompted by the considerations of the moment and would ensure transparency in this area. This principle should also be applied to other administrative procedures.

A number of permits have requirements that actually serve as property or other qualifications that restrict competition. Therefore, one of the principles in regulating the procedures for issuing permits should be that introducing permits that restrict competition or substitute for market-oriented mechanisms is not allowed.

EXPECTED IMPACT

Reduction in the number of permits will accomplish the following:

- create favorable conditions for equitable access to markets;
- abolish the practice of introducing restrictions on entrepreneurial activity through regulations;
- raise the level of legal awareness among entrepreneurs and public servants;
- reduce the number of administrative barriers to entrepreneurial activity;
- reduce the potential for corruption.

Draft a law to regulate permit procedures and define public policy in this area

Since the problems with issuing permits are system wide, they should be addressed in a comprehensive way. Drafting a law defining standard public policy in this area will be necessary to accomplish this.

The law should include the following:

- a definition of "permit" and other related terms;
- principles of the system for issuing permits, including that new permits may be introduced solely by law, that priority is to be given to moving to "one window" applications, that the declaratory principle is to be introduced for obtaining permits, etc.;
- an exhaustive list of the actions and types of activity for which entrepreneurs need permits;
- the procedures for obtaining specific permits.

This law would legalize the fundamental principles and provisions of the permit system and the procedure for issuing permits (time allowed for reviewing applications and issuing permits, a substantiated and exhaustive list of the documents to be submitted, the reasons why a permit may be denied, the procedure and conditions for appealing decisions, reinstatement, suspension, resumption, and invalidation of permits, the procedure for and amounts of fees, and the rights and obligations of the parties.)

The aim of the proposed model for reforming the issuing of permits is to establish a system governed by law rather than regulations.

EXPECTED IMPACT

The establishment of a standardized and transparent regulatory framework addressing the procedures for issuing permits would accomplish the following:

- standardize permit issuing procedures, thus ending the practice of arbitrary rules, and thereby removing ambiguity from requirements and eliminating regional differences;
- reduce the number of documents required and shorten decision-making time, since a state agency would have to substantiate any new document requirement and justify the number of the days required for issuing a permit to the legislative body;
- resolve the problem of inaccessibility of information about the procedures for issuing any particular permit, since laws are public documents;
- reduce the potential for corruption;
- raise the level of legal awareness among entrepreneurs and public servants.

One of the main objectives of the proposed system is to ensure transparency in the process of issuing permits. This will allow entrepreneurs to plan for the expense and will reduce the potential for unofficial payments. Moreover, including all of the requirements in one document will make it possible to govern the procedures for issuing permits through direct legislation.

Setting out clear-cut mechanisms for issuing permits in one law will substantially increase the legal protections for businesses and significantly reduce instances of abuse of power.

Monitor compliance with legislation at the regional level and make officials more accountable for fulfilling their duties

To prevent abuse of the permit issuing procedure, compliance with legislation by officials at the regional level should be strictly monitored. In order to increase their accountability, clear-cut mechanisms for imposing penalties on officials for delays, unsubstantiated denial of permits, demands for additional documents, etc., should be developed and introduced.

EXPECTED IMPACT

The introduction of these measures would encourage the officials at permit granting agencies to develop a more responsible attitude to issuing permits and ease the process for SMEs. The possibility that officials will be held accountable would be an effective instrument, helping entrepreneurs to influence the process of obtaining permits and to exercise their rights.

Raise the level of legal awareness of entrepreneurs and pubic servants

Raising the level of legal awareness of entrepreneurs and public servants through arranging a series of workshops as well as through publication and distribution of explanatory materials and the like will make permit procedures less problematic.

EXPECTED IMPACT

An information program would give entrepreneurs a clear idea of the procedures for issuing permits and make them aware of the legal requirements for obtaining them. They would be able to recognize inappropriate demands by local authorities, and this would serve as public control over the actions of officials and reduce the potential for abuse of power.

Box 4.7

Resolution PP-186 of the President, passed in September 2005,[6] discussed in the section "Overview of the Business Environment in Uzbekistan," introduced amendments to the licensing system and also provided for measures to further reform the procedures for issuing permits, as follows:

- it cancelled 12 duplicate and excessive permits, including the wholesale trade permit, the permit for decentralized export of fresh fruits and vegetables, and a permit for the use of natural gas by SMEs;
- it instructed the government to draft and submit to parliament a Law on Permit Procedures containing a list of the actions and types of activity for which permits are required as well as simplified and clear mechanisms for issuing them.

LONG-TERM RECOMMENDATIONS

The system of issuing permits in Uzbekistan should be reformed simultaneously with reforming registration, licensing, and certification procedures. It should stipulate regular revision of the list of permits lists and simplification of procedures for issuing permits to entrepreneurs.

The next phase of the reform should be the introduction of the declaratory principle to applications for permits. Given that the country's Government is interested in improving the system of business registration by the introduction of the declaratory registration principle, it is recommended that the same principle be applied to permit procedures. This would be a logical progression toward establishing a favorable business environment.

The declaratory principle in permit applications implies the following:

- entrepreneurs independently determine whether they meet the requirements and standards specified in legislation and assume responsibility for complying with them;
- entrepreneurs may perform a certain action/engage in a certain activity immediately after notifying the relevant state agencies;
- relevant state agencies monitor the entrepreneur's compliance with the requirements and standards defined in legislation.

The "self-certification" principle for entrepreneurs is widely practiced, having been adopted in many countries. Applicants certify that all of the documents they submit and actions they will perform will comply with the law. Under this system, the state expresses a certain degree of trust in the entrepreneur and simply checks the reliability of the information given. Introducing this principle would require a sufficiently high level of legal awareness among entrepreneurs and an effective state control system.

Another way of improving the permit-issuance system in Uzbekistan would be to adopt the principle that "silence is consent." It works in the following way: A public servant must review an entrepreneur's application and reply to it by a strictly defined deadline, or ask for some additional time to consider it. If the deadline passes without a reply, the entrepreneur has the right to perform the action or engage in the activity that was the subject of the application.

[6] Resolution PP-186 of the President of the Republic of Uzbekistan, "On Reducing the Types of and Simplifying the Procedure for Issuing Permits for Entrepreneurial Activity," September 21, 2005.

Legalization of the "silence is consent" principle is necessary to reduce the administrative obstacles arising from procrastination in replying to applications, prompted by self-interest or inadequate professional skills. In many cases, the "silence is consent" principle provides a guarantee of timely review of applications. Moreover, it would improve discipline among officials and increase their feeling of responsibility by shifting the burden of justifying actions from entrepreneurs to public servants.

Experience in countries that have introduced this principle has shown its effectiveness in administrative regulation of entrepreneurial activity.

Box 4.8

The "silence is consent" principle was legalized in Spain by the Law on Administrative Procedures (Article 42/1992) as one of the institutional principles in the administrative procedures of the country. Under this law, a state agency must reply to any application received within six months. If specific laws provide for shorter terms, they prevail. Periods exceeding six months are only allowed in exceptional cases and provided that they are stipulated by law or other EU acts. If a state agency fails to reply within the prescribed deadline, the applicant, under the "silence is consent" principle, is vested with all the rights required to perform the requested actions or to engage in the requested activity.

In 1990, Italy passed the Law on Administrative Procedures (Law 241/90), aimed at simplifying administrative procedures, reducing the duration and number of direct contacts between the private sector and state agencies. One of the simplification measures was the introduction of the "silence is consent" principle (silenzio assenso). Under the law, a state agency has a deadline by which it must reply to an application. If no negative reply is given within 30 days, the applicant may perform the requested action or engage in the requested activity. To date, the Italian government has applied the principle to 194 administrative procedures.

To facilitate periodic revision of the documents regulating the issuing of permits, it is recommended that a "sunsetting" (derived from the term "sunset clause") rule be applied to them. Under this rule, a regulatory document ceases to be in force upon the expiration of a specified period (generally from five to ten years) unless the interested state agency proves the need to extend the date.

This mechanism provides an opportunity for a regular review of departmental regulations for provisions that have become obsolete or unnecessary, conflict with other legislation, or have simply become unlawful. However, this would involve certain administrative costs, which should be taken into consideration when introducing sunsetting.

In implementing sunsetting, a separate department is generally established which, within the framework of its competence, has the authority to issue binding instructions to other state agencies.

Box 4.9

The National Competition and Intellectual Property Protection Institute in Peru (INDECOPI) has been granted the power to revise regulatory documents governing entrepreneurial activity on a regular basis and provide the country's government with recommendations on removing contradictory and outdated provisions, as well as provision that worsen conditions for doing business. Upon expiration of a 30-day period, the INDECOPI recommendations become binding, unless the government has substantiated the need to preserve those provisions.

REGISTRATION

MAIN FINDINGS

- Contrary to the applicable legislation, most respondents have to carry out some registration procedures themselves: 74% obtained their taxpayer PINs themselves, 57% registered with the Pension Fund, and 44% registered with the Road Fund.
- The registration processing time limits set by law are not met. In 2004, the process took 19 days. The regulatory standard was seven days.
- Entrepreneurs' registration expenses are not getting lower. In 2004, the average costs, including unofficial payments, continued at the 2003 level – 63,000 soums (approximately US $62).
- Although the "one window" registration system was introduced in 2001, more than 16% of newly registered legal entities registered by other means.

The "one window" registration system was introduced in Uzbekistan beginning in the second half of 2001.[1] In 2003, it was somewhat expanded to include the ability to simultaneously obtain some permits.[2] (For more detail, please refer to the IFC 2002-2003 reports "Business Environment in Uzbekistan as Seen by Small and Medium Enterprises" and Annex 7.)

Box 5.1

Peculiarities of registration for individual entrepreneurs

In Uzbekistan, registration for individual entrepreneurs is somewhat different from that for legal entities (see Annexes 8 and 9.) In 2004, registration for individual entrepreneurs took an average of 13 business days. A 2001 survey indicated that, prior to 2001, this procedure took an average of one month.

In 2004, registering as an individual entrepreneur cost about 63,000 soums (approximately US $62; the same as registering as a legal entity) including unofficial payments. According to the survey, nearly one-third of respondents (30%) had to make such payments. Prior to 2002, 17% made such payments during registration.

The survey showed a lack of significant improvement in this process during the period under review. Indicators such as the average time required for registration, the costs of the necessary procedures, the need for unofficial payments, and the complexity of the process, as reported by respondents in 2004, were generally comparable to the previous year.

[1] Resolution 347 of the Cabinet of Ministers of the Republic of Uzbekistan, "On Improving the System for Registering Entrepreneurial Entities," August 22, 2001.

[2] Resolution 357 of the Cabinet of Ministers of the Republic of Uzbekistan, "On Radically Improving the System of Registration Procedures in Establishing a Business," August 20, 2003.

Box 5.2

Why is it necessary to make the registration process easier?[3]

There are opposing views on the need for strict state regulation of the entry of enterprises into the market and the impact of such regulation on the business environment. However, World Bank professionals, in collaboration with Harvard University, conducted a comparative econometric study of the impact of the rules regulating the establishment of companies in 85 countries. The data did not show that stricter regulation barring "one day" firms from entry into the market raised the quality of the goods produced and services provided, improved the environmental or epidemiological situation, or intensified competition. At the same time (controlling for other factors), more stringent regulation of the process of establishing companies was associated with a higher level of corruption in the country as well as with an increase in the unofficial sector as a percentage of the economy.

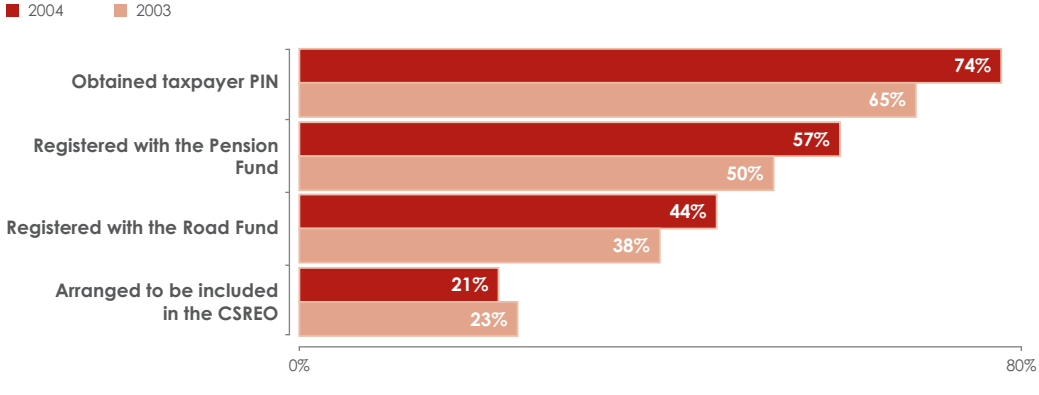
CONTRARY TO THE APPLICABLE LEGISLATION, MOST RESPONDENTS HAVE TO CARRY OUT REGISTRATION PROCEDURES THEMSELVES

The survey showed that many entrepreneurs had to carry out some registrations procedures themselves, even though these procedures were the mandated responsibility of the registration authority. Most frequently, respondents had to obtain their taxpayer PINs from tax agencies and register with the pension and road funds themselves. According to the applicable provision,[4] this responsibility lies with tax agencies after they receive the data on the enterprise to be registered from the registration authority.

Chart 5.1

THE "ONE WINDOW" SYSTEM IS NOT FULLY FUNCTIONAL: RESPONDENTS STILL HAVE TO CARRY OUT REGISTRATION PROCEDURES THEMSELVES

% of respondents registered in the given year



[3] Djankov, Simeon, Rafael la Porta, Florencio Lopez de Silanes, and Andrei Shleifer. 2001. Regulation of entry. (http://rru.worldbank.org/Documents/PapersLinks/551.pdf).

[4] Regulations on the Procedure for State registration and Permit issuance for businesses (Annex 1 to Resolution 357 of the Cabinet of Ministers, August 20, 2003).

The situation can be attributed to several factors:

Lack of an effective mechanism for collaboration between state agencies

The registration procedure has not changed since 2003. Therefore, it was expected that, in the period under review, the registration system would settle, and the procedures for SMEs seeking registration and applying to authorized agencies for permits would be finalized in practice. However, the survey results and the focus group study showed that substantial problems remained in the relationships among registration authorities (regional and municipal registration offices and Ministry of Justice departments) and other state agencies (statistical agencies, the Ministry of Internal Affairs, tax inspectorates, territorial departments of the extra-budgetary Pension and Road funds, municipal departments of labor, employment and social security, etc.) involved in registration and the issuing of permits. These problems stem from the lack of a mechanism for coordinating the work of state agencies in registration and issuing permits by specifying the duties and responsibilities of their officials.

Focus group participants reported that officials in registration agencies often suggested that they deliver their documents to the other agencies themselves, saying that registration would otherwise take much longer. Entrepreneurs preferred to carry out some procedures themselves in order to speed up registration and save time.

> "Each Khokimiyat has its own rules, applicable in its district. There are districts where there are no problems with registration."
>
> *Focus group participant*

Non-compliance with legislation at the regional level

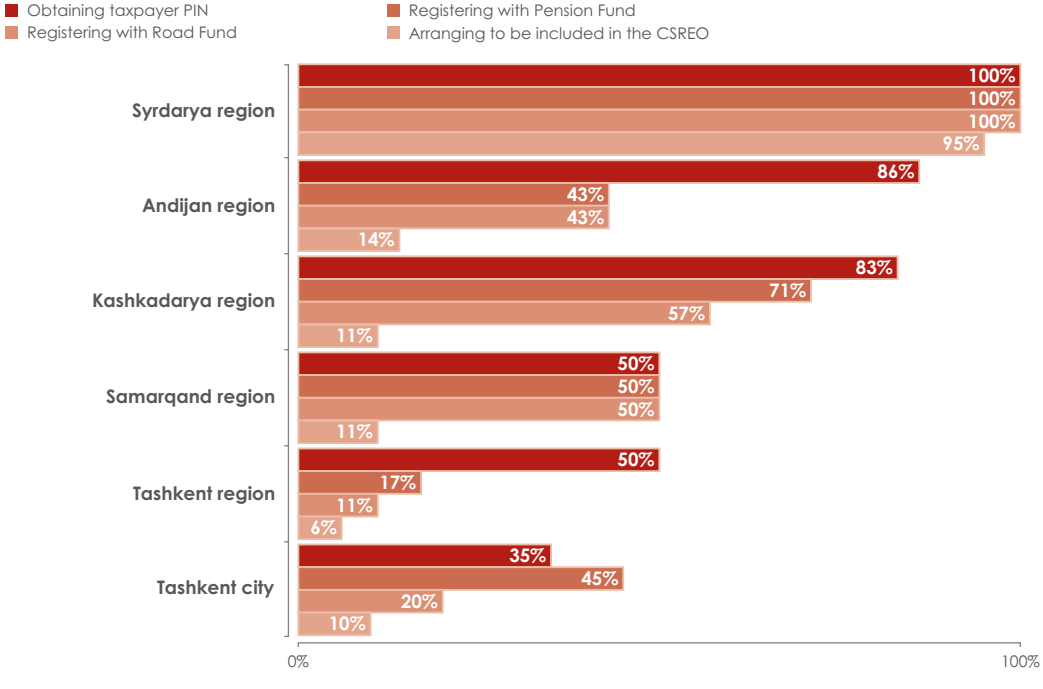
In some regions (Syrdarya Region, for example) nearly all of the newly established enterprises had to deal with the tax agencies themselves. This indicates systematic violations of the established "one window" procedure for state registration of businesses.

> "It cannot be called the "one window" procedure. After registering at the Khokimiyat, I have to go to the tax inspectorate at the place of registration and declare, in writing, "Yes, I've been registered, I exist, and I'm starting my activity."
>
> *Focus group participant*

Chart 5.2

IN SOME REGIONS, MOST RESPONDENTS CARRIED OUT REGISTRATION PROCEDURES THEMSELVES[5]

% of respondents registered in 2004



[5] The number of enterprises registered in other regions is not statistically significant for comparison purposes.

Among the difficulties encountered in the course of registrations, the problems most often mentioned by respondents were lack of scruples on the part of officials and ambiguity in what is required of entrepreneurs. These problems were cited by 38% and 39% of respondents respectively.

Inaccessibility/incomprehensibility of information to/by entrepreneurs

Two out of five respondents who registered in 2004 pointed to the difficulties involved in this procedure. Two-thirds of the newly registered enterprises had problems obtaining full and reliable information from registration authorities on the terms and conditions of registration, such as the documents required, processing time, costs, etc.

REGISTRATION PROCESSING TIME LIMITS ARE NOT MET

Legislation stipulates specific processing time limits for state registration of businesses and for issuing permits; from seven business days to one month, depending on the complexity and the degree of administrative work involved in issuing engineering specifications and other permits. Processing state registration, without permits, may not exceed seven days.

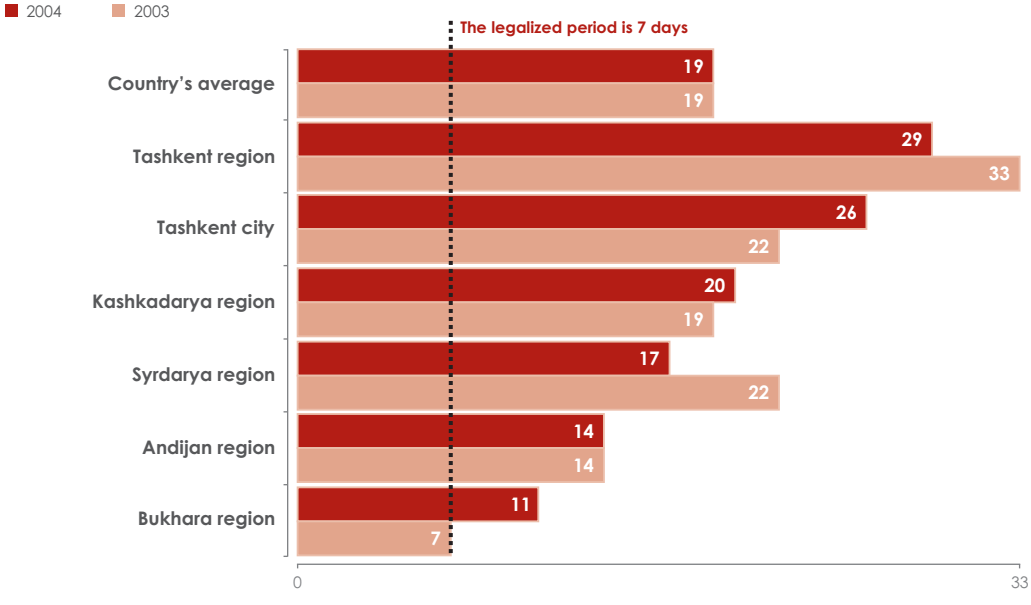
In practice, the registration procedure for SMEs in 2004 took an average of 19 business days; the same as in the previous year.[6]

Respondents considered the actual registration processing times excessive, citing is among the three main problems involved in registration.

As in the past, regional differences exist in the average registration processing time, ranging from 11 business days in Bukhara Region to 29 business days in Tashkent Region.

Chart 5.3

REGISTRATION PROCESSING TIME EXCEEDED THE ESTABLISHED TIME LIMITS IN ALL REGIONS[7]



[6] The 2003 data applied to the whole period. From October 1 through December 31, 2003 (i.e. after modernization of the registration system,) the average registration period was 16 business days.

[7] For comparison purposes, the number of enterprises registered in the other regions is not statistically significant.

This failure to meet registration processing time limits is attributable to several factors:

Lack of an effective mechanism for collaboration between state agencies

Problems with collaboration between state agencies involved in the registration process force entrepreneurs to formalize some documents themselves because inspectorates (or the Ministry of Justice) substantially prolong the registration processing time. This is the result of the lack of a mechanism for collaboration between officials working in the various agencies responsible for registration.

> "The main agency (in our case, the Ministry of Justice) completes the registration within seven days. But this period is insufficient for it to have us registered with the other agencies, such as the tax inspectorate and statistical and other agencies. So, after seven days it [the Ministry] passes the documents on to the other agencies, which take another week and a half to register us."
>
> *Focus group participant*

Lack of an effective mechanism for imposing sanctions on officials for delays and unjustified denial of registration

No matter how good the system of collaboration between state agencies involved in registration, it will be ineffective without specific penalties applicable to officials for failure to meet the established time limits or for unjustifiably denying registration. The currently applicable provisions regulating the registration process[8] do not stipulate a mechanism for imposing penalties on the employees of inspectorates or any other agency for failure to perform their duties as required with respect to businesses registration, thus permitting officials to violate the established procedure with impunity.

Non-compliance with legislation at the regional level

One of the reasons for the long registration processing period is non-compliance with legislation at the regional level. Lack of appropriate monitoring of compliance by officials with the established rules leaves them free to procrastinate in processing registrations.

Most respondents had to carry out a number of associated procedures themselves, and the survey also showed that 16% (more than half of whom were in the agriculture sector) of respondents registered after October 2003 did not use the "one window" system. Cases where SMEs registered under invalid provisions were reported in nearly all parts of the country.

REGISTRATION COSTS ARE NOT GETTING LOWER

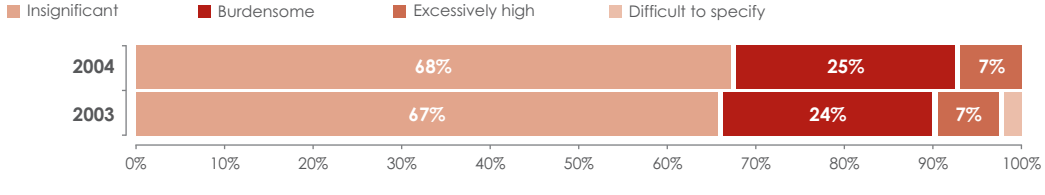
Based on the survey results, in 2004 the average costs related to registration, including unofficial payments, remained at the level of the previous year, amounting to 63,000 soums or approximately US $62. (In 2003, it was 62,000 soums, or approximately US $64.)

The percentage of respondents who considered registration costs burdensome and excessively high decreased insignificantly. In 2004, one-third of respondents held that opinion. This change can be explained by inflation and another rise in the minimum wage as of August 2004.

Chart 5.4

ONE-THIRD OF RESPONDENTS CONSIDERED REGISTRATION COSTS TOO HIGH

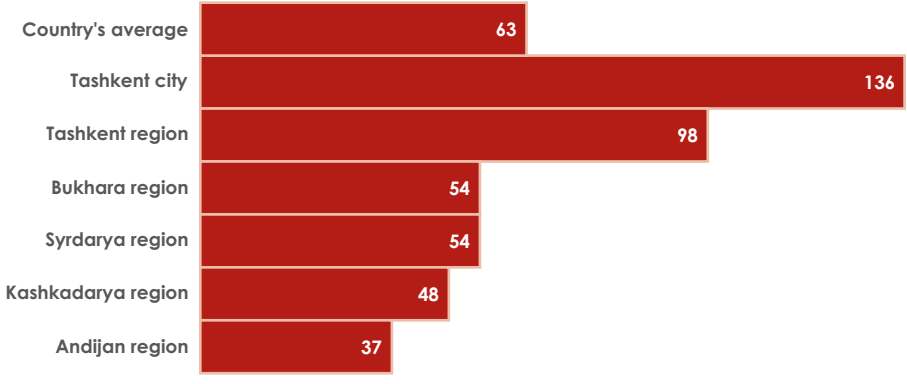
% of respondents registered in the given year



[8] Regulations "On State Registration Procedure and Permit Issuance for Entrepreneurial Entities" (Annex 1 to Resolution 357 of the Cabinet of Ministers, August 20, 2003).

The cost of registration in some regions differed substantially from the country's average. They varied from 37,000 soums (approximately US $36) in Andijan Region to 136,000 soums (US $133) in Tashkent City.

Chart 5.5
AVERAGE REGISTRATION COSTS VARIED AMONG REGIONS[9]
soums, thousands[10]



"People in our district are not very well-to-do, so if you give a Khokimiyat official some 20,000-30,000 soums,[11] he will draft a charter for you himself, and will do it in such a way that no one will be able to find fault with it. But in Tashkent City, I've been told that one needs to pay at least 100,000 soums."

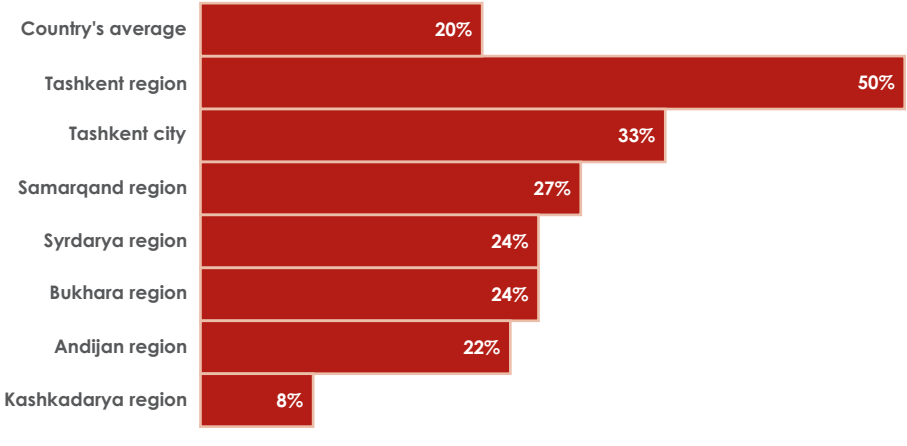
Focus group participant

Registration costs were significantly different from region to region as well, even though official registration fees were the same throughout the country. The differences can be explained in part by the fact that some respondents used the services of various consulting companies, often for "turnkey" registration, for a specific fee. However, there are a number of other subjective factors preventing a reduction in registration costs.

The need to make unofficial payments

The survey results showed that the need to make unofficial payments persists: 20% of respondents registering in 2004 pointed out the need to do so (25% in 2003.) In some regions, more than half of respondents had to resort to unofficial payments.

Chart 5.6
THE INSTANCE OF UNOFFICIAL PAYMENTS IN THE COURSE OF REGISTRATION WAS HIGH IN MOST REGIONS[12]
% of respondents registered in 2004



[9] For comparison purposes, the number of enterprises registered in the other regions is not statistically significant.
[10] The 2004 average soum to US dollar exchange rate set by the CBU was 1,020.
[11] The 2004 average soum to US dollar exchange rate set by the CBU was 1,020.
[12] For comparison purposes, the number of enterprises registered in the other regions is not statistically significant.

The need to contacting officials in various agencies

As mentioned above, the poor functioning of the "one window" registration system forced entrepreneurs to carry out some procedures associated with registration themselves, thus coming into contact with the officials in various agencies. This results in additional transportation costs for entrepreneurs and in higher incidence of unofficial payments. Focus group participants believed that unofficial payments had to be made to speed up the review of their documents. Entrepreneurs often preferred to pay above the official fees to avoid delay in obtaining various permits.

LOW LEVEL OF LEGAL AWARENESS OF ENTREPRENEURS

In addition to the difficulties mentioned above, some problems in the registration system stem largely from the low level of legal awareness with respect to regulation of their activity among entrepreneurs.

While large companies can hire a lawyer to prepare the documents required and assist with registration, SMEs with limited resources usually do it themselves. Without knowledge of the regulations governing the registration process, they cannot insist that officials discharge their mandated duties and have to complete registration procedures themselves that should be performed by registration inspectorates and the Ministry of Justice.

In the opinion of focus group participants, registration time limits are exceeded for the same reason. First, entrepreneurs often fail to prepare the required package of documents correctly, and officials of registration authorities return them for completion. Second, even if they prepare all the documents correctly, entrepreneurs cannot insist that officials comply with regulations if they are not aware of their rights.[13]

Moreover, entrepreneurs often have to pay either officials or consultants to prepare the package of documents required and to assist them in going through all of the procedures. This substantially increases registration costs for entrepreneurs.

Box 5.3

Difficulties facing agricultural enterprises

Within the framework of the program of accelerated development of the agriculture sector in Uzbekistan, the decision was made to transform the unprofitable and obsolete agricultural cooperatives (shirkats) into private farms. Owing to the nature of the business, agricultural enterprises face a number of problems unique to that sector. The main difficulties for farmers are acquiring the necessary machinery, obtaining a plot of land, and getting access to fuel and lubricants, fertilizers, and a water supply (see Statistical Results of the Survey). These difficulties are encountered by both the newly established private farms and those based on former agricultural cooperatives (shirkats). In addition, the latter also face the problem of debts inherited from the shirkats.

SHORT-TERM RECOMMENDATIONS TO ADDRESS THE PROBLEMS RELATED TO REGISTRATION

Establishing a business, even under the most favorable conditions, requires a good deal of determination from entrepreneurs. The state must support their efforts in every possible way. Many problems can be resolved by simply ensuring compliance with the applicable regulations, developing a more effective mechanism for collaboration among various state agencies within the framework of implementing the established procedures, and introducing a system of accountability for officials who fail to comply with registration

[13] Resolution 357 of the Cabinet of Ministers of the Republic of Uzbekistan dated August 20, 2003 has established only the general period from the date of application to the date of state registration including issuance of permits ranging from 7 business days to one month. Only based on an analysis of the procedure of document formalization partially described in the Annex it can be concluded that in the event of the state registration of a business without any permit issuance the procedure may not exceed seven (7) days.

regulations. Some measures will involve additional expense; for instance, the preparation and distribution of information materials on the registration procedure and the arrangement of large-scale workshops and training events addressing this problem. However, if the government wants to improve the situation in this area dramatically, it should establish an entirely new mechanism of registration using the declaratory principle, with the possibility of moving to on-line registration in the future.

These recommendations are dealt with in more detail below.

Developing a mechanism for collaboration between state agencies

To address the problem of the lack of collaboration between various state agencies in the course of the registration process, it is necessary to formulate and introduce clear and understandable requirements for the performance of the registration functions by these agencies. These requirements would regulate the procedures and the time limits for document circulation, the rights and responsibilities of the parties, and accountability for non-compliance with the legislation regulating the registration process.

EXPECTED IMPACT

These measures would increase the accountability of all agencies involved in registration with respect to compliance with established procedures because their respective responsibilities would be clearly defined. This would eventually end the practice of unjustified extension of registration processing time limits, standardize procedures across all the regions, and substantially reduce costs and time spent for entrepreneurs in the initial phases of their starting a business.

Introduce the declarative principle for registration

The problems caused by not meeting registration processing time limits and red tape could be resolved by the introduction of the "silence is consent" principle. This means that an enterprise is automatically considered registered if the registration agency does not respond with a justified denial of registration within the prescribed time limit.

EXPECTED IMPACT

The introduction of the declarative principle would reduce the potential for abuse of power by officials because their contacts with entrepreneurs would be reduced to a minimum. Businesses would be able to register in a timely fashion, which would lead to an increase in the number of new businesses. In addition, expenses for entrepreneurs would be reduced, competition would intensify with the entry of more new businesses into the market, and the number of jobs would increase.

[14] For more details about the declarative principle and the 'silence is consent' principle, please refer to the "Permits" chapter.

Box 5.4

In 2004, 51,728 new SMEs were registered. Based on the survey results, their average sales were 3 million soums (approximately US $3,000) per month, and the average profit for the newly established enterprises was 20.6%. Calculations based on these figures show that accelerating the business start-up process by just one day could increase the volume of sales in this sector by 1.4 billion soums per year (approximately US $1.4 million.)

Box 5.5

The "silence is consent" principle has been applicable to business registration in Georgia[15] since 1995. Under the Law on Entrepreneurs, all legal entities must be registered by a court of law. To complete this process, entrepreneurs must notarize foundation documents, apply to the court, provide documentary evidence of contribution to the authorized fund (a bank document if the contribution was made in the form of money, or an auditor's appraisal if the contribution was property,) pay the registration fee, and submit documents to the court. The court issues a state registration certificate to the entrepreneur. If the court does not notify the entrepreneur of the registration or denial of it within the time limit specified by law, the legal entity is considered registered. In that case, the court is obliged to issue a registration certificate upon request. The review period before the registration authority must make a decision on the registration was reduced from 15 days in 1997 to five days in 2003. As a result, the World Bank Project "Doing Business in 2005"[16] included Georgia on the list of countries with the least time consuming process for starting a business.

After state registration, an enterprise must register with a tax agency, where it is assigned an identification number. The 2004 IFC survey[17] showed that 75% of entrepreneurs did this within one business day. Ninety percent of SME representatives in Georgia said that there was no need to make unofficial payments in the course of registration. Moreover, most focus group participants agreed that, if they had prepared all the documents required by the tax agencies correctly, there would have been no need for unofficial payments in that phase of registration at all.

[15] IFC. Business environment in Georgia, as seen by small and medium enterprises 2004.

[16] Doing Business in 2005: Removing Obstacles to Growth. 2005. A copublication of the World Bank, the International Finance Corporation and Oxford University Press.

[17] IFC. Business environment in Georgia, as seen by small and medium enterprises 2004.

Box 5.6

Addressing a joint session of both chambers of the Oliy Majlis in January 2005,[18] President I.A. Karimov of Uzbekistan announced a phased introduction of the declaratory principle of SME registration as one of the priority measures aimed at promoting SME development.

Resolution PP-24 of the President "On the Program for Implementing the Objectives and Tasks of Democratizing and Renewing Society and Reforming and Modernizing the Country," March 10, 2005, and Decree UP-3618 of the President "On Measures for Accelerating the Implementation of Priority Directions in Intensifying Economic Reforms and Further Liberalizing the Economy," June 14, 2005, provide for drafting a regulatory document, within the first quarter of 2006, regulating, among other things, the declaratory principle of SME registration.

Box 5.7

The World Bank Project "Doing Business in 2005"[19] identified Canada as the country with the simplest and fastest procedures for establishing companies. Registration may be carried out in person, by mail, by fax, and via the Internet. At present, approximately 80% of all new companies in Canada are registered through the on-line document processing center[20].

The registration procedure in Canada includes the following phases, each of which can be completed on the Internet[21]:

- confirming the company name using the electronic database on existing companies, which takes up to one business day;
- submitting documents to the registration agency. Two forms are submitted with the application (one for the company charter and the other for information on the company's office and directors) along with confirmation of the company name. Notarization of the foundation documents is not required. (But an entrepreneur is liable under the law for submitting unreliable information.) This phase takes one business day to complete and can be done at the same time as the first phase. The registration certificate is issued by e-mail. At this point, a 9-digit number is assigned to the company;
- registration with tax agencies (2 days);
- registration with labor and social insurance agencies (carried out immediately.)

[18] Karimov, I.A. Our Main Objective Is to Democratize and Renew Society, and Reform and Modernize the Country. Report at the joint session of the Legislative Chamber and the Senate of the Oliy Majlis, January 28, 2005.

[19] Doing Business in 2005: Removing Obstacles to Growth. 2005. A copublication of the World Bank, the International Finance Corporation and Oxford University Press.

[20] de Sa, Liliana, Business Registration Start-up: a Concept Note (draft). IFC and the World Bank, September 28, 2005.

[21] Ibid.

Monitor compliance with legislation at the regional level and apply penalties for officials not performing their duties

To prevent non-compliance with established registration procedures, stringent control at the regional level is required. Simultaneously, clear mechanisms should be developed and introduced for imposing penalties on officials for exceeding registration processing time limits, non-compliance with the "one-window" registration procedure, unjustified denial of registration, and similar actions/omissions.

EXPECTED IMPACT

These measures will increase the accountability of the officials of the agencies responsible for business registration and significantly ease the process for entrepreneurs. The prospect that officials will be held accountable for dereliction of duty would be an effective instrument to helping entrepreneurs to influence the registration procedure and to exercise their rights.

Undertake a wide-scale information campaign and facilitate access to information

It is recommended that ongoing efforts be made to familiarize both entrepreneurs and officials with legislation applicable to them. Open access to this information should be ensured making information materials available at registration inspectorates and departments of the Chamber of Trade and Industry, and publishing them in the mass media. These materials should be as accessible and easy to understand as possible in order to eliminate the need for the services of consulting firms and lawyers during registration.

EXPECTED IMPACT

A program of disseminating information aimed at raising the level of legal awareness of entrepreneurs and officials would allow entrepreneurs to monitor compliance by state agencies with established procedures and establish a measure of public control over the appropriateness of the actions of officials. In turn, this would reduce the potential for abuse of power.

LONG-TERM RECOMMENDATIONS

Subsequent steps in reforming the business registration process should be aimed at a further reduction in the time and costs involved in registration and maximize the simplification of all phases of registration process.

One way to streamline the process should be the development and introduction of registration via the Internet (the current procedure stipulates the option of submitting documents in person or by mail.) This would require the use of electronic

signatures. The relevant legal framework already exists in Uzbekistan for regulating electronic document circulation and the use of digital signatures[23] and should be used to promote the introduction of on-line registration.

The ability to choose the method for submitting documents to the registration agency would allow entrepreneurs to use their working time more effectively. In addition, on-line registration would minimize the number of contacts between entrepreneurs and state agencies, which would reduce substantially the potential for abuse of power and corruption.

Experience in countries that have introduced on-line registration shows that it is effective.

A major expense in starting a business, and therefore a constraint on the establishment of new businesses, is the minimum authorized capital requirement.

According to international practices, the requirement for minimum authorized capital is primarily explained by the need to protect the interests of the company's creditors and investors. However, the amount of the minimum capital often does not cover the company's liabilities. Moreover, the contribution can be made in a form other than money and can be withdrawn after registration.

The need in minimum authorized capital requirements for banks, exchanges, or insurance companies, is beyond doubt. However, it is necessary to examine whether the existence of such requirements for other businesses is expedient and corresponds to the declared objectives.

Box 5.9

Minimum authorized capital requirements are generally introduced in order to ensure liquidity at the level required to minimize the risk of business failure. However, surveys have not revealed any correlation between the amount of capital requirement and the number of business failures.[24]

Therefore, the governments in many countries have concluded that these requirements are only a barrier to business development, and have taken steps to reduce or abolishing them. For instance, in Australia, Botswana, Vietnam, Canada, Nepal, the USA, Thailand, Uganda, France and other countries, there are no requirements for a minimum amount of limited liability capital.[25]

Box 5.7 (continue)

The option of Internet registration was introduced in Denmark[22] in September 2001. Prior to that, an entrepreneur could submit the required documents to a registration agency personally or by mail, e-mail, or fax. Now, an entrepreneur (or an agent acting on his behalf) can fill out a registration application and submit all the required documents via the Internet. Their authenticity is confirmed by an electronic signature.

This method allows a more flexible registration schedule, which speeds it up considerably. In Denmark, it is now possible to register a company within a few hours – not days as in the past.

Box 5.8

Authorized capital amounts in Uzbekistan:

Limited or additional liability company – the minimum authorized capital is 50 times the minimum wage as established by legislation on the date document are submitted for the company's state registration (as of January 1, 2005, 326,000 soums or US $310.)

Closed joint-stock company – the minimum authorized capital is 200 times the minimum wage as established by legislation on the date of the company's state registration (as of January 1, 2005, 1.3 million soums or US $1,200.)

Open joint-stock company – the minimum authorized capital is US $50,000 at the Central Bank exchange rate.

Markets – the minimum authorized capital is 500 times the minimum wage established by legislation on the date of the market's state registration (as of January 1, 2005, 3.3 million soums or US $3,000.)

[23] Law of the Republic of Uzbekistan, "On Electronic Digital Signature," December 11, 2003; Law of the Republic of Uzbekistan, "On Electronic Document Circulation," April 29, 2004.

[24] de Sa, Liliana, Business Registration Start-up: a Concept Note (draft). IFC and the World Bank, September 28, 2005.

[25] Doing Business in 2005: Removing Obstacles to Growth. 2005. A copublication of the World Bank, the International Finance Corporation and Oxford University Press.

[22] European Commission Enterprise Directorate. 2002. (Final Report) Benchmarking the Administration of Business Start-ups. (http://europa.eu.int/comm/enterprise/entrepreneurship/support_measures/start-ups/bench_admin_business_start-up_final_2002.pdf).

TAXES AND TAX ADMINISTRATION

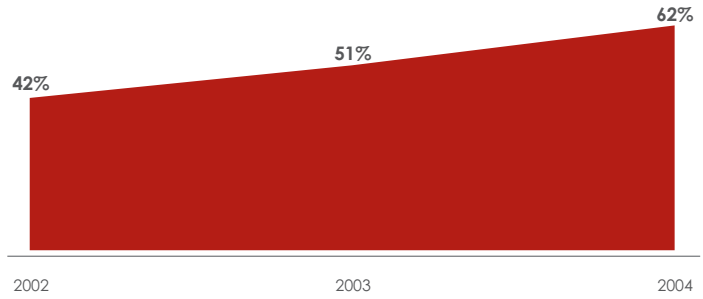
MAIN FINDINGS

- In 2004, the average tax burden in Uzbekistan was 20% of sales.
- Tax legislation is complicated. The problems most respondents faced included the large number of taxes and fees, contradictory regulations, the instability of the taxation system, the large number of regulatory documents, and the complexity of regulations.

The state needs funds to implement its social and economic programs, including those aimed at improving the business environment in the country. They are mostly implemented from budgetary funds collected in the form of taxes and other mandatory payments. These taxes and payments, in turn, impose a burden on entrepreneurs and, along with administrative constraints, reduce their incentives and opportunities for further investing in their businesses and creating jobs. One of the main tasks of the Uzbek Government is to ensure balance between the interests of the state and businesses by establishing an effective, equitable, and sustainable taxation system.

The survey showed that taxation causes difficulties for most entrepreneurs and addressing issues related to it was one of the most difficult aspects of their activity. Three out of five respondents described the taxation process as "rather problematic" and "very problematic." IFC surveys have shown that the taxation process is becoming more problematic year over year.

Chart 6.1
THE TAXATION PROCESS HAS BECOME INCREASINGLY PROBLEMATIC
% of respondents describing the taxation process as "rather problematic" and "very problematic"



THE TAX BURDEN IS HEAVY

In 2004, the tax burden on SMEs was an average of 20% of revenue, which respondents considered excessive. Focus group participants felt that the existing tax burden had a negative impact on their ability to invest in their businesses. In the opinion of respondents, the optimum tax rate for Uzbekistan would be 10% of sales, or half the current rate (see Statistical Results of the Survey.)

A heavy tax burden not only hampers business development but also forces entrepreneurs into the "shadow" sector of the economy in order to remain competitive.

"Today, taxes are so high that if you pay them honestly, you get pushed out of the market."

Focus group participant

The survey revealed the following factors in the heavy tax burden:

High tax rates

Despite the trend toward reducing taxes, tax rates are still high. In construction and some other sectors where SMEs paid the unified tax, the 2004 rate was 13% of sales.[1]

Box 6.1

In Russia, for example, for SMEs paying taxes under the simplified taxation system, the unified tax rate was 6% of revenue or 15% of revenue less expenses.[2] The entrepreneur has a choice of tax system.

Businesses using the simplified taxation system do not pay the value-added tax (VAT), with the exception of the VAT on goods imported into the customs territory of the Russian Federation.[3]

For businesses taxed under the general taxation system, the 2004 tax on profit was reduced from 20%[4] to 18%.[5] However, not all of their expenses were deductible. SMEs also paid additional tax at the rate of 8% of net profit for territory improvement and development of social infrastructure.[6]

All businesses, regardless of the taxation system chosen, were also required to contribute a percentage of revenue to targeted funds; namely, 0.7% to the pension fund and from 1% to 2.5% (depending on the type of business) to the road fund.[7] Starting in January 2005, these contributions were increased by the requirement to pay 1% of sales to the education fund.[8]

Box 6.2

Impact of the tax burden on foreign direct investment (FDI)

An analysis of the results of 25 surveys regarding the impact of the tax level on foreign direct investment (mostly data on FDI in the USA or made by American firms) showed that a tax rate increase of approximately one percentage point reduced FDI by approximately 3.3%.[9]

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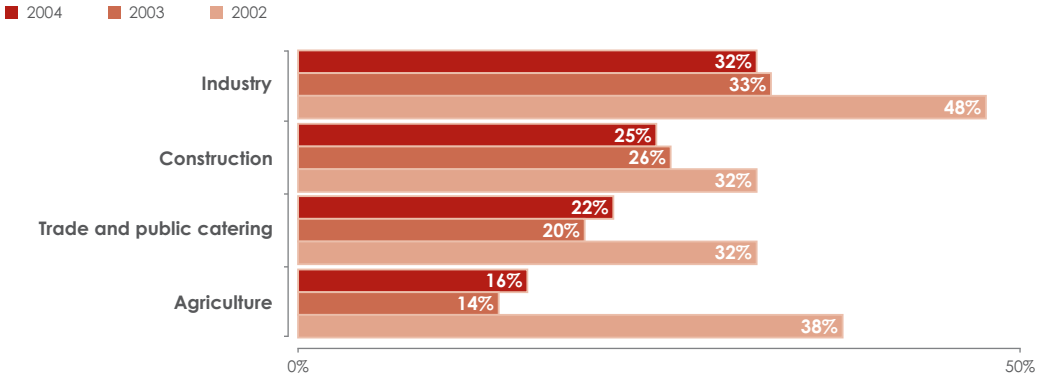
1 Resolution 567 of the Cabinet of Ministers of the Republic of Uzbekistan, December 25, 2003.
2 Article 346.20 of the Tax Code of the Russian Federation.
3 Article 346.11 of the Tax Code of the Russian Federation.
4 Resolution 455 of the Cabinet of Ministers of the Republic of Uzbekistan, December 30, 2002.
5 Resolution 567 of the Cabinet of Ministers of the Republic of Uzbekistan, December 25, 2003.
6 ibid.
7 ibid.
8 Decree UP-3431 of the President of the Republic of Uzbekistan, May 21, 2004.
9 World Bank. 2004. World Development Report 2005: a Better Investment Climate for Everyone.

High tax costs of investment

Entrepreneurs consider several factors in deciding whether to invest in business development. The existing and projected taxation conditions are the decisive factor. The results of four annual surveys on the business environment in Uzbekistan showed that the percentage of respondents making capital investments was diminishing year over year. In 2001, one in two respondents made such investments; in 2004, only one in five did so.

Chart 6.2
FEW RESPONDENTS MAKE CAPITAL INVESTMENTS
% of respondents



"In my opinion, an effective taxation system should be based on the following proportions: One third of the profit goes to the state in the form of taxes and fees, one third is retained in the business for further development and investment, and the remaining third is the owner's profit. In this country, the state takes practically everything, and after taxes and various mandatory fees are paid, there is nothing left for business development."

Focus group participant

In Uzbekistan, there are legal limits on the deduction of investment expenses from the basis for calculating tax on profit. Interest expenses on credit extended for a period of over 12 months and deductions made according to accelerated depreciation rates are subject to taxation.[10] A company obtaining credit to invest in its business not only pays interest on the debt, but also pays profit tax on the expenses involved.

Box 6.3

Legislation restrains the renewal of fixed assets in Uzbekistan

The Tax Code sets the depreciation periods for equipment at 5 to 20 years, depending on the type. For instance, the schedule allows businesses to depreciate no more than 20% of the cost of computers and computer technology annually, which implies their replacement every five years.[11] However, because of the rapid progress in technology and the universal use of information technologies, innovations are introduced every six months. In industrialized countries, companies replace such equipment almost annually so as not to lag behind their competitors.

Accelerated depreciation is available in Uzbekistan, but if applied, all deductions above the percentages set by the Tax Code are subject to profit tax. If equipment is purchased through credit from a bank, the profit tax will also apply to the interest. So, it can be said that by discouraging businesses from opting for accelerated depreciation of their equipment, the current legislation restricts the introduction of new technologies.

As well, companies in Uzbekistan do not receive input credits on the 20% VAT paid on fixed assets (premises, equipment, etc.) This increases the costs to the businesses, which they depreciate over a term that depends on the type of asset – from five years (for cars or computers) to 20 years (for buildings or infrastructure.)

[10] Regulations "On the Structure of Costs in the Production and Sale of Products (work, services) and the Procedure for Calculating Financial Results," approved by Resolution 54 of the Cabinet of Ministers of the Republic of Uzbekistan, February 5, 1999.

[11] Article 23 of the Tax Code of the Republic of Uzbekistan.

High social security contributions and a progressive income tax schedule

Mandatory social security fees, which have the same status as taxes, put a substantial burden on SMEs.[12] In addition to paying personal income tax based on a progressive tax rate schedule, employees pay contributions to the pension fund and dues to the Trade Union Federation Council.

The result of the progressive personal income tax rate schedule and the high rates of contributions to funds aimed at improving social security is that neither employers nor employees are interested in formalizing the labor relationship. This restricts wage and salary increases as well as growth in the number of jobs, expands the shadow economy, deprives the public budget of revenue, and leaves employees vulnerable. According to focus group participants, a substantial number of SMEs address this issue by paying wages and salaries unofficially. In those cases, both the companies and the employees are breaking the law. High payroll deductions and personal income tax make it customary to do so.

> "Look at the salary of company employees… Even the salary of directors is only 30,000-40,000 soums![13] Everyone knows very well that this figure is for the tax inspectorate, and most of the salary is paid with envelopes of cash. Where do we take this cash from? We have to make some payments bypassing the settlement account in order to find the money. And this is going on everywhere."
>
> *Focus group participant*

Box 6.6

What harm does the shadow sector do?

Companies that conceal some of their transactions pay lower taxes, thereby shifting the tax burden onto the taxpayers who operate legally. But operating in the shadow sector is also harmful for the businesses themselves. Companies operating within the law do not have to expend resources to conceal their activities, and therefore can develop and achieve optimum growth. This premise is supported by the World Bank project "Doing Business in 2005,"[14] which found that, "on average, in the ten developing countries sampled, the output of shadow enterprises was 40% less than that of legal businesses operating in the same economic sectors."

In addition, enterprises operating in the shadow sector have limited ability to attract external funding. Companies that understate their profit to avoid tax are also deprived of other opportunities – low financial indicators do not permit them to secure bank credit or use the services of leasing companies.

Box 6.4

Flaws in legislation impede modernization of businesses in Uzbekistan

In Uzbekistan, imported manufacturing equipment is exempt from the value-added tax. This privilege does not apply to equipment imported for subsequent resale in the domestic market. Small companies without sufficient resources to buy equipment abroad buy through intermediaries operating in the domestic market who specialize in importing equipment.

To start production, many SMEs purchase second-hand equipment in the domestic market. Unsophisticated equipment they usually order from local manufacturers. In establishing production, they spend large amounts of money on the construction of production premises by local companies.

Entrepreneurs pay 20% VAT in acquiring fixed assets (equipment and production and auxiliary premises.) If they buy imported equipment through an intermediary company, they first have to pay the customs duty on which the VAT will be calculated. The business receives credit for the VAT paid on raw materials and consumables in the course of one production cycle, on manufacturing equipment (through depreciation) in equal portions over 13 years, and on production premises over 20 years. This is stipulated by the following clause in the Tax Code: "The tax on fixed assets acquired and intangible assets used in the business is not subject to input credit."[15] By contrast, the tax codes of most countries (including the USA, Germany, Russia, Kazakhstan, etc.) allow input credits for capital purchases.

Subsequent sale of imported equipment is also problematic. If a company sells equipment in order to buy new equipment, even after a significant period, it will have to pay VAT, customs duties based on the initial (contract) value, plus the penalty accrued since the date it was imported into the territory of Uzbekistan. (For more detail, please refer to the 2001–2003 IFC reports "Business Environment in Uzbekistan as Seen by Small and Medium Enterprises.")

Box 6.5

In Russia, income tax is payable at a proportional (flat) tax of 13%. In addition, the social tax is levied according to a regressive schedule. Under this schedule, tax is payable at a reduced rate on salaries exceeding a specified amount. The maximum rate is 26% (20% for agricultural enterprises.)[16]

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[12] In 2004, businesses paid a consolidated social security contribution of 33% of payroll. Effective January 1, 2005, this was reduced to 31%. Revenue from the consolidated social security contribution is distributed among the extra-budgetary pension fund, the State Employment Fund, and the Trade Unions Federation Council. In addition, businesses contributed a percentage of sales to the pension fund.

[13] In 2004, the average US dollar exchange rate set by the CBU was 1,020 soums.

[14] Doing Business in 2005: Removing Obstacles to Growth. 2005. A copublication of the World Bank, the International Finance Corporation and Oxford University Press.

[15] Article 75 of the Tax Code of the Republic of Uzbekistan.

[16] Article 241 of the Tax Code of the Russian Federation.

Box 6.7

Tax treatment of expenses restricts the development of private enterprise

The prevailing tax treatment of a number of expenses not only creates additional difficulties in the basis for calculating profit tax, it also substantially reduces opportunities to enter the market – especially taking into account that the standards have not changed since the planned economy era, when state enterprises did not need to spend significant funds on promoting their goods and the government wanted to limit these expenses.

For instance, in Uzbekistan the annual deductible advertising expense is only 2% of annual gross income for trade, procurement, and supply-and-sales enterprises and annual revenue from the sales (work, services) including VAT for other sectors,[17] even though companies have to spend the greater part of their income on entering new markets (especially markets in industrialized countries.)

Box 6.8

In Uzbekistan, companies that utilize more resources pay more for environmental pollution than those that actually pollute the environment.

The ecology tax applicable in the country is unique in its taxable basis. It is small (1%), but it is levied on production costs. That is, the tax is based not on excessive water or air pollution but on all operating costs (raw materials, remuneration, etc.) and periodic expenses, with the exception of mandatory payments to the budget, taxes, fees, and contributions to social funds.[18] Thus, the tax is levied on the company's expenses rather than its income. The more resource-intensive the business, the higher the payments.

[17] Resolution 444 of the Cabinet of Ministers of the Republic of Uzbekistan, October 15, 2003.

[18] Article 111 of the Tax Code of the Republic of Uzbekistan.

Some business expenses are included in the basis for calculating profit tax

The current limitations[19] on deducting some expenses from the basis for calculating tax on profit effectively results in taxation of expenses. For example, companies cannot deduct interest paid on credit extended for a period of more than 12 months or on short-term credit in excess of the discount rates set by the Central Bank, and they pay tax on accelerated depreciation rates.

A similar situation exists with respect to expenses involved in entering new markets and maintaining or expanding positions in those already developed. The tax legislation in Uzbekistan specifies expense rates for market research and for travel and hospitality expenses. All expenses exceeding these rates are subject to profit tax.

Double taxation, "tax on tax," and taxation of sales

A fundamental taxation principle is the one-time taxation of any taxable item. Uzbekistan is not currently adhering to that principle. For example, sales revenue is the basis not only for the unified tax payable (in the case of the simplified taxation system) but also for mandatory payments to the pension fund, road fund, and education fund.

Another example is the territory improvement and infrastructure development tax. It is levied on profit, net of all taxes (including the profit tax.)

As well, the VAT on imports is calculated on a basis including the customs value, the excise tax, and customs duties.[20] This "tax on tax" is a heavy burden on the importer (see Annex 10.) The same applies to goods subject to excise tax produced in Uzbekistan.

In addition to income taxes, a number of compulsory fees are levied based on the volume of sales. Thus, if an enterprise has a low profit margin, it is overtaxed even though the percentage of the tax seems small.

Thus, even though the rates of taxes and other mandatory payments are low and comparable with neighboring countries, because they are levied on the same taxable basis, and expenses, excise taxes and customs duties are included in the taxable basis, the tax burden is actually a heavy load hampering business development in Uzbekistan.

[19] Regulations "On the Structure of Costs in the Production and Sale of Products (work, services) and the Procedure for Calculating Financial Results," approved by Resolution 54 of the Cabinet of Ministers of the Republic of Uzbekistan, February 5, 1999.

[20] Article 70 of the Tax Code of the Republic of Uzbekistan.

> In wholesale trade, we consider ourselves lucky if the profit is 3–4%. We cannot set a higher markup – people's incomes are too low, and they will simply stop buying our goods. Our only salvation is high sales and high turnover. That much profit is enough to keep us going and for further development. But if you are forced to pay 2–3% of the sales to all kinds of funds, you are effectively working for nothing."
>
> *Focus group participant*

Numerous individual tax concessions

The taxation system should be based on equitable principles. If a state wishes to promote business development in generally unprofitable areas, it can either subsidize those sectors (and many economists believe that this is the most effective and easily-controlled method[21]) or apply various kinds of preferential tax treatment. In the latter case, however, the application of tax concessions should be simple and transparent, and preferential treatment should not depend on the subjective decisions of a limited number of people. All tax concessions and the criteria for entitlement should be governed by the Tax Code, including a detailed mechanism for their application. At present in Uzbekistan, both temporary and one-time tax concessions are used as a result of lobbying, which is then formalized by government resolutions. This is inequitable for taxpayers, undermines fair competition, and creates opportunities for corruption.

Tax treatment of local companies is worse than that of enterprises with foreign investment

Uzbekistan has a system of incentives for companies with foreign investment. Most are granted various tax concessions.

Box 6.10

Preferential treatment for companies with foreign investment

In addition to existing concessions,[22] effective July 1, 2005, enterprises in a number of economic sectors that attracted foreign direct investment were exempt from income (profit) tax on their primary activity, property tax, social infrastructure development and territory improvement tax, environmental tax, the unified tax for micro-firms and small enterprises, as well as a number of mandatory deductions to the road fund.[23]

These concessions were granted for periods based on the amount of foreign direct investment:

- US $300,000 to $3 million – 3 years;
- US $3 million to $10 million – 5 years;
- Over US $10 million – 7 years.

Box 6.9

The practice of granting individual tax concessions in Uzbekistan

The Order of the President of the Republic of Uzbekistan on drafting of a new Tax Code, passed in January 2005, highlights the need to pay special attention to the issue of equalizing tax conditions for all taxpayers, primarily by canceling unjustified concessions and exceptions to the general taxation system.[24] However, the practice of granting such privileges continues. In addition to the concessions granted to many of companies earlier (and which will continue to be in effect for some years,) a further number of companies received such concessions in 2005. In the first quarter alone, the following exemptions were granted:

value-added tax

- Samarkand Tea-Packing Factory, on the sale of its own packaged tea;[25]
- Shurtan Gas Complex, on the entire volume of raw materials (granules) sold to plants producing PVC film;[26]
- Jizzak Plastmassa Joint-Stock Company, on the sale of finished PVC film to cotton farms;[27]
- Andijonpolietileni Joint Venture, on the sale of finished PVC film to cotton farms;[28]

customs fees (with the exception of the customs clearance duty)

- UzDAEWOOAuto, on components and units for the assembly of cars in the amount of 3,008 pieces;[29]
- Samarkand Tea-Packing Factory, on raw tea, equipment, machinery, and inventory imported for its own production needs;[30]

all local taxes

- VBD Toshkent Ltd.[31]

[21] Hussey, Ward M. and Donald S. Lubick. Basic World Tax Code. 1996. http://www.taxanalysts.com/www/website.nsf/Web/BasicWorldTaxCode?OpenDocument.

[22] For example, those introduced by Decrees of the President of the Republic of Uzbekistan UP-1652 of November 30, 1996, UP-2143 of November 24, 1998, and UP-3267 of June 20, 2003.

[23] Decree UP-3594, April 11, 2005.

[24] Order P-2108 of the President of the Republic of Uzbekistan, January 7, 2005.

[25] Resolution 15 of the Cabinet of Ministers of the Republic of Uzbekistan, January 12, 2005.

[26] Resolution 4 of the Cabinet of Ministers of the Republic of Uzbekistan, January 5, 2005.

[27] ibid.

[28] ibid.

[29] Resolution PP-39 of the President of the Republic of Uzbekistan, March 29, 2005.

[30] Resolution 15 of the Cabinet of Ministers of the Republic of Uzbekistan, January 12, 2005.

[31] Resolution 8 of the Cabinet of Ministers of the Republic of Uzbekistan, January 7, 2005.

This policy puts local businesses at a disadvantage, which in turn has a negative effect on the competitiveness of the goods they produce. According to focus group participants, local investors get around the problem by illegally taking their capital abroad, establishing companies in foreign countries, and making investments in Uzbekistan through them. This was confirmed by officials of some state regulatory agencies who participated in focus groups.

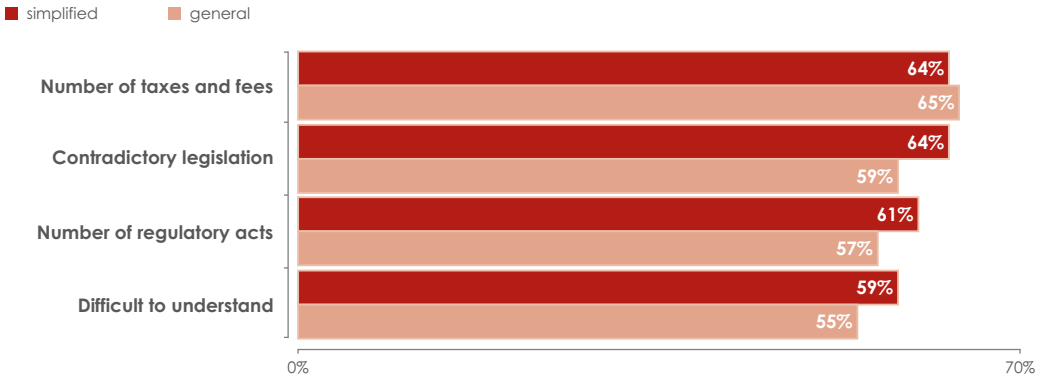
International practices have shown[32] that concessions granted to individual enterprises and to whole sectors are not generally an effective mechanism for promoting their development. Stability and transparency in the taxation system is more effective, and the system should be theoretically neutral; that is, it should have a minimum impact on an entrepreneur's decision as to the type of business activity to pursue.

TAX LEGISLATION IS COMPLICATED

According to the survey, current tax legislation is too complex. It was not only the respondents paying tax under the general system who found it so; those who opted for the simplified taxation system held the same opinion. Twelve per cent of respondents using the simplified system expressed a desire to go back to the general system.[33]

Chart 6.3
MANY ASPECTS OF TAXATION ARE COMPLEX IN BOTH THE GENERAL AND SIMPLIFIED TAXATION SYSTEMS

% of respondents citing the given factor as complicating the taxation system



There are several reasons for the excessive complexity of the taxation system:

The large number of taxes and fees

Businesses paid a large number of taxes and equivalent fees. Even SMEs using the simplified taxation system paid an average of five taxes in 2004.

[32] Hussey, Ward M. and Donald S. Lubick. Basic World Tax Code. 1996. http://www.taxanalysts.com/www/website.nsf/Web/BasicWorldTaxCode?OpenDocument.

[33] In Uzbekistan, not all businesses have the right to choose their taxation payment system. Trade and public catering businesses pay tax on gross revenue, agricultural enterprises pay the consolidated land tax applicable to the production and processing of their own farm produce, legal entities engaged in organizing lotteries, sweepstakes, and other risk-based games pay a consolidated tax on gross revenue, and certain types of entrepreneurial businesses pay a fixed tax.

Chart 6.4
EVEN UNDER THE SIMPLIFIED TAXATION SYSTEM, MANY SMEs PAID MORE THAN FIVE TAXES

# of taxes

Article 123 of the Constitution of the Republic of Uzbekistan provides that the right to set taxes rests with the Oliy Majlis, the country's parliament. However, some taxes and mandatory fees (examples include the unified social security fee, which is regarded as a tax and controlled by tax agencies, and contributions to the extra-budgetary education fund introduced January 1, 2005) are not included in the Tax Code passed by the Oliy Majlis in 1997. They were introduced through later government decisions, contradicting the Constitution.

Some taxes are levied on the same base amount (such as sales or payroll) but administered separately. An entrepreneur has to transfer the amounts accrued on the same base amount to different accounts with the relevant agencies and submit separate tax calculations for each of them. This increases the administrative load on enterprises substantially.

Instability of the taxation system

The current taxation system is characterized by a high degree of instability. In 2004, over 35 regulatory acts were passed introducing approximately 100 amendments to the tax legislation. In the survey, 51% of respondents pointed to the instability of tax legislation as a factor having a negative impact on the operation of a business. Given the unpredictability of tax liability, companies cannot adequately plan their cash flow or business development. Moreover, the frequent changes in taxation requirements, of which businesses are either not aware or are informed after the changes have come into effect, prevent SMEs from operating legally in compliance with tax legislation.

The large number of documents regulating taxation

The numerous amendments introduced into tax legislation over the course of many years since the adoption of the Tax Code have resulted in a swollen regulatory basis for governing taxation. At present, apart from the Tax Code, which often covers only general tax matters, the taxation process is governed by a large number of other regulatory acts, including resolutions of the Cabinet of Ministers and departmental documents.[34] This is not transparent, and it makes the taxation system cumbersome and difficult to understand for both entrepreneurs and tax officials, which significantly increases the number of tax problems for businesses.

[34] According to some experts, the legal framework for taxation includes more than one thousand documents approved in the past seven or eight years.

Box 6.11

How should the tax on profit be calculated?

The survey showed that 49% of SMEs pay taxes under the general tax method. According to focus group participants, one of the reasons is that the tax rates under the simplified tax method are rather high. SMEs with small profit margins found it more advantageous to pay tax on profit rather than on gross sales. However, even arriving at the correct taxable figure requires skill on the part of the accountant because there are substantial differences between calculating expenses for accounting purposes versus taxation purposes. Taxable income (profit) is determined by factoring some expenses back into the figure.

Special Regulations "On the Structure of Costs Involved in the Production and Sale of Products (work, services) and the Procedure for Calculating Financial Results"[35] were passed for this purpose. They included schedules classifying business expenses (with 17 subcategories) and established the procedure for calculating profit for tax purposes. Annex 1 to the Regulations lists expenses (with approximately 70 subcategories) deductible from income in calculating net profit for the period, but which are to be included in calculating profit for tax purposes. Annex 2 lists expenses that are not deductible from the taxable basis during the reporting period, but may be deducted in later periods (another 15 subcategories.) Based on the Regulations, ministries, departments, and economic amalgamations (corporations, associations, companies, etc.) identify the particular deductible expense structure and accounting procedure relevant to their respective sectors.

This complex calculation method leads to many errors, disputes, and additional costs for both businesses (accounting and auditing services and penalties) and the state (labor costs associated with subsequent inspections and communications and further training for tax officials.)

[35] Approved by Resolution 54 of the Cabinet of Ministers of the Republic of Uzbekistan. February 5, 1999.

Contradictory laws and regulations and ambiguity in interpretation

The disorganized introduction of amendments to tax legislation and the large number of regulatory documents in force complicates control over their content and compliance with the fundamental provisions of the Tax Code. (For more detail, please refer to the 2003 IFC Report "Business Environment in Uzbekistan as Seen by Small and Medium Enterprises.") As a result, tax legislation is losing cohesion. The provisions of various regulatory documents can be contradictory or ambiguous, leaving tax inspectors free to interpret controversial issues, often not in the entrepreneur's favor.

Low level of legal awareness among entrepreneurs and officials of the state tax inspectorates

Many problems related to taxation are explained by the low level of legal awareness among both entrepreneurs and tax inspectors. Lack of competence on the part of tax officials impeded the establishment of a good working relationship between them and the taxpayers. This led to opportunities for abuse of power by officials in the form of penalties. As a result, respondents were disinclined to consult inspectors when they did not understand the provisions of tax legislation.

SHORT-TERM RECOMMENDATIONS TO ADDRESS ISSUES IN THE TAXATION SYSTEM

Reducing the tax burden

Measures to reduce the heavy tax burden restraining the development of enterprises should include the following:

- reduce the existing tax rates and simultaneously cancel a large number of tax preferences (this would maintain public budget revenue balance and ensure equitable conditions for competition,) and strengthen tax administration to increase the tax collected;
- establish equitable conditions for local and foreign investors and abolish the practice of granting individual preferential treatment – all concessions, and the conditions and procedures for granting them should be prescribed in the Tax Code;
- reduce the instances of double taxation and taxation based on sales;
- change the basis for calculating profit tax by allowing the deduction of an enterprise's objective expenses, including interest paid on long-term credit and accelerated depreciation of equipment;
- allow VAT input credit on capital purchases;
- analyze personal income levels with a view to revising the income tax burden and the amounts of social security contributions.

EXPECTED IMPACT

Reducing the tax burden on businesses will help:

- establish equitable conditions for all businesses and thus foster the development of fair competition in the market;
- increase sales and investment activity for existing companies;
- encourage the establishment of new enterprises;
- increase public revenue;
- reduce corruption.

Most respondents believed that entrepreneurs conceal some of their revenue to evade tax they consider excessive (see Statistical Results of the Survey.) Tax reform would help reduce the shadow sector, thus increasing the tax base.

In turn, a reduction in social security contributions and income tax would assist in the following aims:

- increase the incomes of the working population through reduced mandatory deductions from income and higher wages and salaries;
- as officially reported salaries increase (including formalization of previously unofficial portions) employees would enjoy a higher standard of living through becoming eligible for benefits such as mortgages and consumer loans, medical insurance, and voluntary pension funds (which would partially reduce the burden on the state);
- increase the number of jobs and develop labor-intensive sectors;
- reduce the shadow economy by encouraging legal employment.

Simplifying the tax system

One measure for simplifying the tax system could be to reduce the number of the taxes. To that end, it is recommended that taxes levied on the same basis but administered separately be consolidated. Tax agencies could subsequently redistribute tax revenue for various purposes at the discretion of the state.

Box 6.12

Measures taken by the Government of Uzbekistan to improve the simplified tax system

The country's government acknowledged the need to simplify the tax system and reduce the number of taxes and mandatory contributions. Effective July 1, 2005, a consolidated tax payment for SMEs using the simplified tax system was implemented, replacing the unified tax plus mandatory deductions to the extra-budgetary pension fund, the road fund and the education fund.[36] This measure reduced the tax burden for entrepreneurs (the tax rate decreased from 15.2% to 13% for the industry and construction sectors, for example) and also reduced their administrative burden since it was no longer necessary to administer deductions to target funds separately.

However, this measure did not apply to some businesses that adopted the simplified tax system (procurement and supply-and-sales enterprises, brokerage firms and enterprises providing services under service agreements) or to businesses using the general tax system. This somewhat reduced the significance of the innovation because it further fragmented the existing tax regime and did not simplify tax accounting for most companies.[37]

[36] Decree UP-3620 of the President of the Republic of Uzbekistan, June 20, 2005.

[37] According to the survey, this measure may directly concern 15% of existing SMEs.

The new version of the Tax Code, now being drafted, is intended to address the excessive complexity of the tax legislation. To eliminate the unwieldiness, instability, and contradictions in the tax system and avoid these problems in the future, the Tax Code should become a direct-action law, that is, it should fully regulate all issues related to taxation without reference to other regulatory acts. Any ambiguity should be interpreted in the taxpayer's favor.

In addition, it is recommended that any changes to tax legislation be allowed only through the introduction of amendments to the Tax Code by the Oliy Majlis, a quarter (at least) before the changes come into effect at the beginning of the next tax year. This will allow entrepreneurs to bring their business in compliance with the planned changes. It is also recommended that newly established business be guaranteed a stable tax regime for a certain period (at least 12 months) after start-up.

Box 6.13

Drafting a revised Tax Code

According to the Order of the President of the Republic of Uzbekistan,[38] redrafting the Tax Code is to focus on the following:

- develop clear and robust principles, approaches and canons for the formulation of tax policy;
- reduce the tax burden on businesses, enhance the role of taxes in encouraging the development of production and service businesses, ensure rational and economical use of resources, and abolish ineffective taxes and contributions;
- ensure the direct action of the Tax Code and simplify the tax system through maximum consolidation of the rules for calculating and paying specific taxes;
- equalize tax treatment, primarily by eliminating unjustified concessions and exceptions from the general tax system;
- ensure the stability of the tax system, permitting entrepreneurs to plan business development;
- improve tax administration and increase tax collection by ensuring full payment of taxes and contributions to the public revenue and extra-budgetary funds and reducing opportunities for tax evasion.

EXPECTED IMPACT

Simplifying the tax system will aid in the following objectives:

- reduce administrative expenses for both the state and businesses;
- increase tax collection through fewer unintentional errors on the part of taxpayers;
- permit more adequate planning for business development;
- reduce unofficial business transactions;
- reduce the potential for corruption and abuse of power by officials.

Fewer taxes and simplified tax legislation would reduce the administrative burden on businesses. However, efforts should not be confined to the revising the Tax Code. Along with implementing those changes, the fiscal system should be improved further.

LONG-TERM RECOMMENDATIONS

The ultimate objective in reforming the tax system should be to create a business environment in which local enterprises are able to compete with similar businesses abroad (primarily in the CIS countries and the Central Asian region.) This would engender accelerated development of domestic entrepreneurship and serve as additional incentive to attract foreign investment in the country's economy.

[38] Order P-2108 of the President of the Republic of Uzbekistan, January 7, 2005.

Tax reform in Uzbekistan should continue in two directions: further reduction in the tax burden and simplification of tax administration.

To move further in the first direction, it is recommended that tax rates continue to be reduced and that some taxes and contributions be eliminated. In addition, the approach to identifying the basis for some kinds of taxes (the tax on the profit of legal entities, for example) should be revised.

Box 6.14

Uzbekistan's competitiveness with other countries

Given the globalization of the world economy and the free flow of capital, fiscal policy should take into consideration the situation in neighboring countries. Today's "country competition" means that countries must create a business climate that allows local businesses to be competitive in the international market and make their economies more attractive for investment A trend took shape in Europe after the EU expansion. A combination of low taxes, simple administration procedures, and a cheap and skilled labor force turned the Central and East European countries into a magnet for investment. Slovakia, for example, with a population of 5.5 million, attracted US $4 billion in FDI in 2002.[39]

Competition exists on both global and regional levels. Uzbekistan's main competitors are Kazakhstan and Russia, which are carrying out phased reduction in tax rates. For example, the value-added tax is 20% in Uzbekistan, but 10–18%[40] in Russia and 15% in Kazakhstan.[41]

To simplify tax administration, experience in the Baltic countries should be drawn upon, where there are only about ten public taxes.

Box 6.15

As international experience has shown, tax systems based on a small number of taxes and contributions are most effective. The Baltic countries provide an example. Their taxation systems are simple, transparent and highly effective. In Latvia,[42] for example, there are nine taxes; namely, business income tax, value-added tax, personal income tax, mandatory social security contributions, property tax, customs duties and fees, tax on natural resources, excise tax, and gambling and lottery tax. The simple tax system and the low total tax burden have permitted Latvia to eliminate the practice of granting tax concessions. This has made the taxation system still more transparent. In Estonia,[43] there are only seven taxes: personal income tax, business profit tax, social tax, sales tax, land tax, gambling tax, and excise tax.

The issue of a system of government spending of public money received into national and local budgets and target funds is becoming more vital. The amount of revenue from taxes and from various mandatory contributions, and how the money is spent, should be published in the mass media on a regular basis, in as much detail as possible.

Another important concern is to eliminate among tax officials the approach that inspections are a means of obtaining income. Among other things, the possibility of raising their salaries should be considered, along with introducing financial incentives dependent on successful tax collection and effective advisory work with taxpayers and not on the number of offences found and the amount of the penalties imposed.

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[39] "Can the optimum share of the budget in the GDP be determined?" Economic Review, # 7 (70), 2005, September 27–October 30, 2004.

[40] The applicable tax rate depends on the type of the good (article 164 of the Tax Code of the Russian Federation).

[41] Article 245 of the Tax Code of the Republic of Kazakhstan.

[42] Source: the State Revenues Service of the Republic of Latvia.

[43] Yusupov, Yu., "Do We Need a New Tax Code?" Economic Review, # 7 (70), 2005.

STATISTICAL RESULTS OF THE SURVEY

This section contains the main statistical findings of the fourth business environment survey in Uzbekistan. It incorporates some additional information on the issues dealt with in detail in the previous chapters of the report and the results of the survey on aspects of entrepreneurial activity in which regulation has not been substantially amended since the previous report. Those interested in a more detailed analysis of the problems not dealt with in the previous chapters may refer to the 2001-2003 IFC reports "Business Environment in Uzbekistan as Seen by Small and Medium Enterprises."

This section includes the following subsections:

- a summary of respondents' assessment of the difficulty with the main administrative procedures, with breakdowns by region;
- respondents' opinion of the conditions for doing business;
- additional information on the issues reviewed in the preceding chapters of the report (Inspections, Permits, Registration, and Taxes and Tax Administration);
- information on other aspects of entrepreneurial activity (Entrepreneurs and Banks, Export, Import, Certification and Obtaining Standards, and Licensing);
- results of a survey of agricultural enterprises and individual entrepreneurs;
- information on survey respondents.

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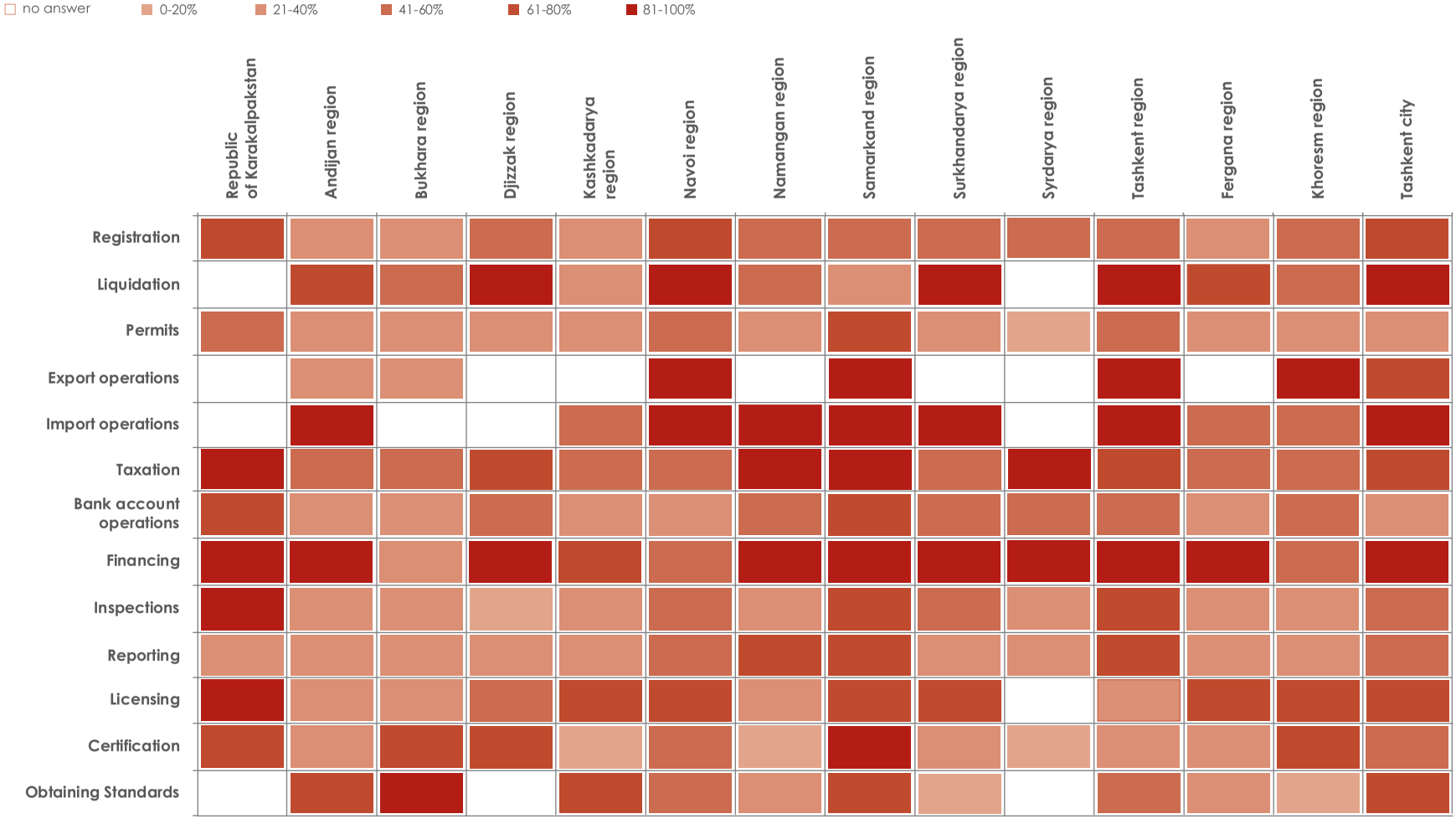
- information on survey respondents.

DIFFICULTY OF PROCESSES

Chart 7.1

DIFFICULTY OF PROCESSES

% of respondents describing the given process as "problematic" and "very problematic"



PROFILE OF RESPONDENTS

Chart 8.1
RESPONDENTS, BY SECTOR
% of respondents

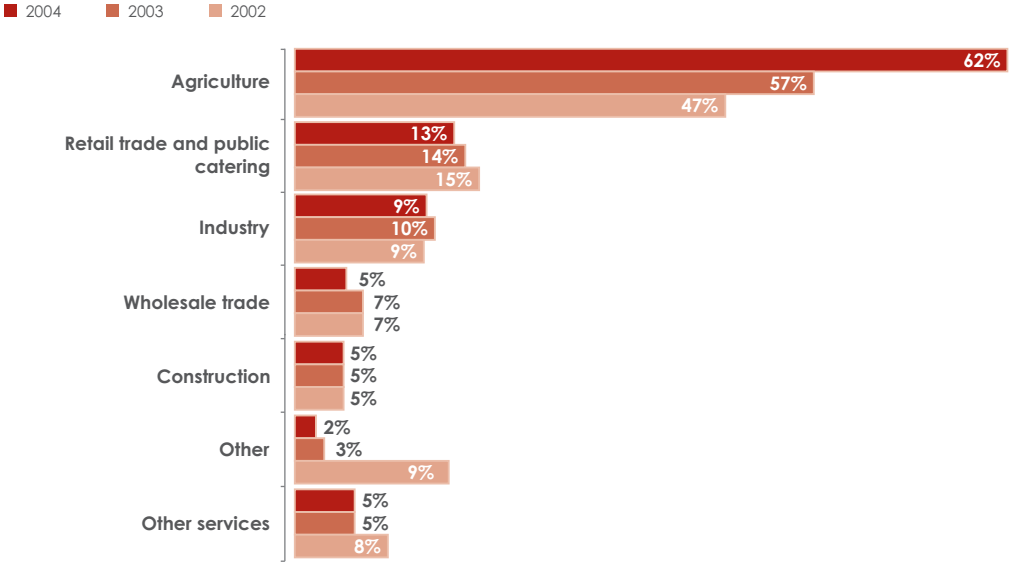


Chart 8.2
AVERAGE REPORTED RATE OF GROWTH IN SME SALES (BY SECTOR)
% increase over previous year

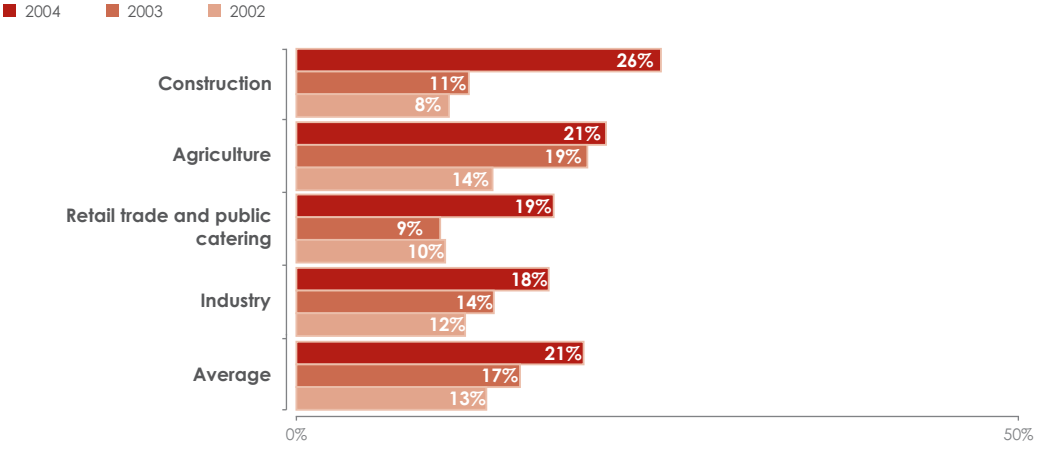


Chart 8.3
AVERAGE REPORTED SME PROFITABILITY (BY SECTOR)
% increase over previous year

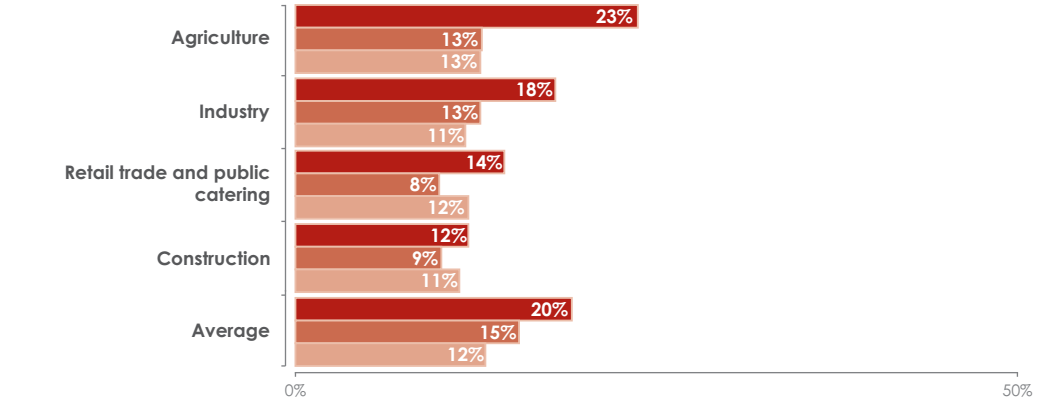


Chart 8.4
AVERAGE NUMBER OF EMPLOYEES OF AN ENTERPRISE
number of employees

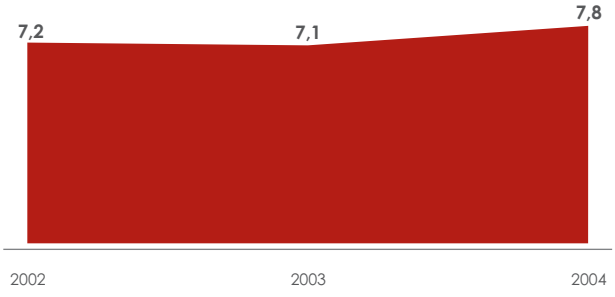


Chart 8.5
RESPONDENTS, BY EDUCATION
% of respondents

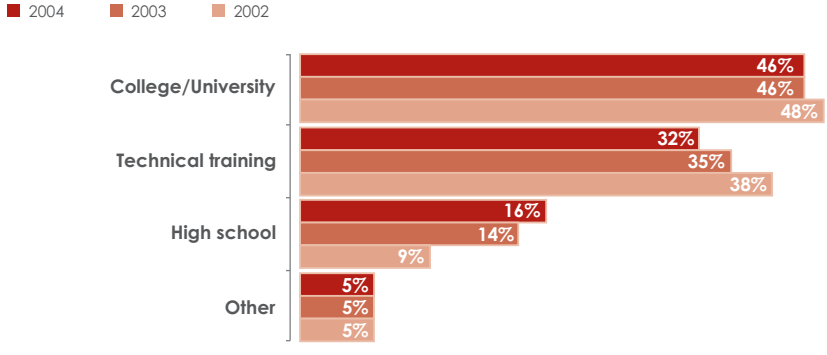


Chart 8.6
RESPONDENTS USING COMPUTERS AND INTERNET IN THEIR WORK
% of respondents

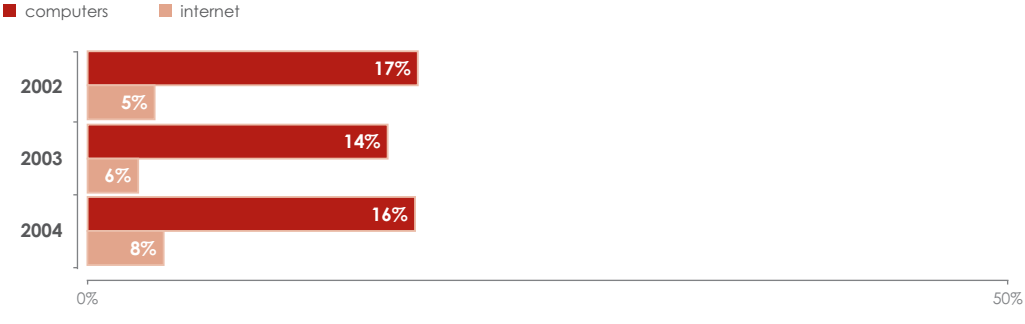


Chart 8.7
ENTERPRISES USING COMPUTERS IN THEIR WORK IN 2004 (BY SECTOR)
% of respondents in sector

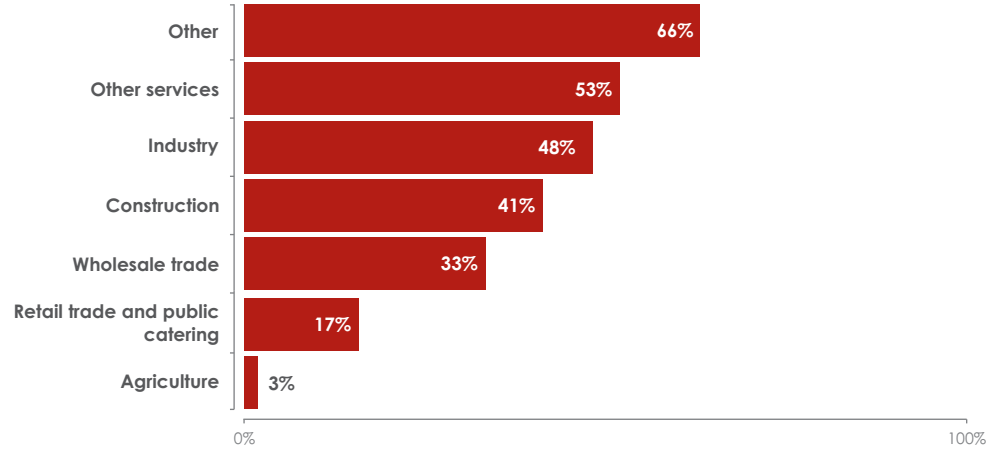


Chart 8.8
ENTERPRISES USING COMPUTERS AND THE INTERNET IN THEIR WORK (BY REGION)

% of respondents in region

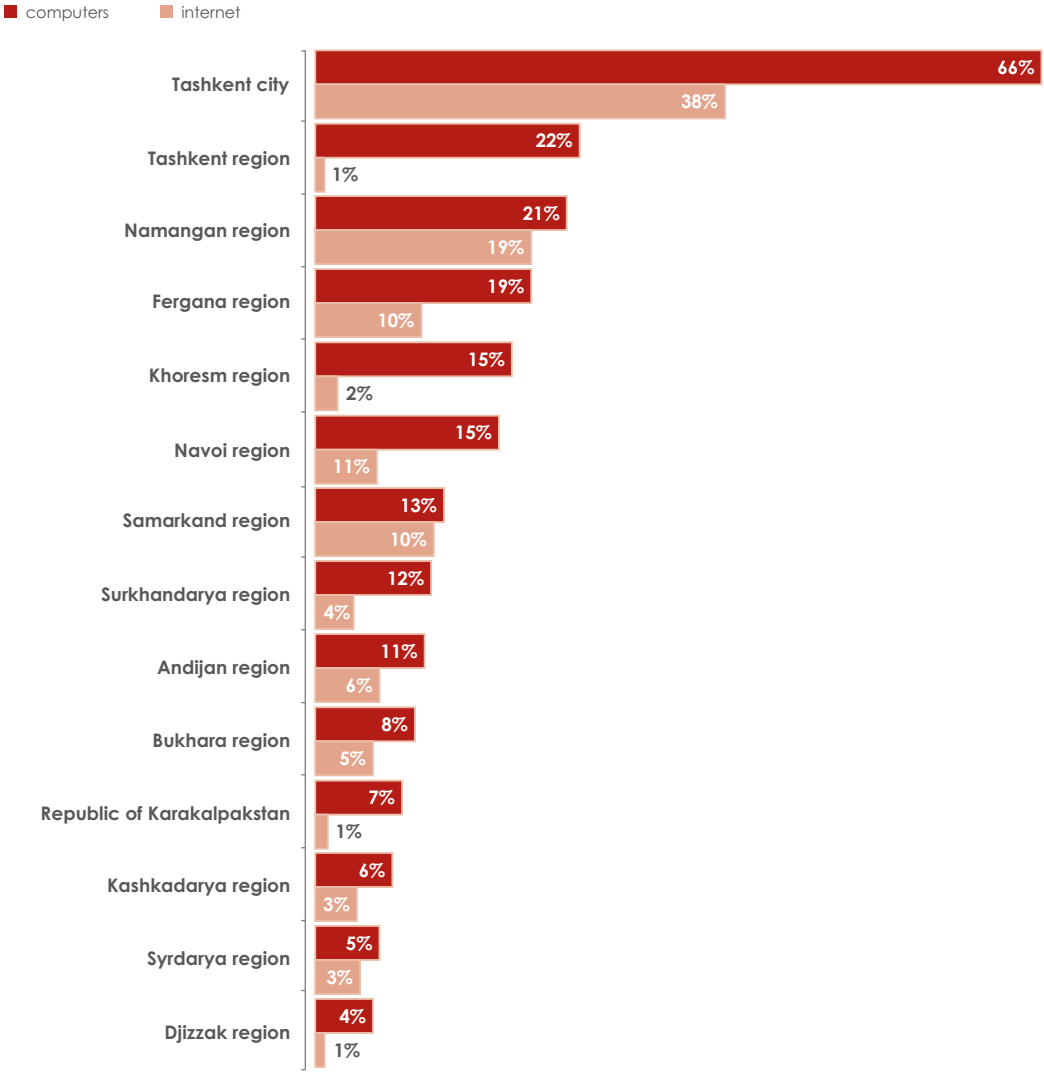
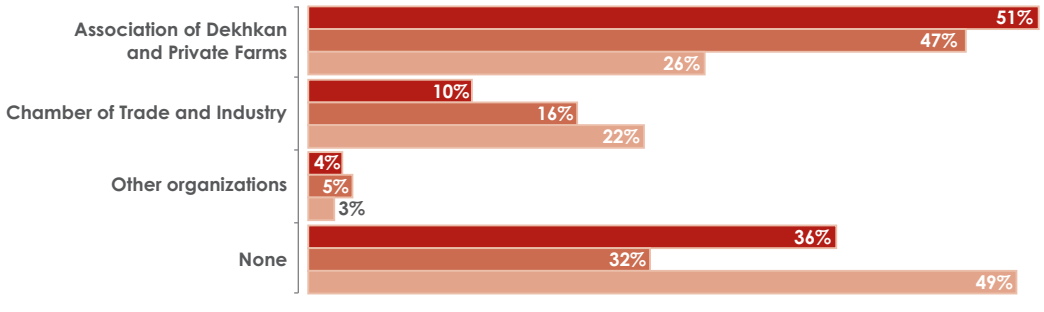


Chart 8.9
SME MEMBERSHIP IN BUSINESS ASSOCIATIONS AND ORGANIZATIONS

% of respondents



RESPONDENTS' ASSESSMENT OF BUSINESS ENVIRONMENT

Chart 9.1
RESPONDENTS' ASSESSMENT OF WORKING TIME SPENT IN SOLVING PROBLEMS WITH STATE BODIES

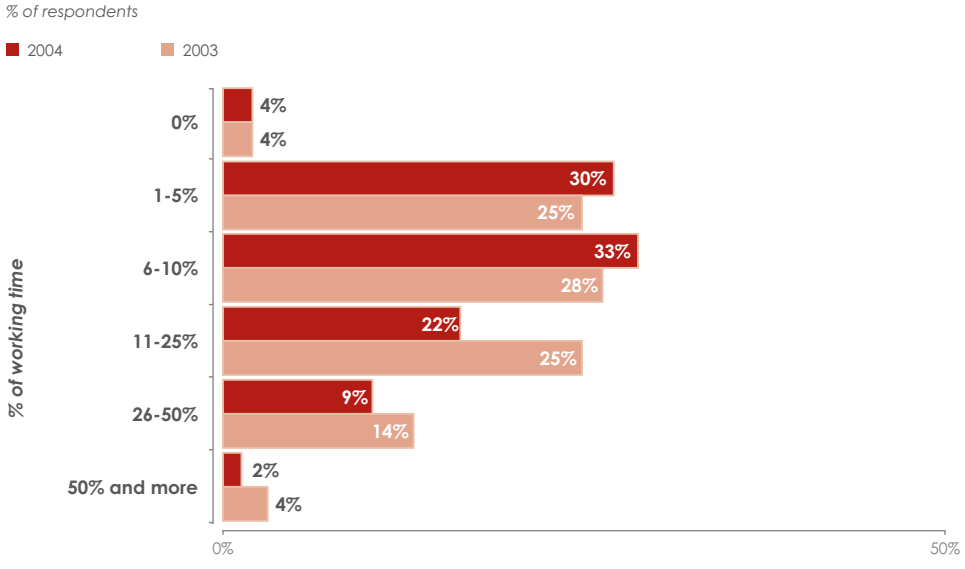


Chart 9.2
RESPONDENTS' ASSESSMENT OF WORKING TIME SPENT IN SOLVING PROBLEMS WITH STATE BODIES (BY REGION) IN 2004

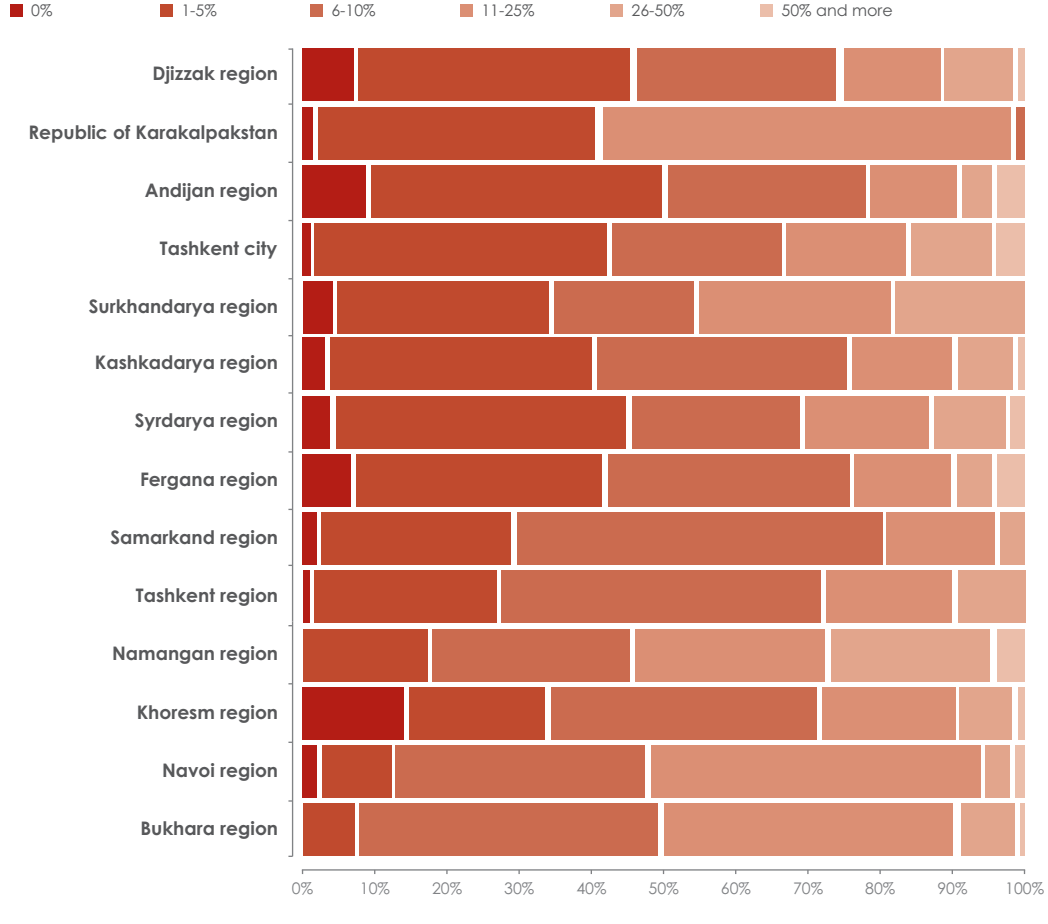


Chart 9.3

RESPONDENTS WHO WOULD START THEIR BUSINESS AGAIN (BY REGION)

% of respondents

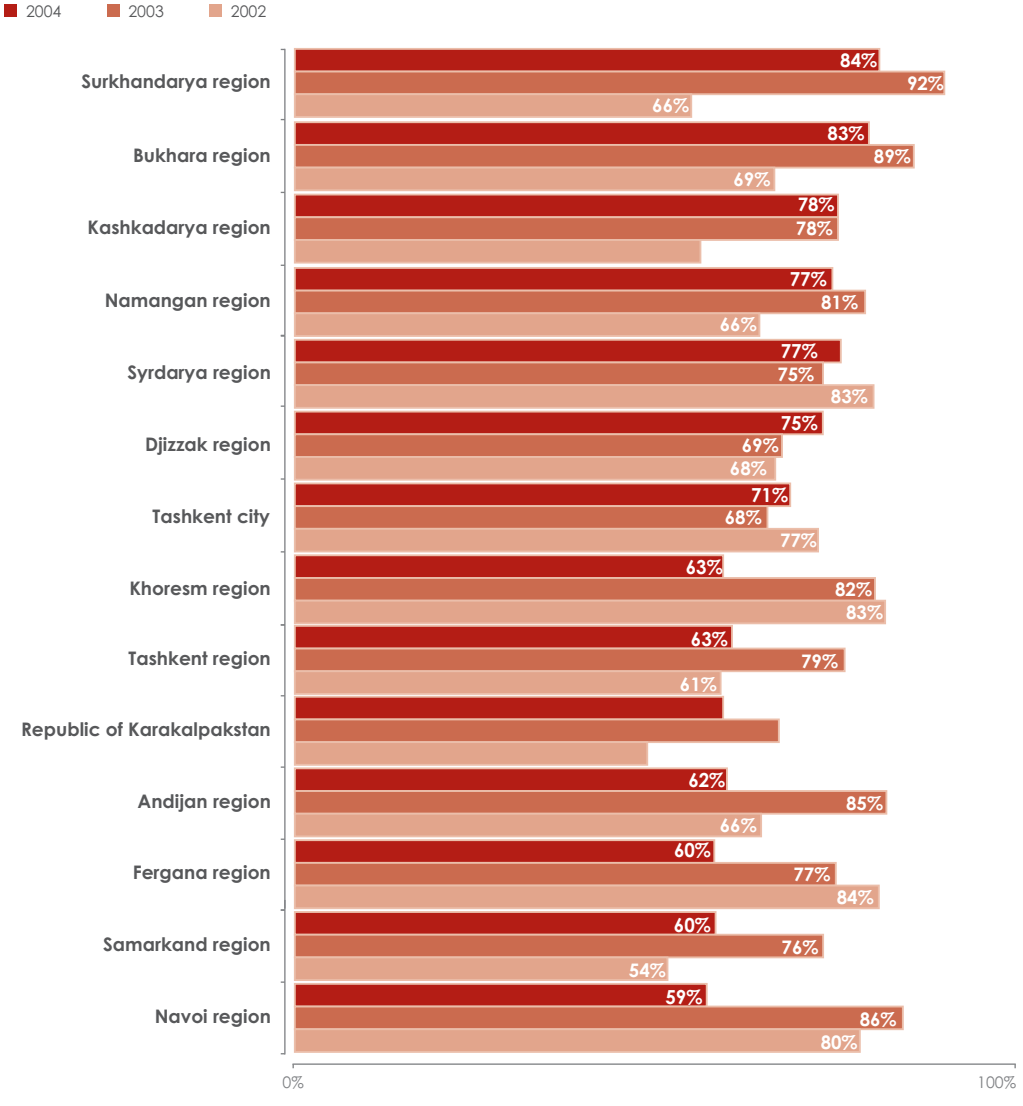


Chart 9.4

RESPONDENTS' EXPECTATIONS OF HOW THE BUSINESS ENVIRONMENT IN THE COUNTRY AS A WHOLE WILL CHANGE IN THE NEXT 12 MONTHS

% of respondents

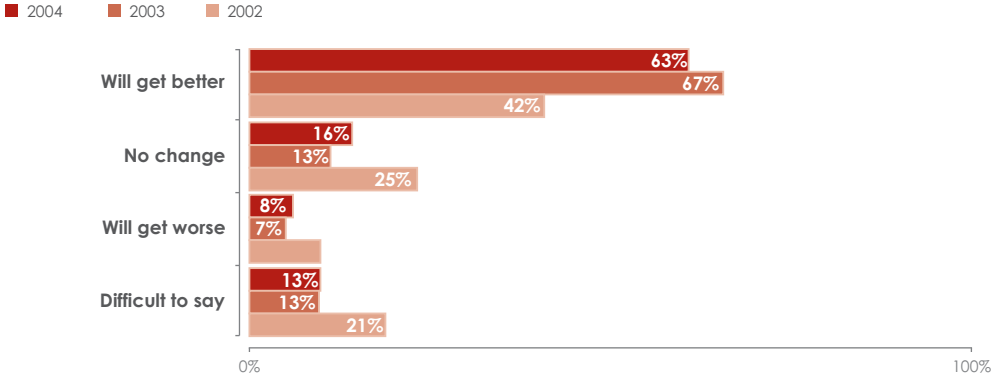


Chart 9.5

RESPONDENTS' EXPECTATIONS OF HOW THE BUSINESS ENVIRONMENT IN THEIR REGION WILL CHANGE IN THE NEXT 12 MONTHS

% of respondents in region expecting business environment to improve

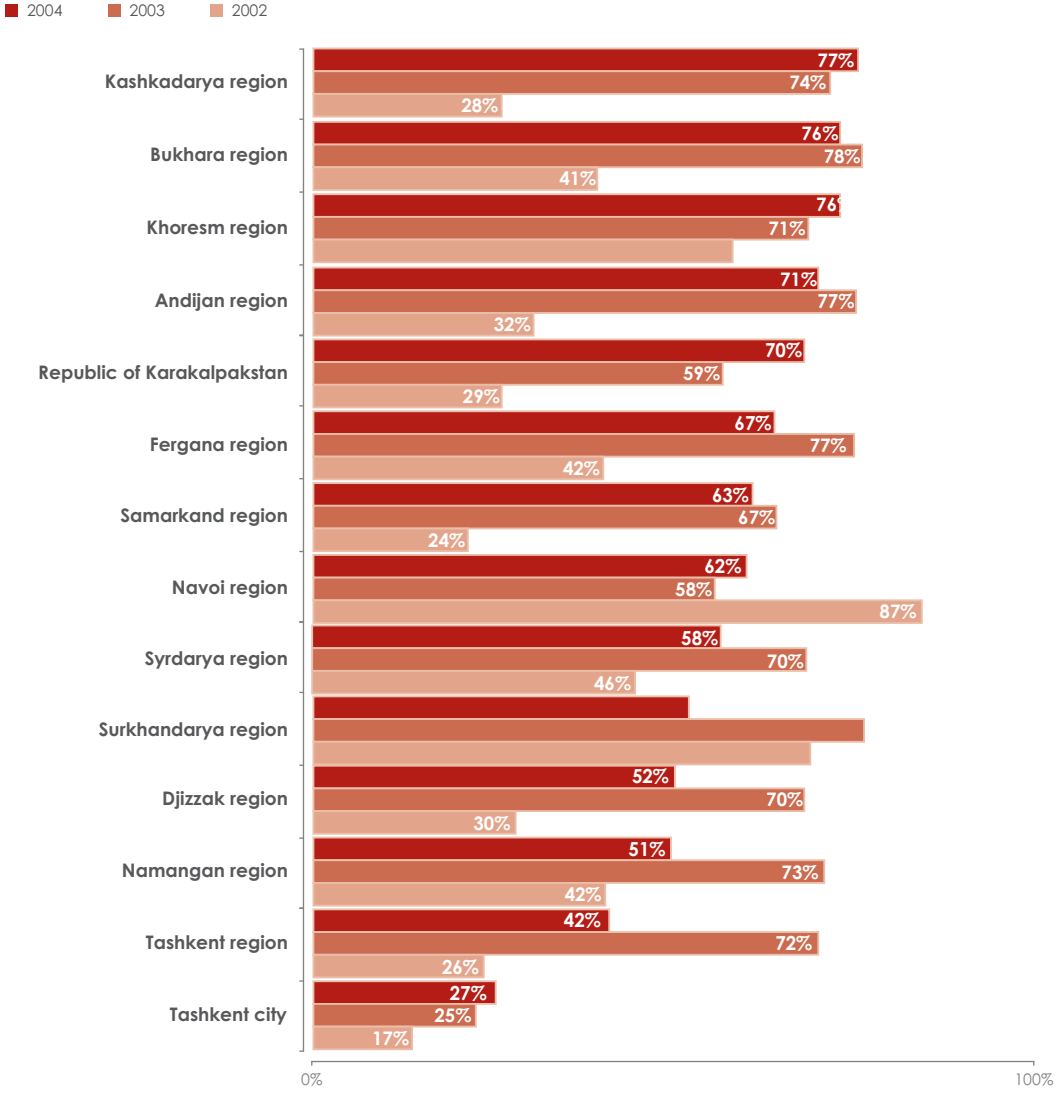
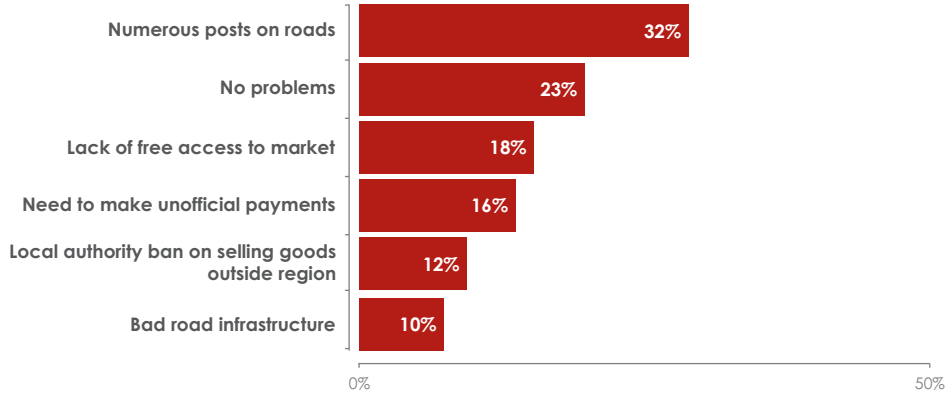


Chart 9.6

PROBLEMS FOR TRADE IN THE REGIONS IN 2004

% of respondents



REGISTRATION

Chart 10.1
RESPONDENTS REGISTERED
% of respondents

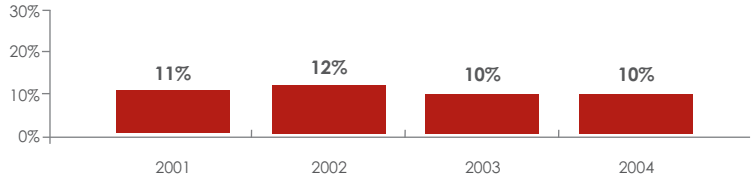


Chart 10.2
REGISTRATION COSTS (INCLUDING UNOFFICIAL PAYMENTS)
in soums

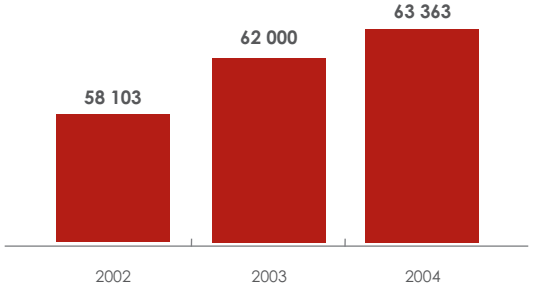


Chart 10.3
RESPONDENTS' OPINIONS ON REGISTRATION COSTS
% of respondents who registered in the given year

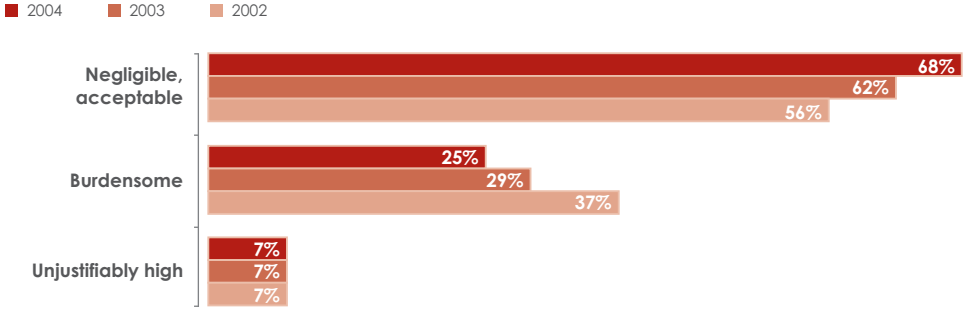


Chart 10.4
UNOFFICIAL PAYMENTS DURING REGISTRATION
% of respondents who registered in the given year

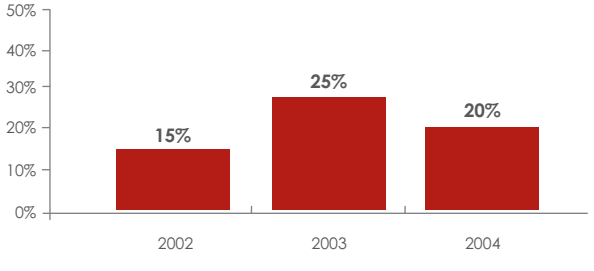
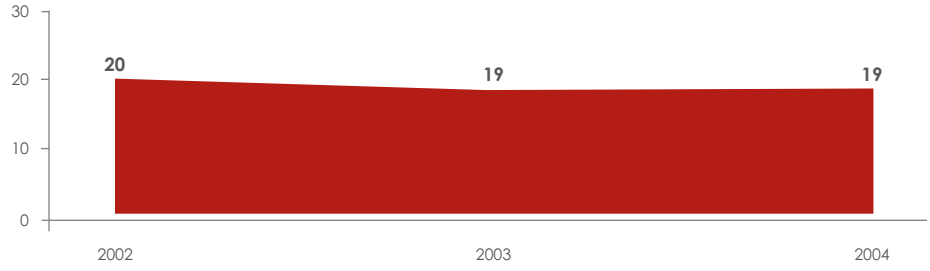


Chart 10.5
AVERAGE DURATION OF REGISTRATION PROCESS
In business days



PERMITS

Chart 11.1
RESPONDENTS OBTAINING AT LEAST ONE PERMIT
% of respondents

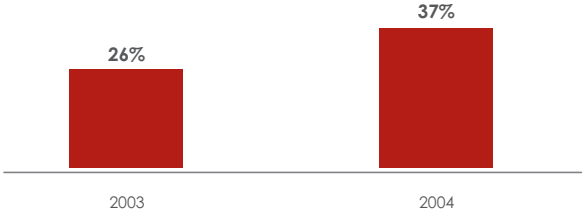


Chart 11.2
RESPONDENTS OBTAINING AT LEAST ONE PERMIT IN 2004 (BY SECTOR)
% of respondents

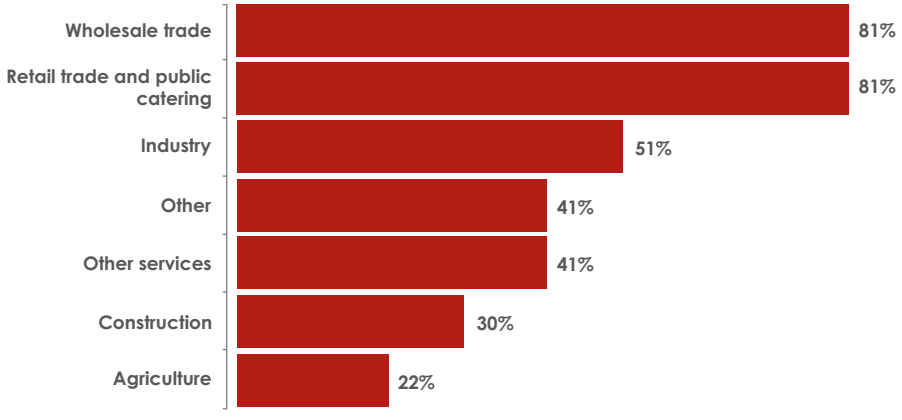


Chart 11.3
MOST FREQUENTLY ISSUED PERMITS IN 2004
% of respondents who obtained permits

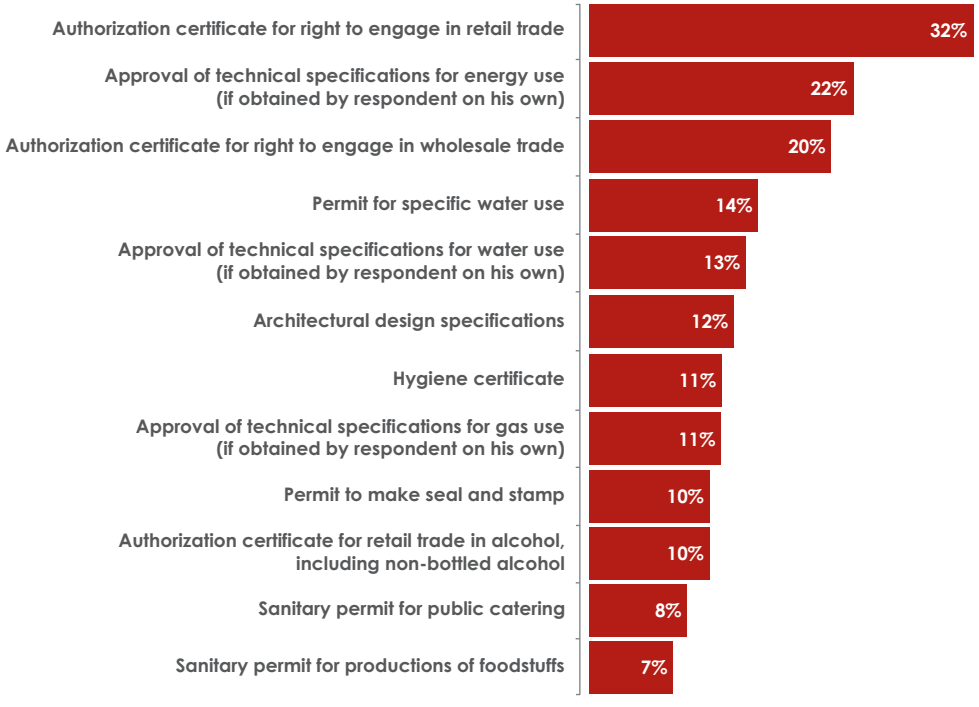


Chart 11.4
MOST FREQUENTLY ISSUED PERMITS AT THE BEGINNING OF OPERATIONS IN 2004
% of respondents who registered in 2004

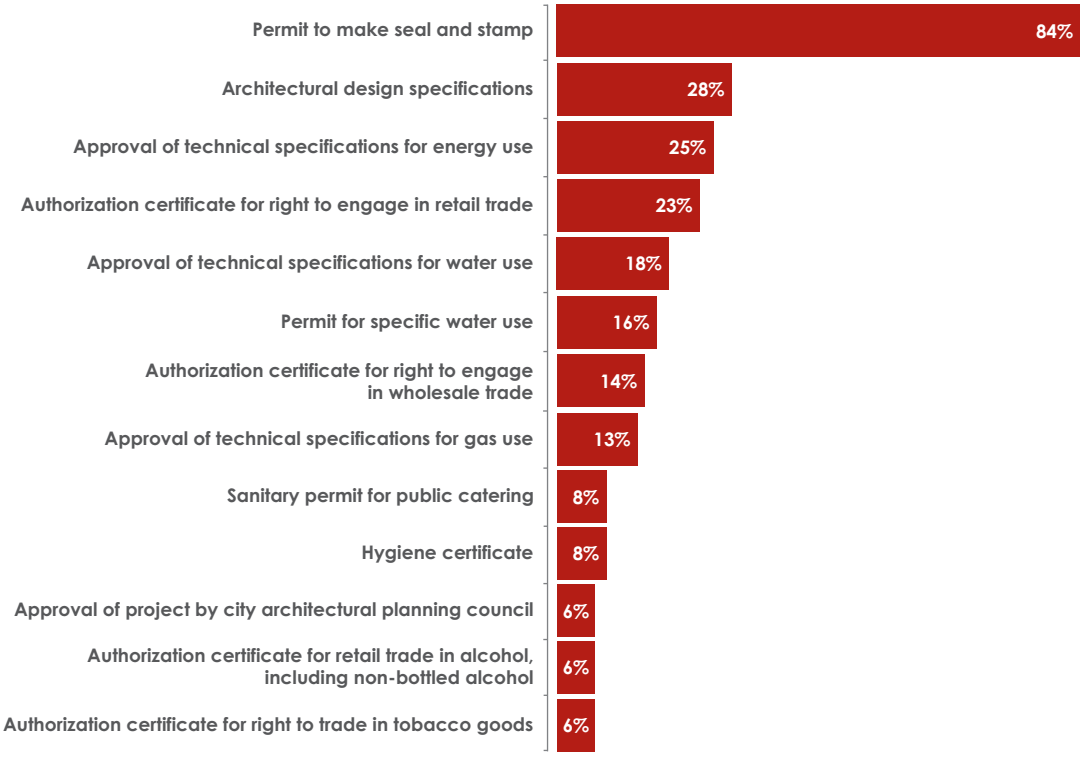


Chart 11.5

RESPONDENTS' ASSESSMENT OF MONEY SPENT TO OBTAIN PERMITS

% of respondents who obtained permits

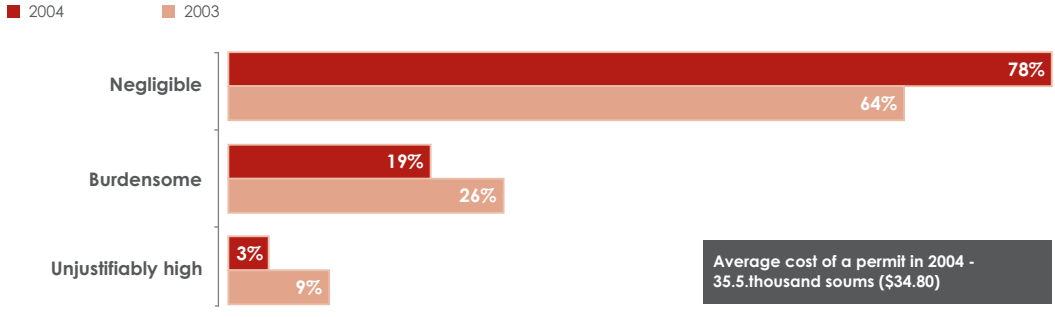
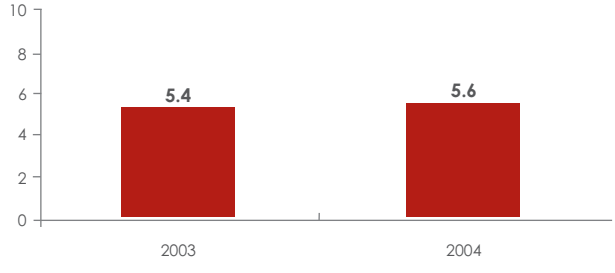


Chart 11.6

AVERAGE TIME SPENT OBTAINING ONE PERMIT

In business days



TAXES AND TAX ADMINISTRATION

Chart 12.1

TAX SYSTEM USED BY RESPONDENTS

% of respondents

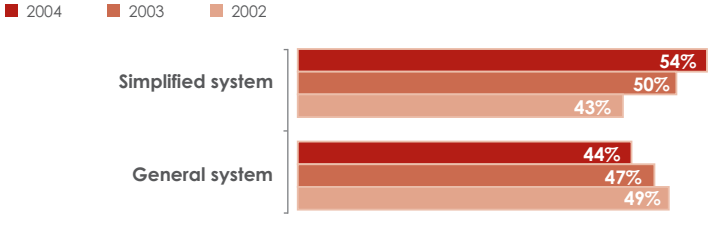


Chart 12.2

AVERAGE TAX BURDEN OF ENTERPRISES PAYING TAXES UNDER SIMPLIFIED AND GENERAL TAX SYSTEM

tax burden as a % of revenue

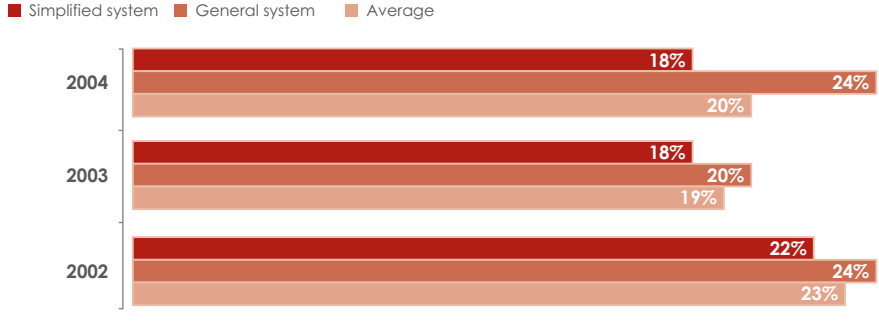


Chart 12.3

AVERAGE TAX BURDEN (BY SECTOR)

tax burden as a % of revenue

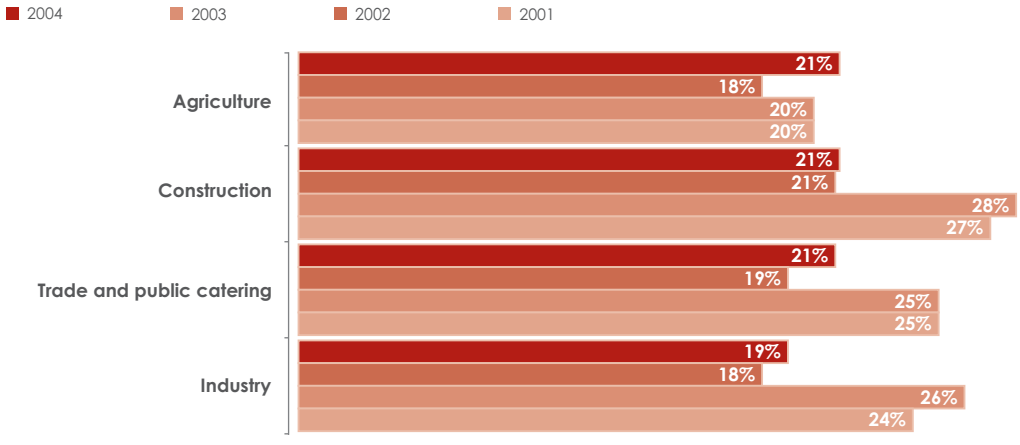


Chart 12.4

RESPONDENTS PAYING TAXES UNDER SIMPLIFIED TAX SYSTEM (BY SECTOR)

% of respondents in sector

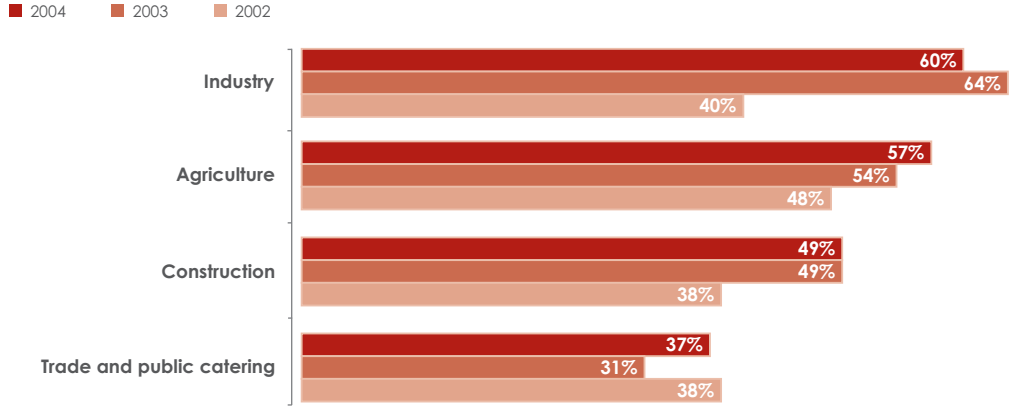


Chart 12.5

AVERAGE TAX BURDEN OF ENTERPRISES PAYING TAXES UNDER SIMPLIFIED AND GENERAL TAX SYSTEMS IN 2004 (BY REGION)

tax burden as a % of revenue

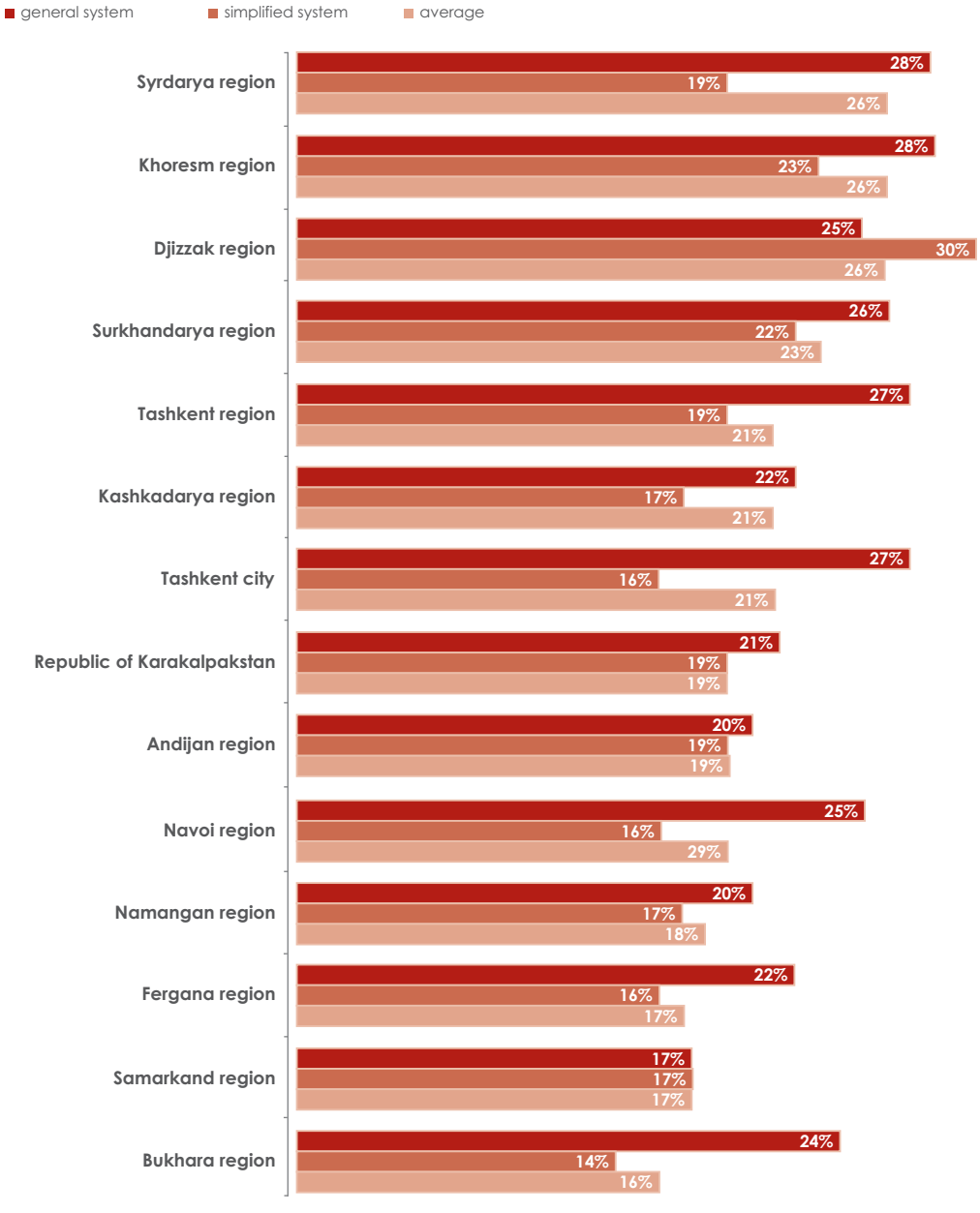


Chart 12.6
RESPONDENTS' ESTIMATE OF REVENUE CONCEALED FROM TAXATION BY SMEs

% of respondents who admitted concealment of revenue

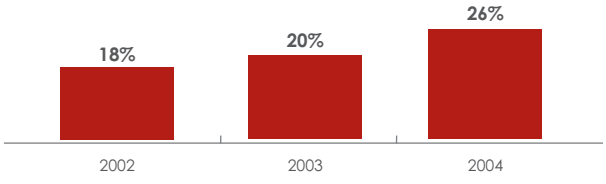


Chart 12.7
RESPONDENTS' ESTIMATE OF REVENUE CONCEALED

% of revenue

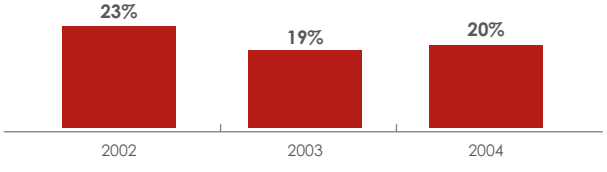


Chart 12.8
REASONS FOR CONCEALING INCOME IN 2004

% of enterprises who admitted concealing revenue

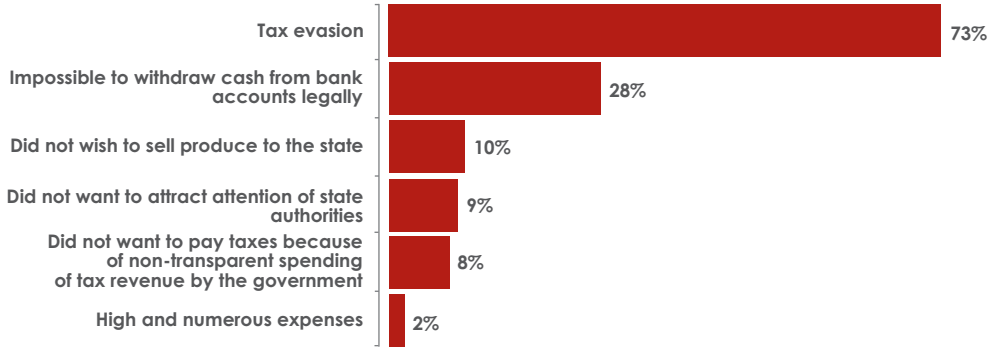


Chart 12.9
DIFFICULTIES WITH TAX LEGISLATION IN 2004

% of respondents reporting the given factors as having a negative and highly negative impact on business development

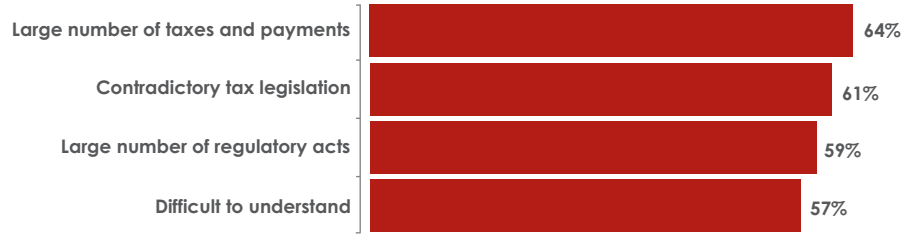


Chart 12.10

PERCENTAGE OF REVENUE ENTREPRENEURS ARE WILLING TO PAY IN TAX (BY REGION) 2004

tax burden as a % of revenue

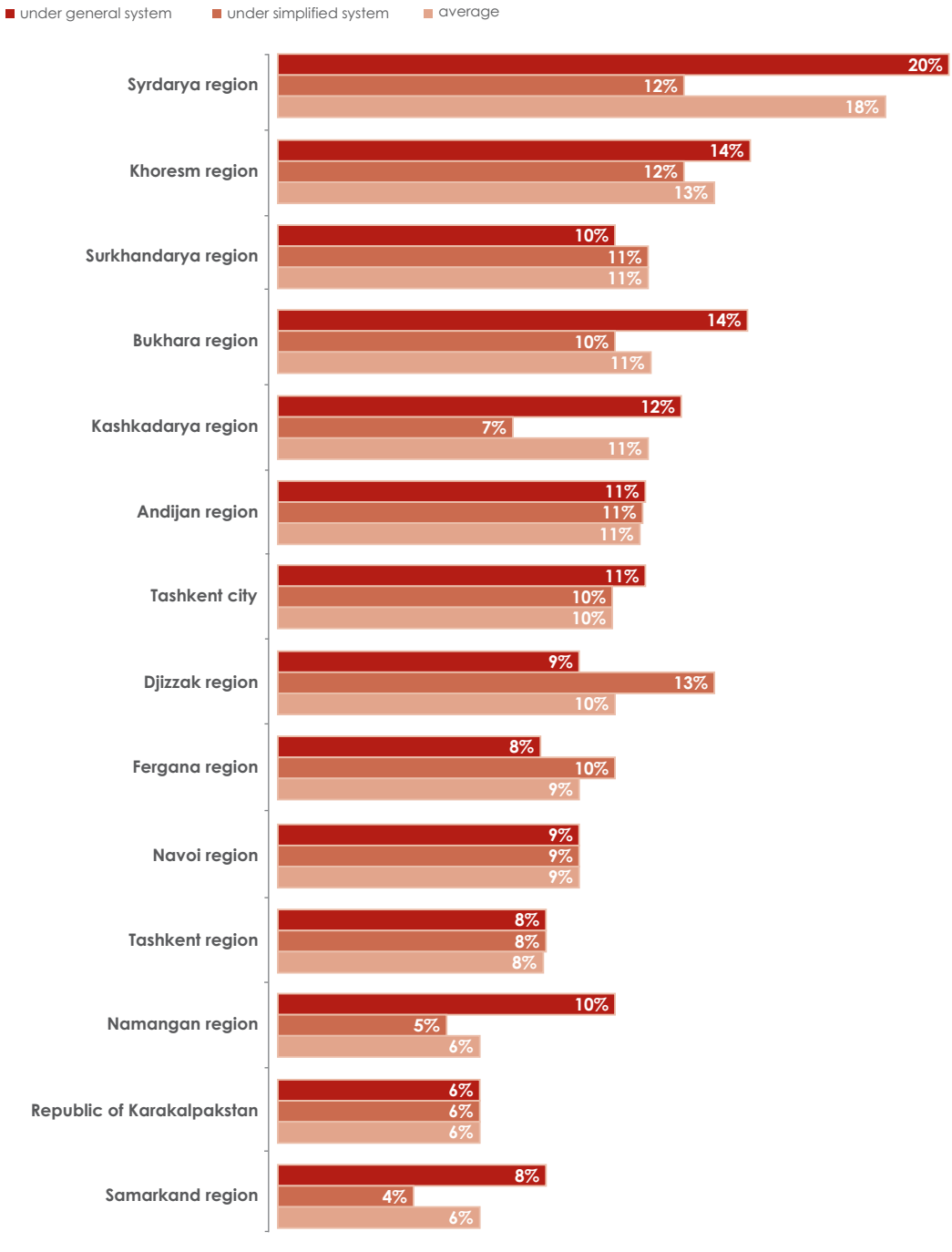
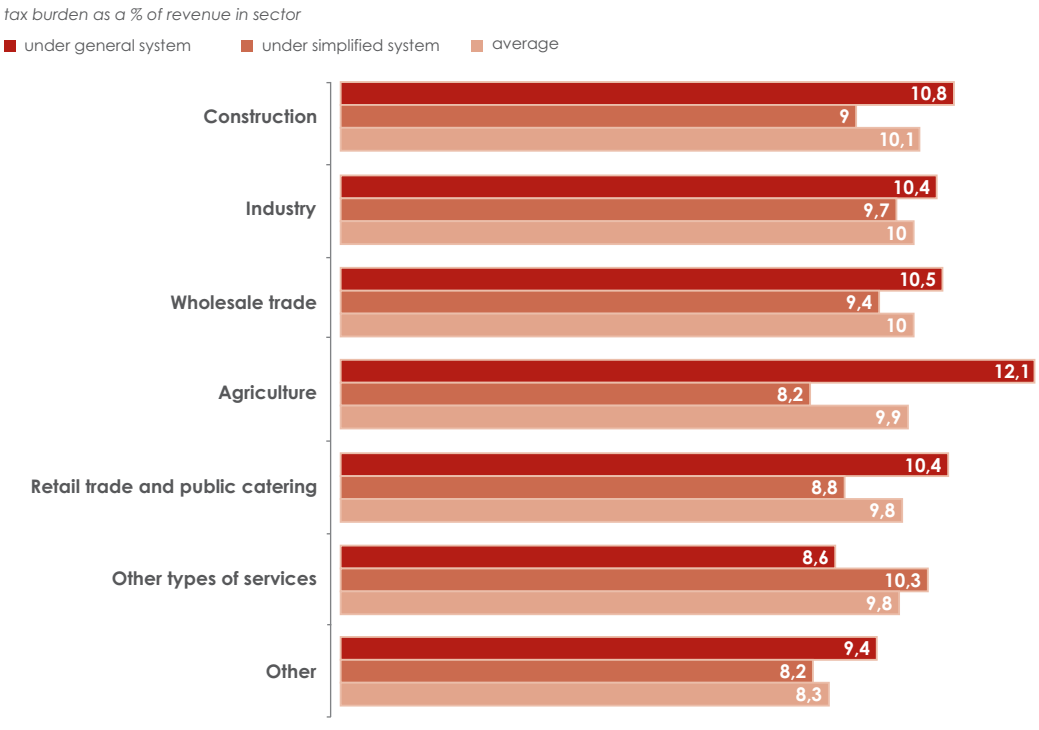


Chart 12.11

PERCENTAGE OF REVENUE ENTREPRENEURS ARE WILLING TO PAY IN TAX (BY SECTOR). 2004.



INSPECTIONS

Chart 13.1

ENTERPRISES UNDERGOING AT LEAST ONE INSPECTION IN THE GIVEN YEAR (BY SECTOR)

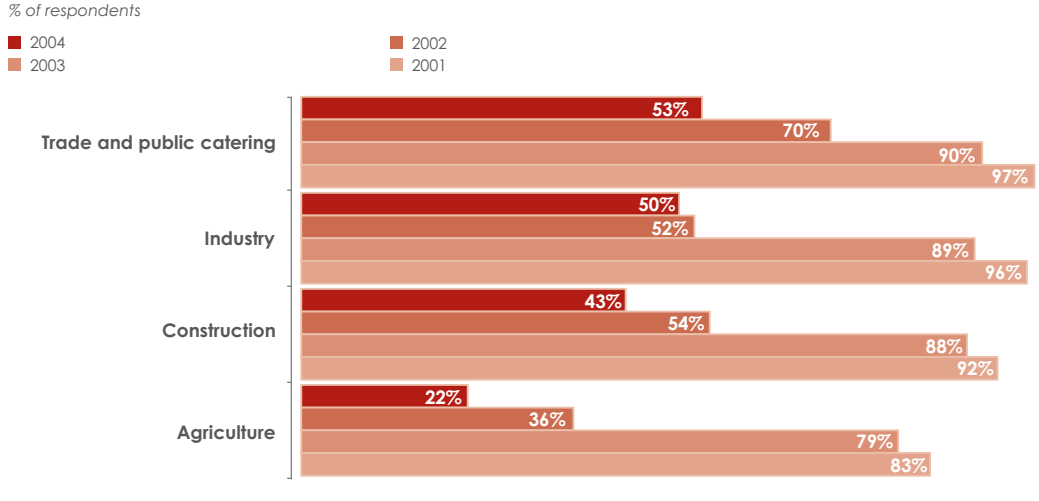


Chart 13.2
ENTERPRISES UNDERGOING AT LEAST ONE INSPECTION IN 2004 (BY REGION)

% of respondents

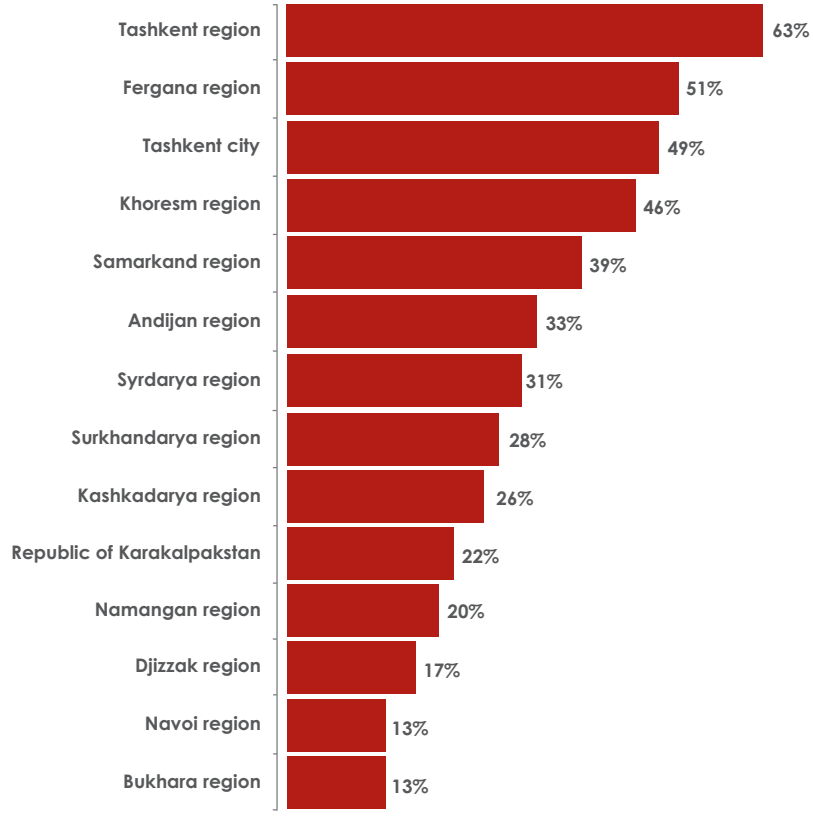


Chart 13.3
BODIES CONDUCTING INSPECTIONS MOST FREQUENTLY

% of respondents inspected

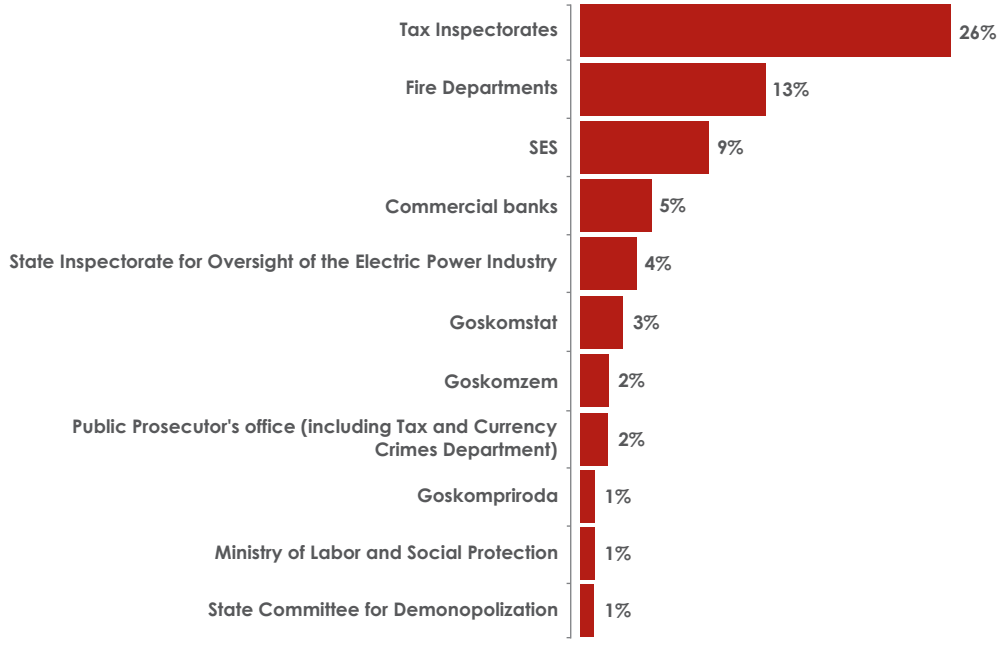


Chart 13.4
NUMBER OF INSPECTIONS PER INSPECTED RESPONDENT (BY SECTOR)
number of inspections in sector

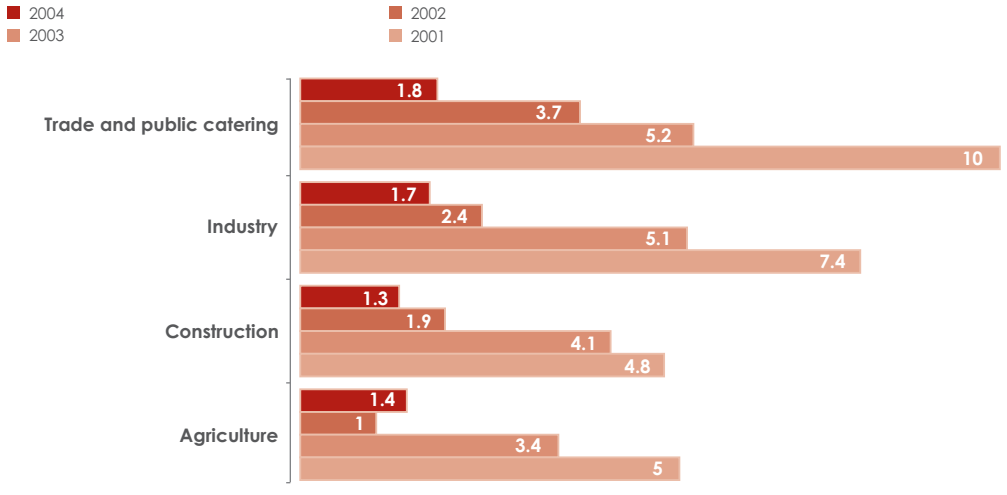


Chart 13.5
TOTAL NUMBER OF DAYS SPENT BY RESPONDENTS ON INSPECTIONS IN THE GIVEN YEAR
business days

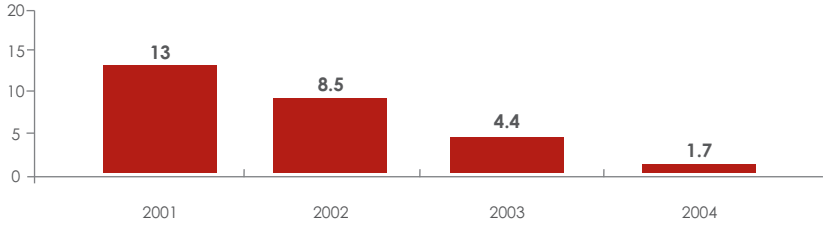


Chart 13.6
CONSEQUENCES OF INSPECTIONS IN 2004
% of respondents inspected reporting consequences

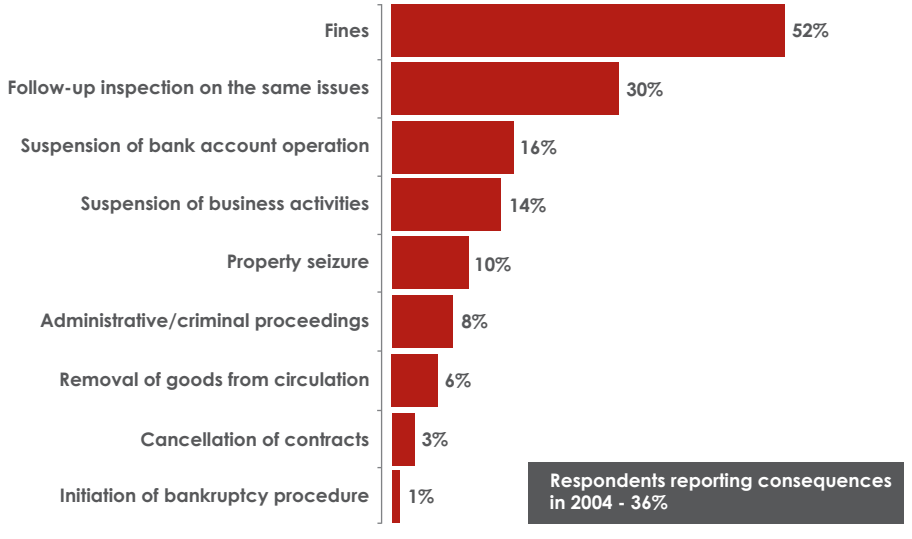


Chart 13.7
RESPONDENTS' OPINION ON THE COST OF INSPECTIONS (INCLUDING OFFICIAL AND UNOFFICIAL PAYMENTS)

% of respondents inspected

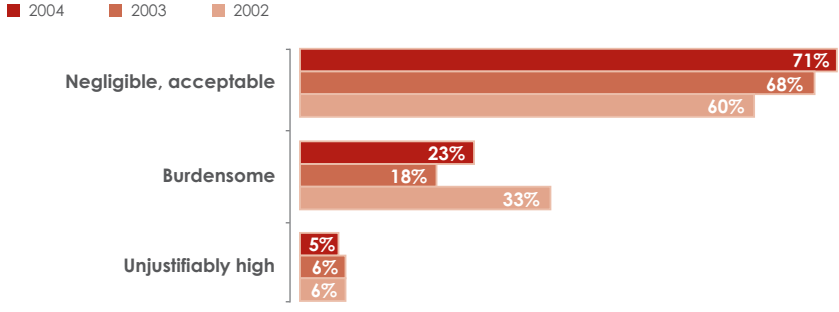


Chart 13.8
COMPLEXITY OF COMPLIANCE WITH STANDARDS AND RULES CHECKED BY INSPECTORATES

% of respondents inspected describing compliance as "problematic" and "very problematic"

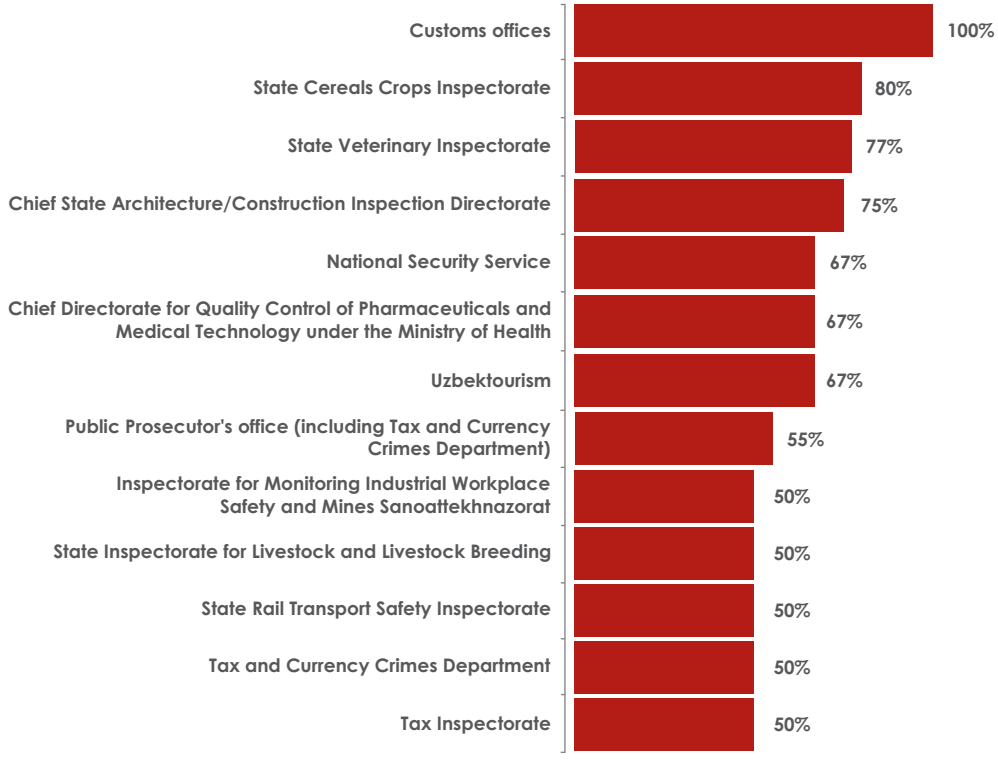


Chart 13.9
RESPONDENTS HAVING INSPECTIONS REGISTRATION BOOK

% of respondents

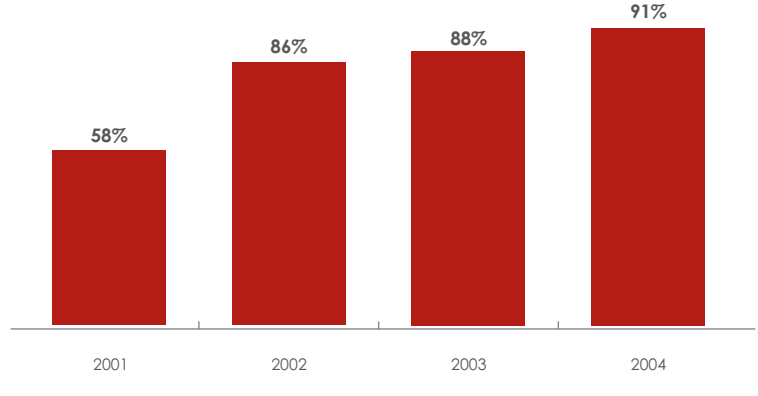


Chart 13.10
SMEs' KNOWLEDGE OF LEGISLATION GOVERNING INSPECTIONS
% of respondents

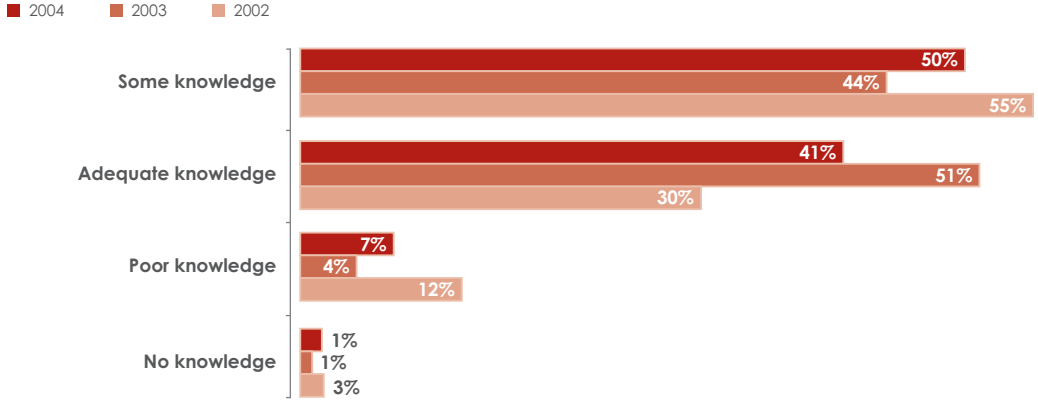
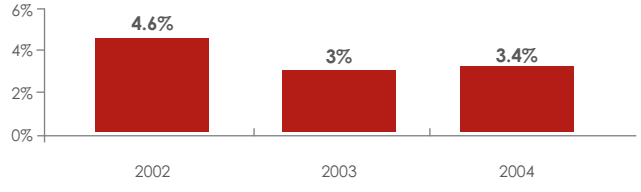


Chart 13.11
RESPONDENTS WHO APPEALED INSPECTORS' ACTIONS
% of respondents inspected



SMEs AND BANKS

Chart 14.1
DIFFICULTIES WITH BANKING IN 2004
% of respondents who had problems

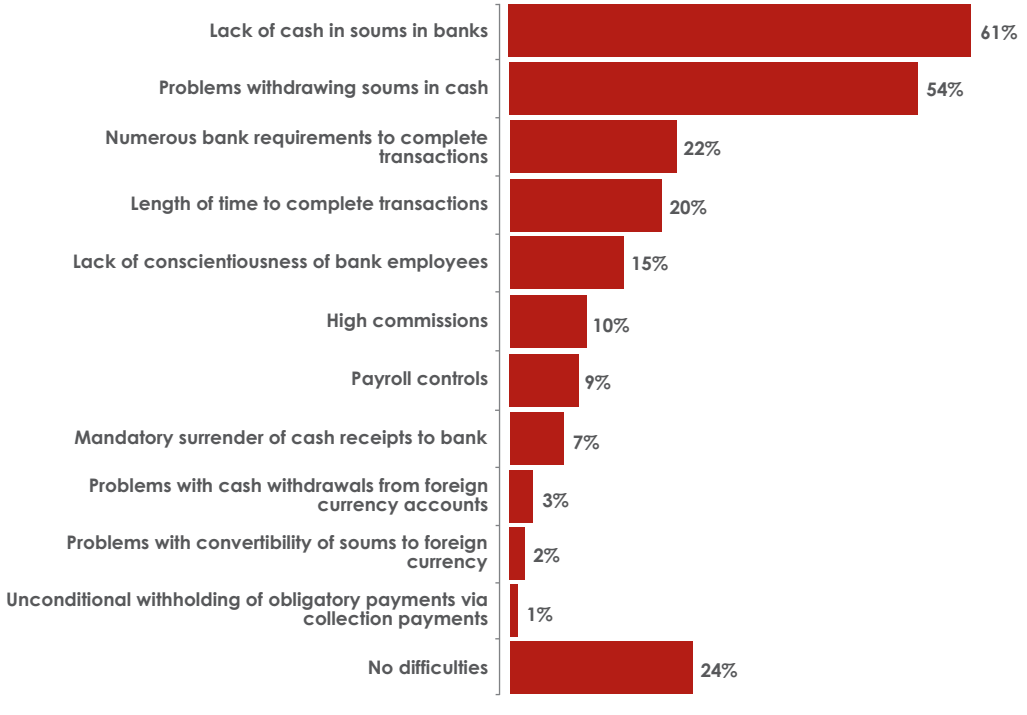


Chart 14.2
AVERAGE DURATION OF ONE BANK ACCOUNT TRANSACTION IN 2004
number of business days

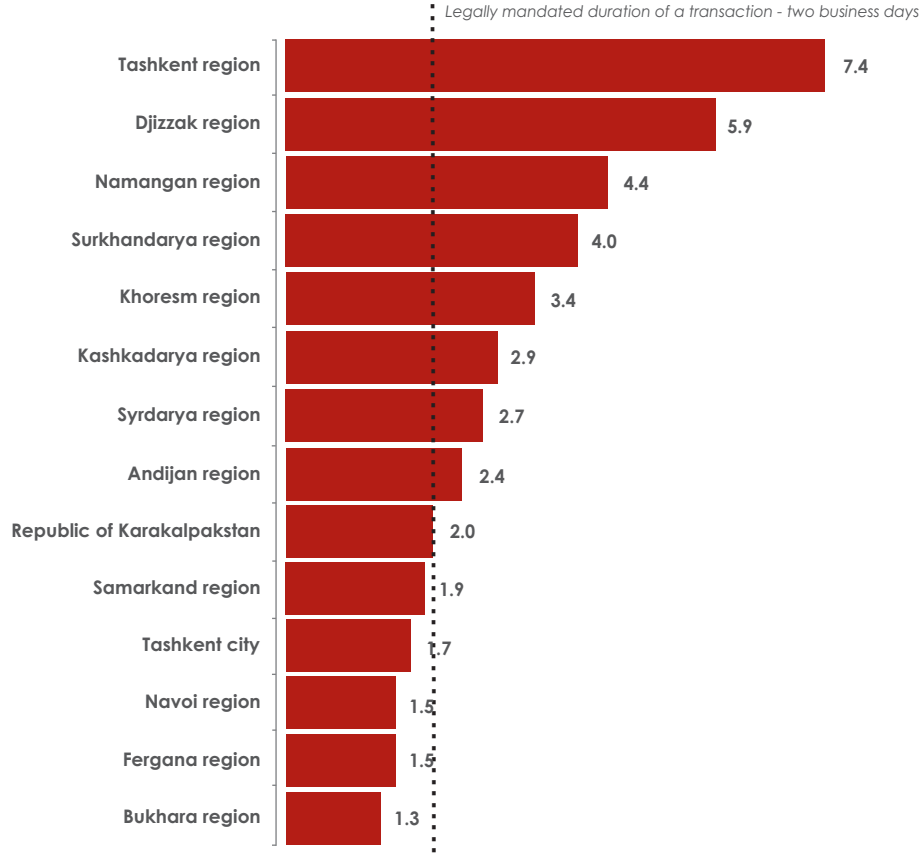


Chart 14.3
COMMERCIAL BANK REQUIREMENT FOR CASH PLAN IMPLEMENTATION
% of respondents

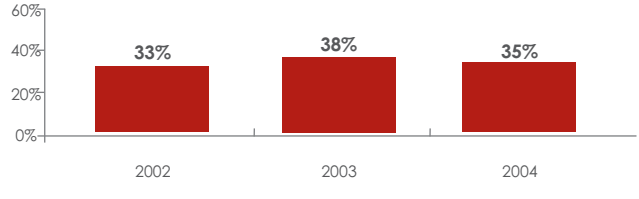


Chart 14.4
COMMERCIAL BANK REQUIREMENTS FOR CASH PLAN IMPLEMENTATION IN 2004 (BY SECTOR)
% of respondents in sector

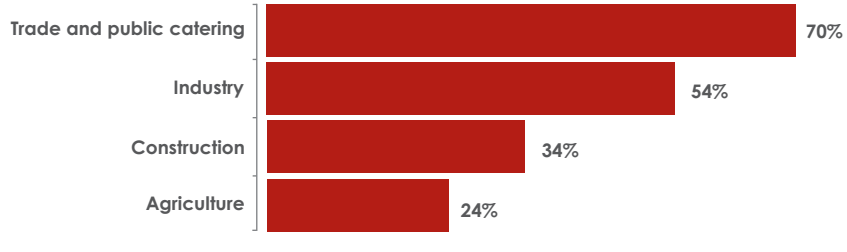


Chart 14.5
COMMERCIAL BANK INSPECTION OF CASH DISCIPLINE

% of respondents

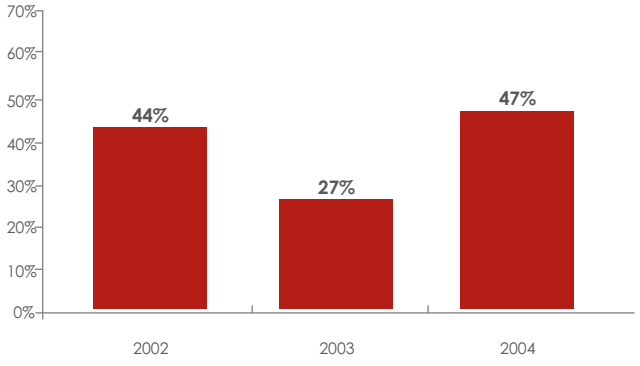


Chart 14.6
DISCLOSURE OF ACCOUNT INFORMATION BY BANKS TO OUTSIDE ORGANIZATIONS

% of respondents reporting that bank provides information to the given body

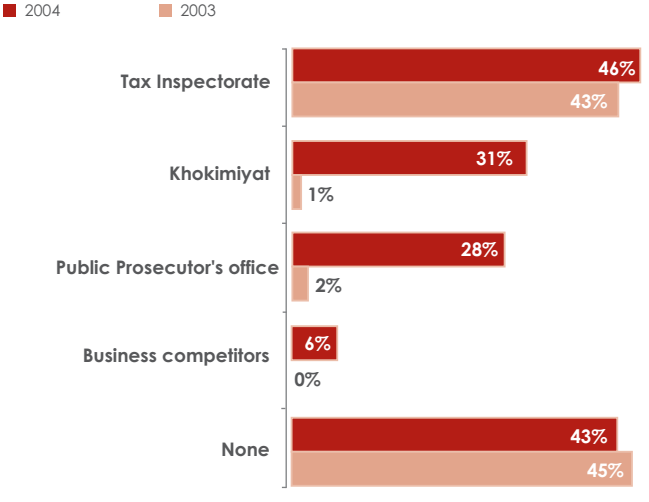


Chart 14.7
RESPONDENTS INVESTING IN FIXED ASSETS (BY SECTOR)

% of respondents

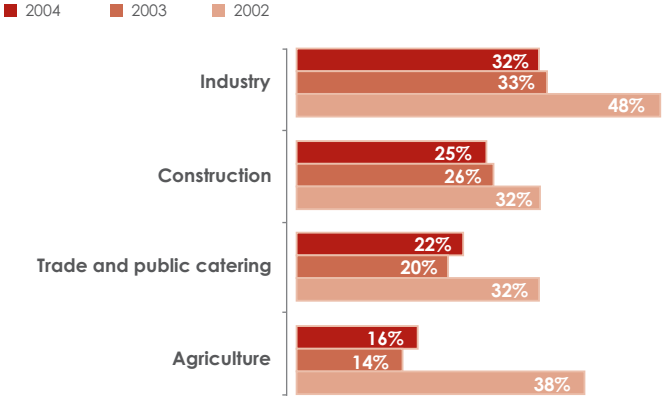


Chart 14.8

RESPONDENTS INVESTING IN FIXED ASSETS (BY REGION)

% of respondents in region

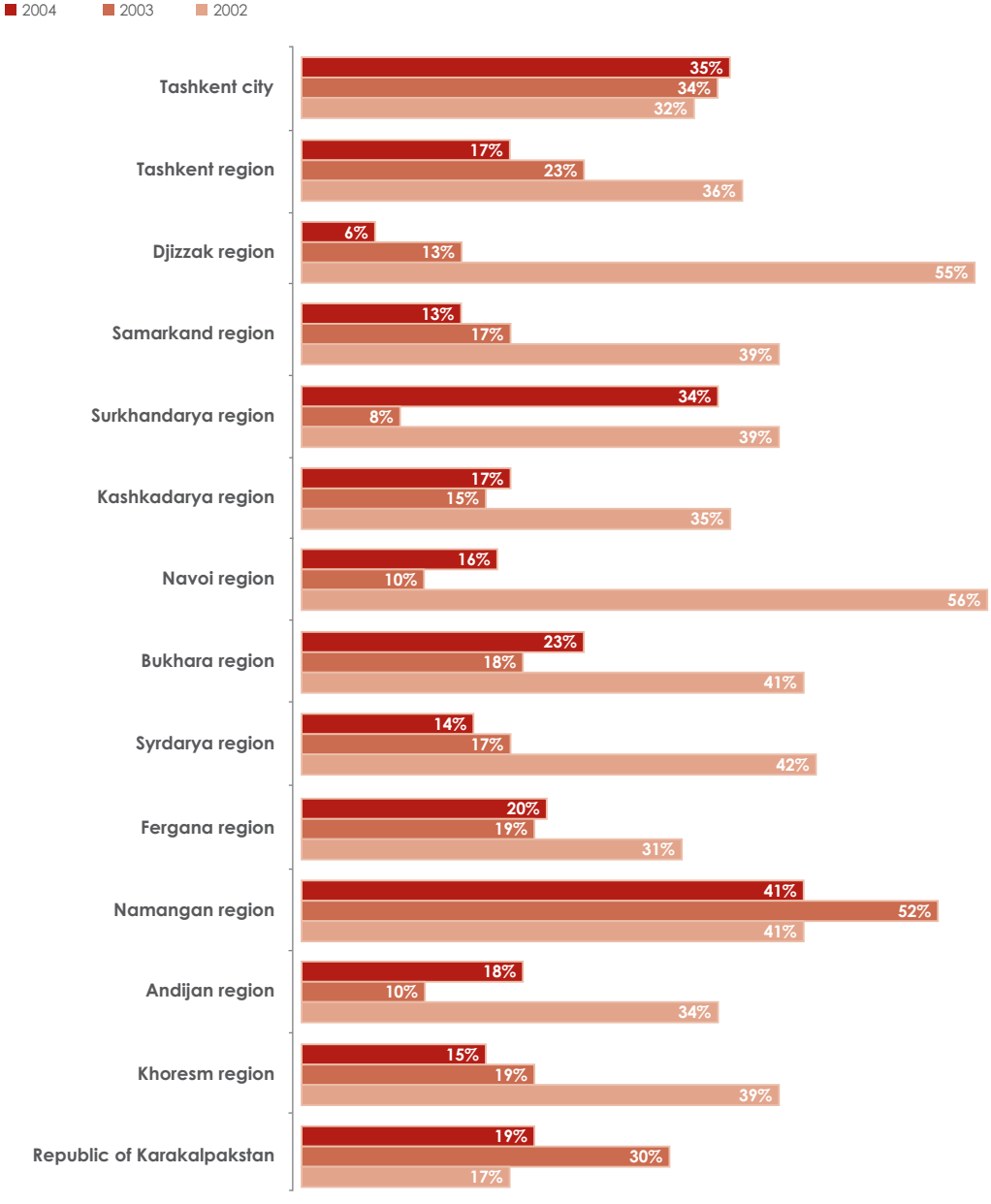


Chart 14.9

EXTERNAL FINANCING NEEDS OF SMES (BY SECTOR)

% of respondents in sector

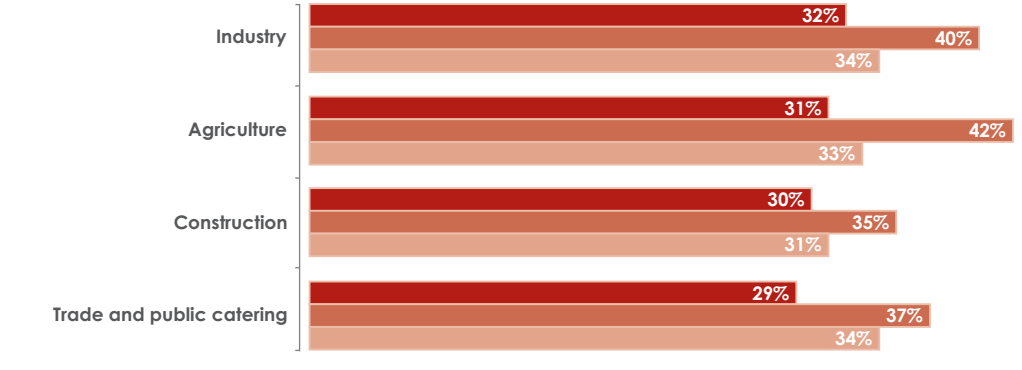
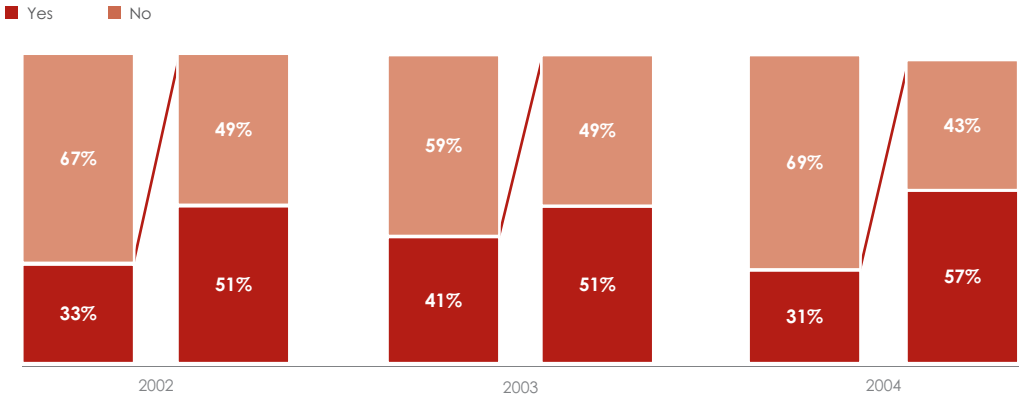


Chart 14.10
SMEs' NEED FOR EXTERNAL FINANCING AND APPLICATION FOR BANK LOANS



Left column - external financing needs of SMEs, % of respondents

Right column - respondents applying for loans, % of respondents needing external financing

Chart 14.11
SMEs APPLYING FOR BANK LOANS (BY SECTOR)

% of respondents in sector needing external financing

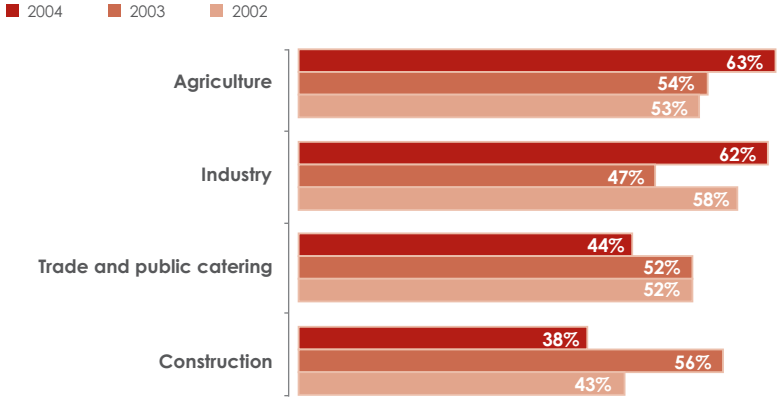


Chart 14.12
RESPONDENTS RECEIVING LOANS (BY SECTOR)

% of respondents in sector who applied to a bank

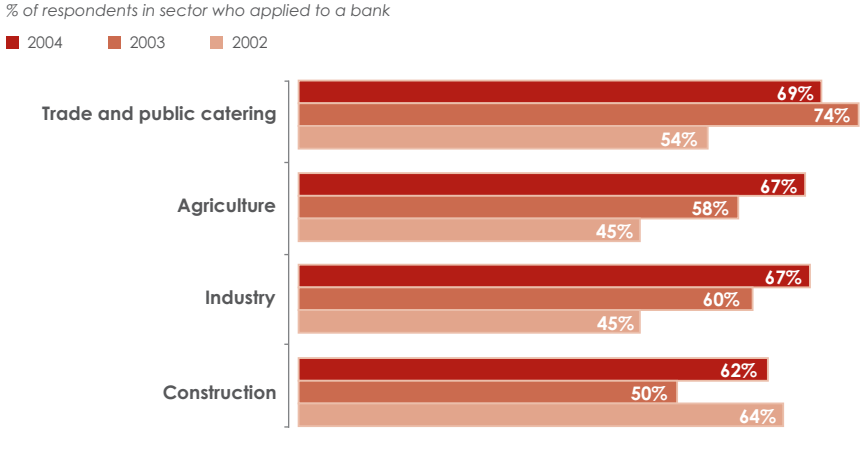


Chart 14.13
UNOFFICIAL PAYMENTS TO OBTAIN LOANS
% of respondents who obtained loans

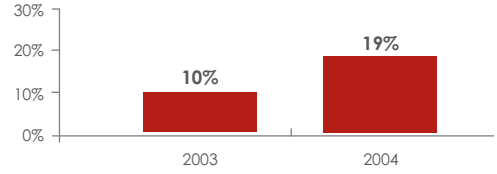
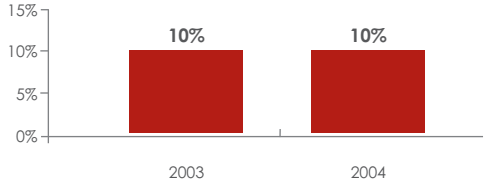


Chart 14.14
AVERAGE UNOFFICIAL PAYMENT MADE TO OBTAIN LOANS
% of the amount of the loan



EXPORT OPERATIONS

Chart 15.1
EXPORTERS, BY SECTOR IN 2004
% of exporters

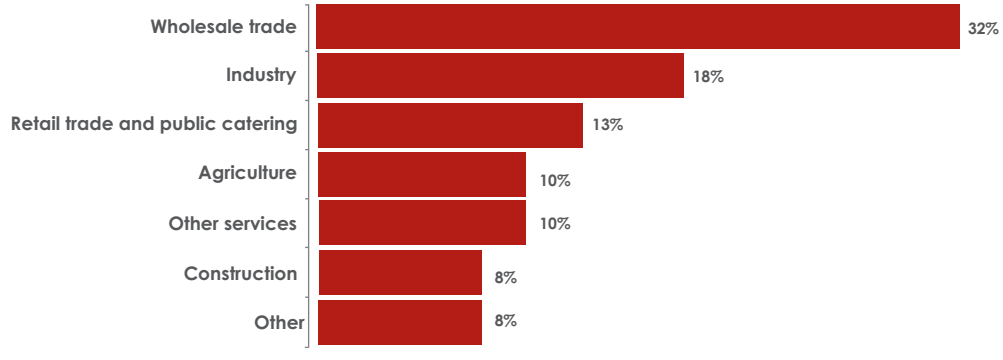


Chart 15.2
EXPORTS, BY CATEGORY OF GOODS. 2004
% of exporters

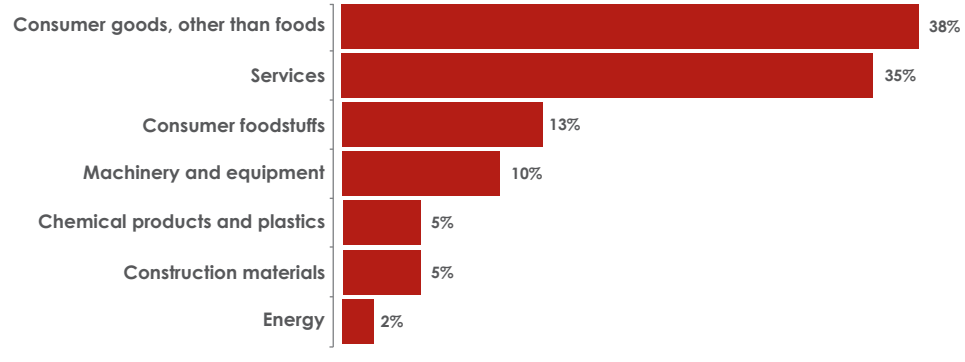


Chart 15.3
EXPORT DESTINATIONS. 2004
% of exported goods

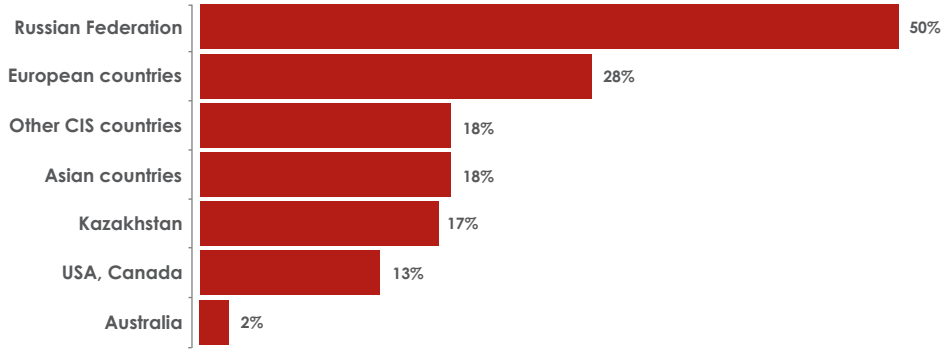


Chart 15.4
AVERAGE NUMBER OF EXPORT CONTRACTS PER EXPORTER, BY YEAR
number of contracts

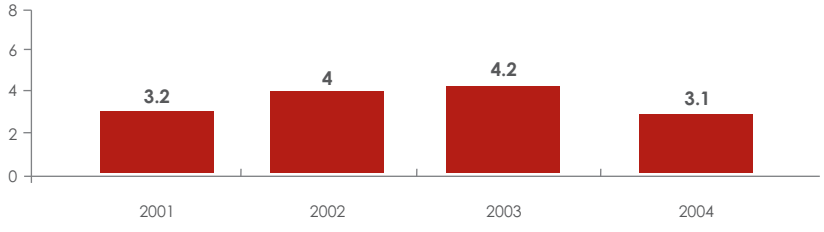


Chart 15.5
DEGREE OF DIFFICULTY OF EXPORT OPERATIONS, BY YEAR
% of exporters describing the given year as "problematic" and "very problematic" for export operations

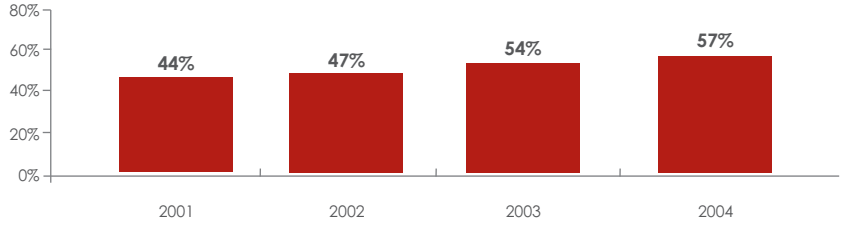


Chart 15.6
TRANSPORT USED FOR EXPORTS. 2004.
% of respondents

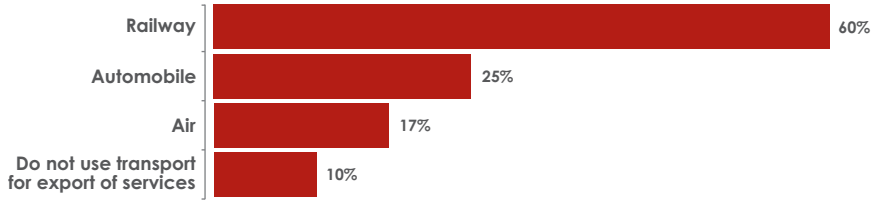


Chart 15.7
REQUIREMENTS MET BY EXPORTERS WHEN REGISTERING EXPORT CONTRACTS. 2004

% of exporters

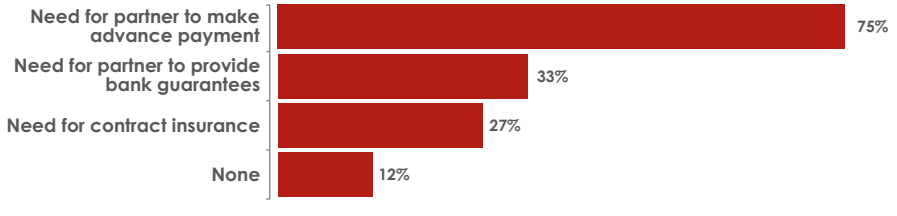


Chart 15.8

AVERAGE DURATION OF EXPORT PROCEDURES IN 2004

number of business days

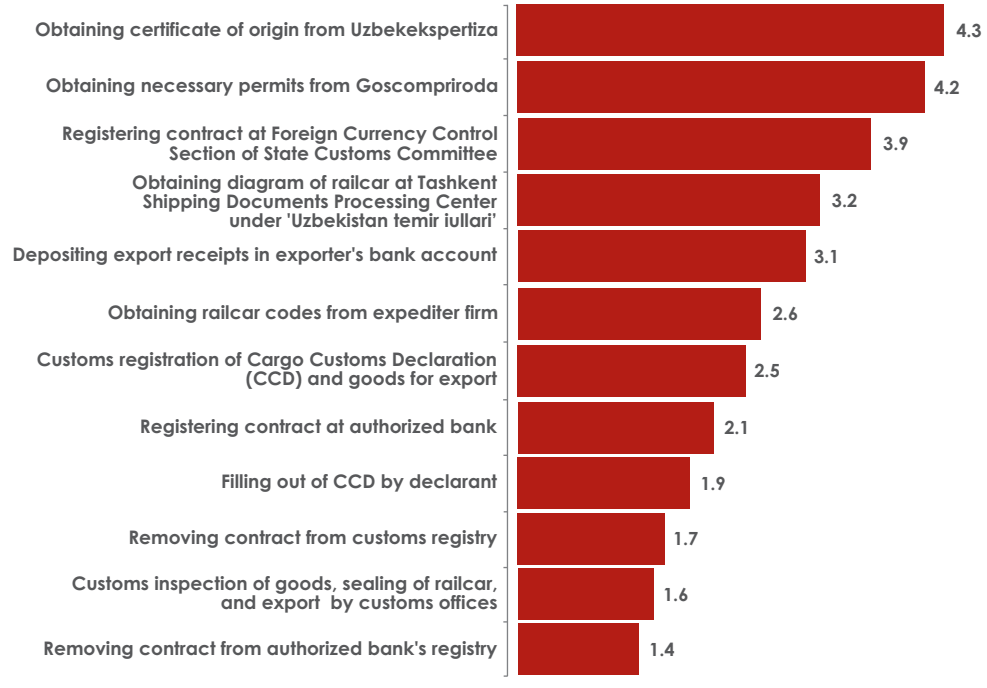


Chart 15.9

COST OF EXPORT PROCEDURES IN 2004

in soums

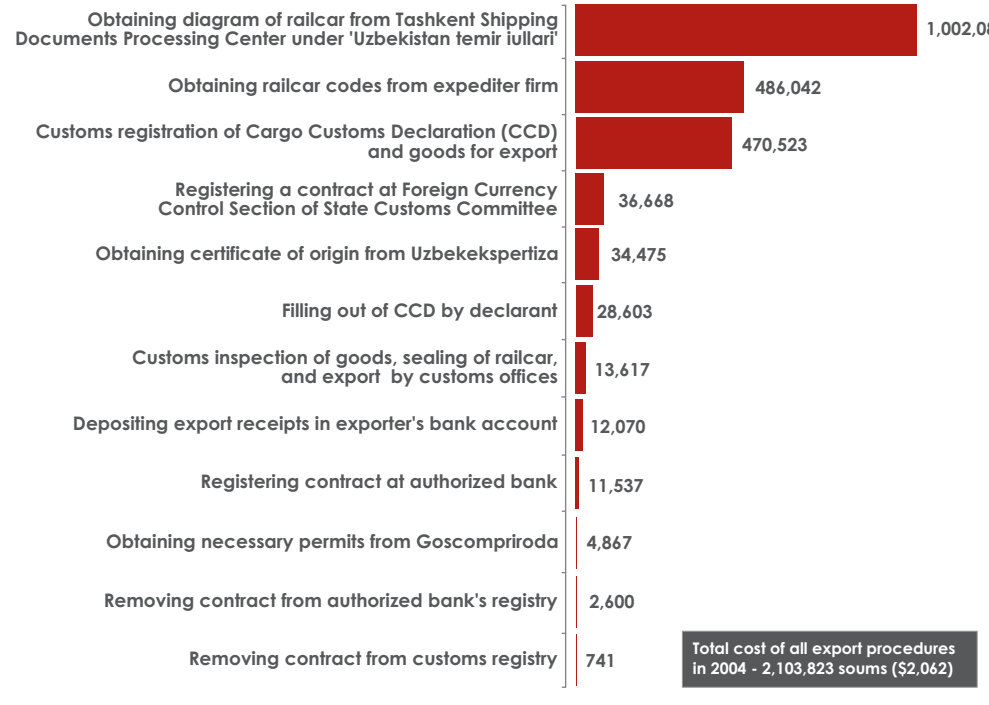


Chart 15.10
UNOFFICIAL PAYMENTS DURING EXPORT PROCEDURES IN 2004

% of exporters undergoing the given procedure

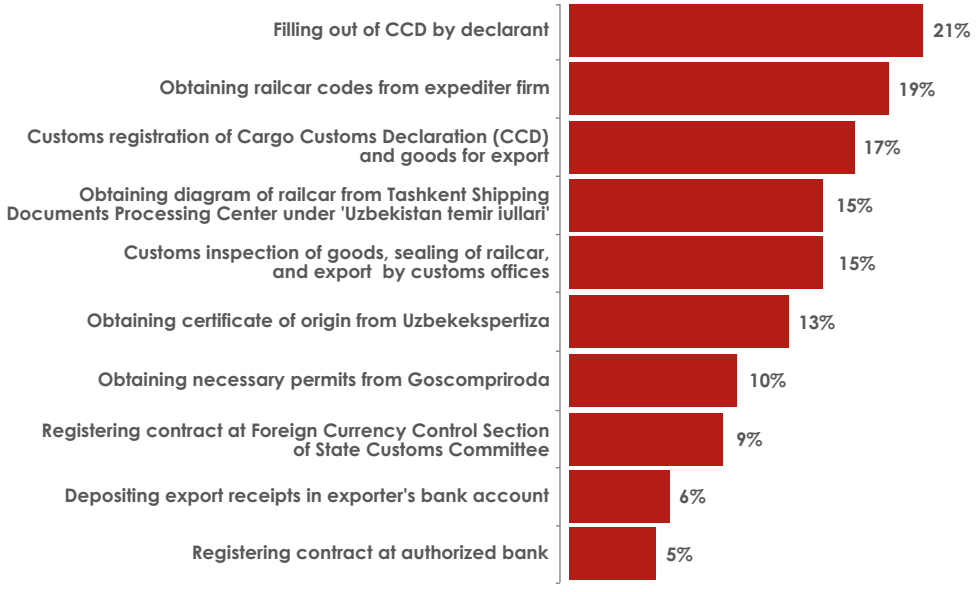


Chart 15.11
DEGREE OF DIFFICULTY OF EXPORT PROCEDURES IN 2004

% of exporters undergoing the given procedure who described it as "problematic" and "very problematic"

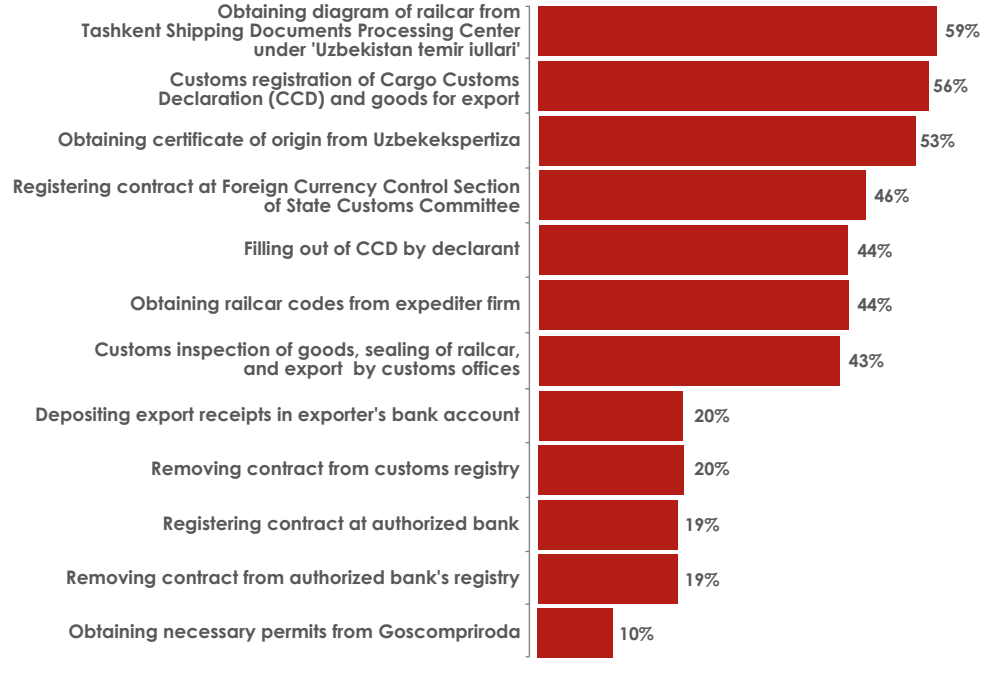


Chart 15.12
NATURE OF EXPORTED GOODS. 2004
% of exporters

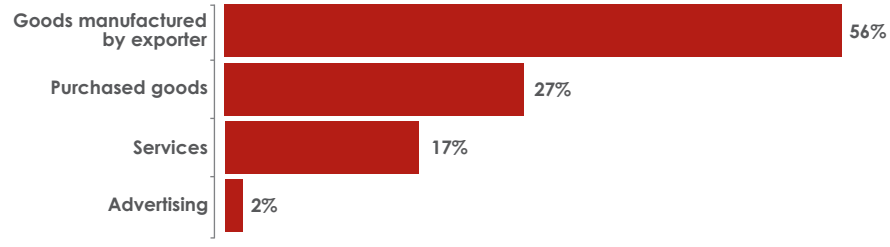


Chart 15.13
AVERAGE NUMBER OF EMPLOYEES ENGAGED IN EXPORT OPERATIONS AT AN ENTERPRISE (BY SECTOR) IN 2004
number of employees

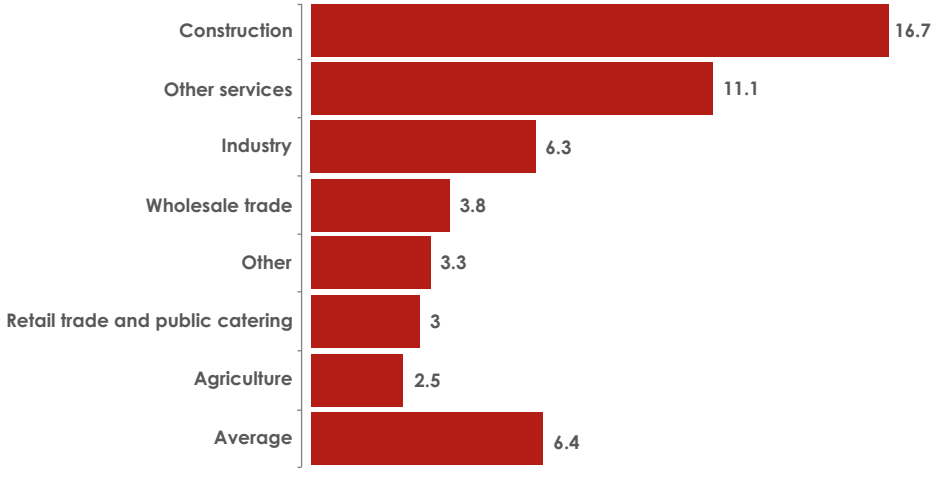


Chart 15.14
EXPORT RECEIPTS IN 2004, BY CURRENCY
% of exporters

Chart 15.15
SOURCES OF INFORMATION ON PARTNERS IN 2004
% of exporters

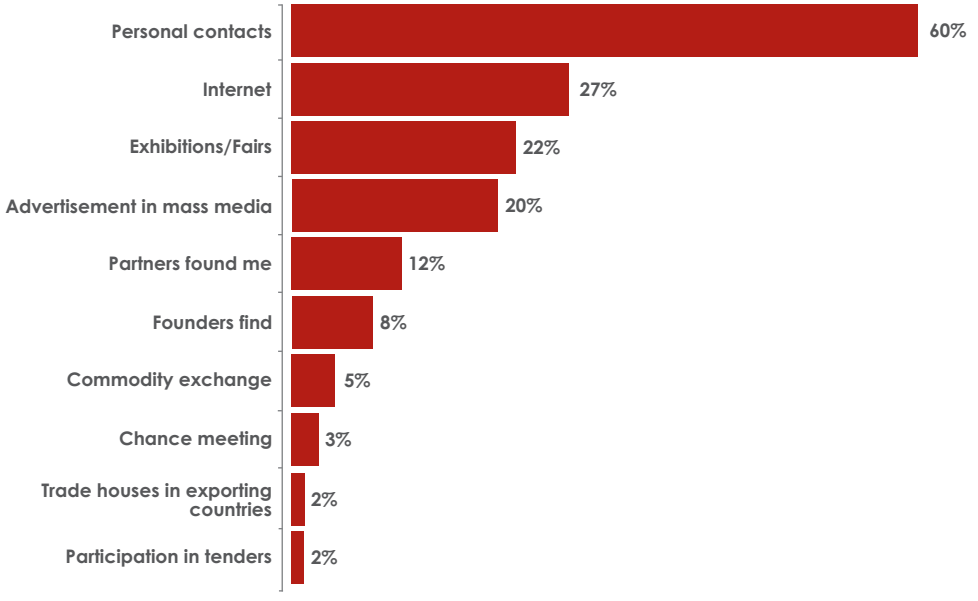


Chart 15.16
RESPONDENTS' ESTIMATE OF ENTERPRISES EXPORTING UNOFFICIALLY. 2004

Chart 15.17
UNOFFICIAL EXPORT OPERATIONS IN 2004

Chart 15.18
RESPONDENTS' OPINION ON SUPPORT FOR EXPORT OPERATIONS. 2004
% of exporters considering the given body supportive

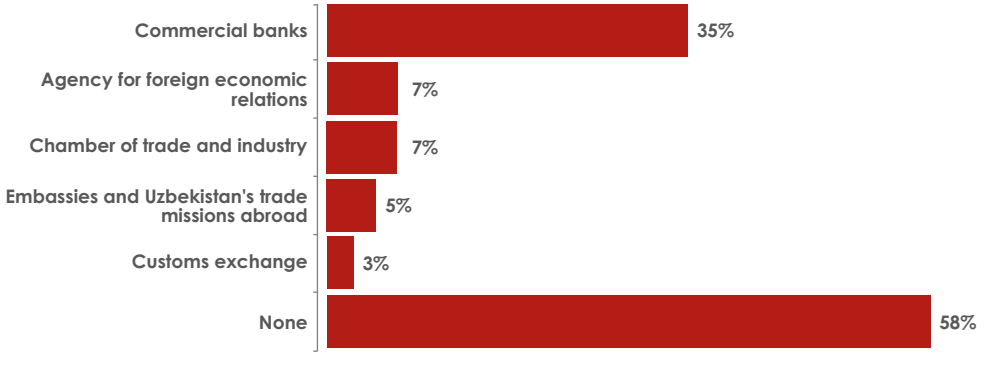


Chart 15.19
RESPONDENTS' OPINION ON IMPACT OF EXISTING EXPORT AND CUSTOMS PROCEDURES ON EXPORT POTENTIAL. 2004
% of exporters

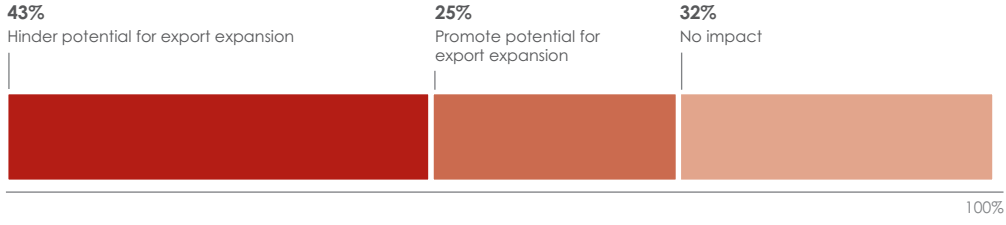
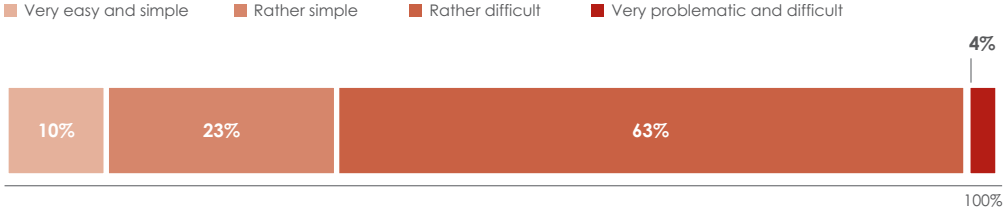


Chart 15.20
DIFFICULTY OF EXPORT OPERATIONS AT TIME OF SURVEY. 2004
% of exporters



IMPORT OPERATIONS

Chart 16.1
IMPORTERS IN 2004, BY SECTOR
% of importers

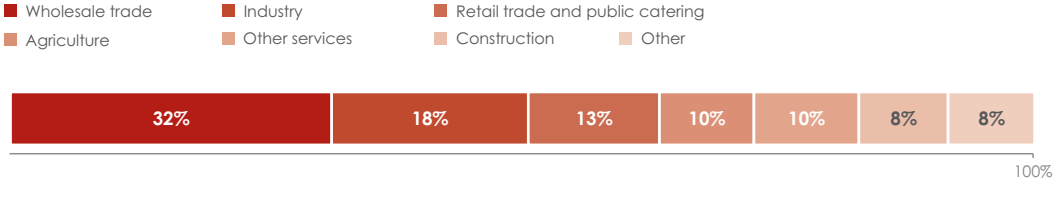


Chart 16.2
IMPORTS BY CATEGORY OF GOODS. 2004
% of importers

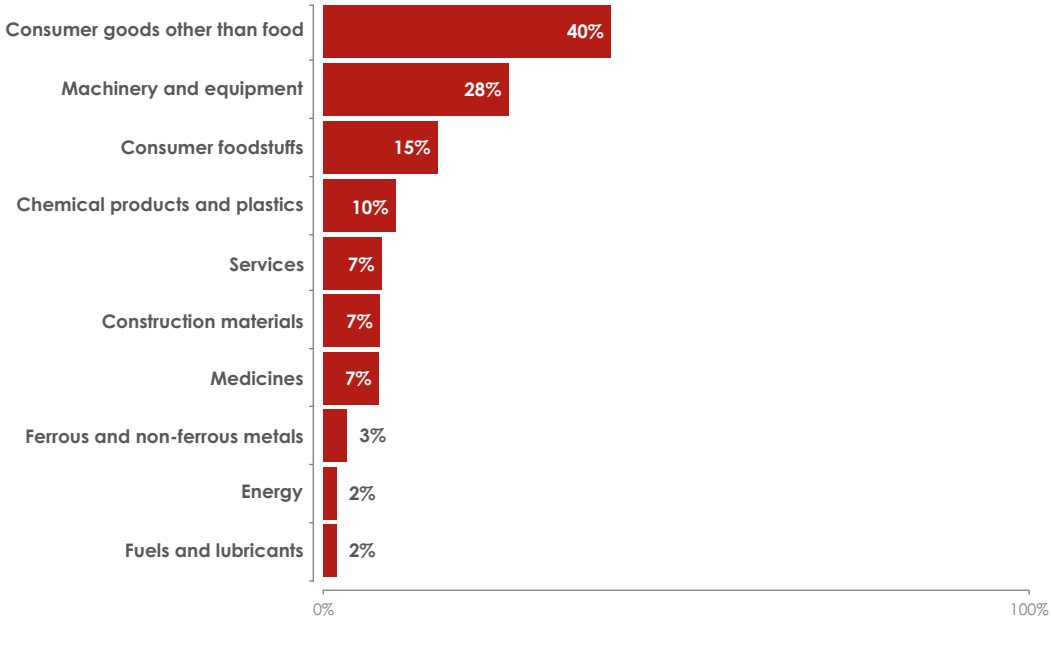


Chart 16.3
ORIGIN OF IMPORTS. 2004
% of imported goods

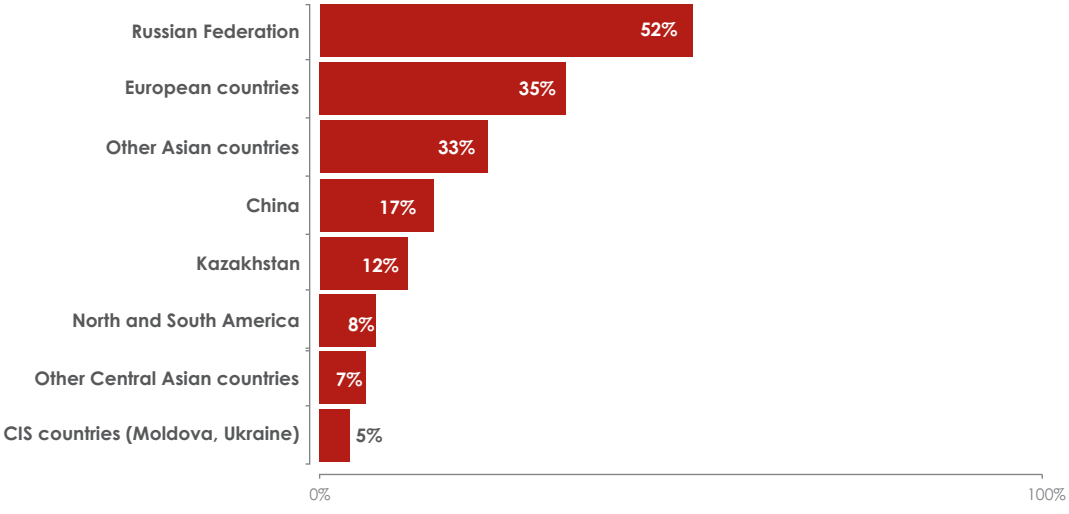


Chart 16.4
NUMBER OF IMPORT CONTRACTS PER IMPORTER
number of contracts

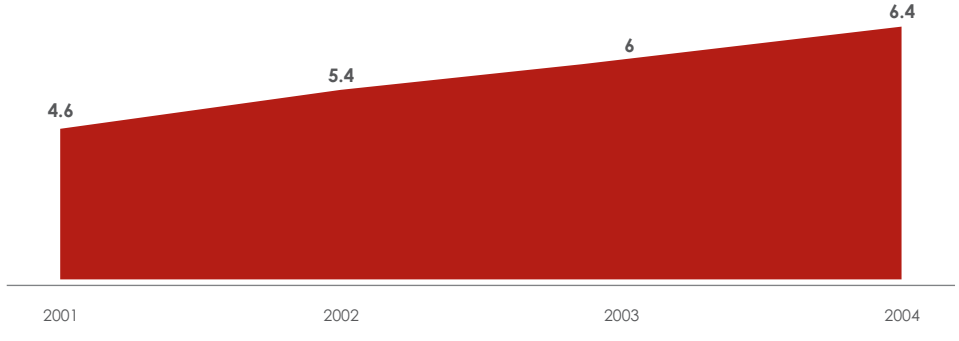


Chart 16.5
AVERAGE VOLUME OF IMPORT OPERATIONS PER IMPORTER
US dollars, thousands

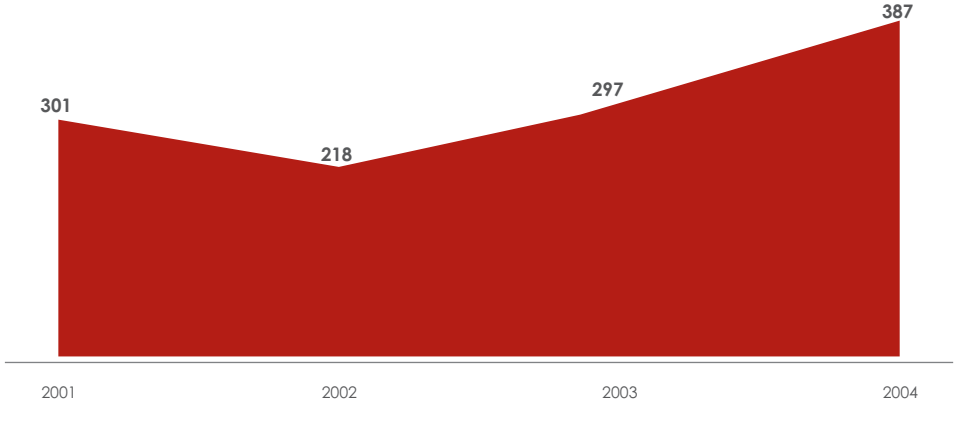


Chart 16.6

DIFFICULTY OF IMPORT OPERATIONS, BY YEAR

% of importers describing the given year as "problematic" and "very problematic" for import operations

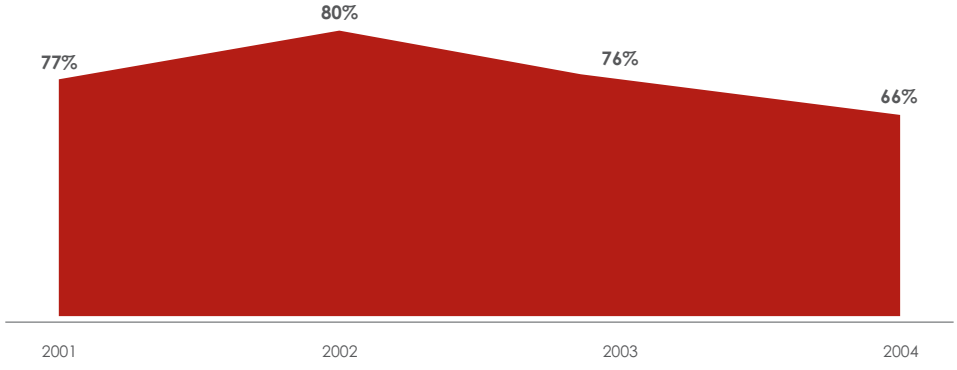


Chart 16.7

SOURCES OF FINANCING FOR IMPORT OPERATIONS

% of importers

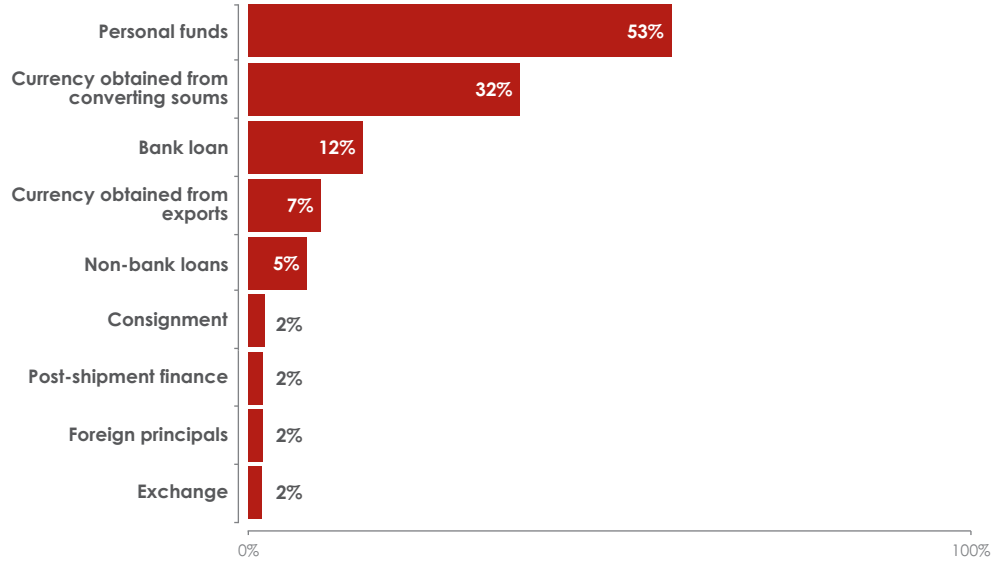


Chart 16.8
AVERAGE DURATION OF IMPORT PROCEDURES IN 2004
number of business days

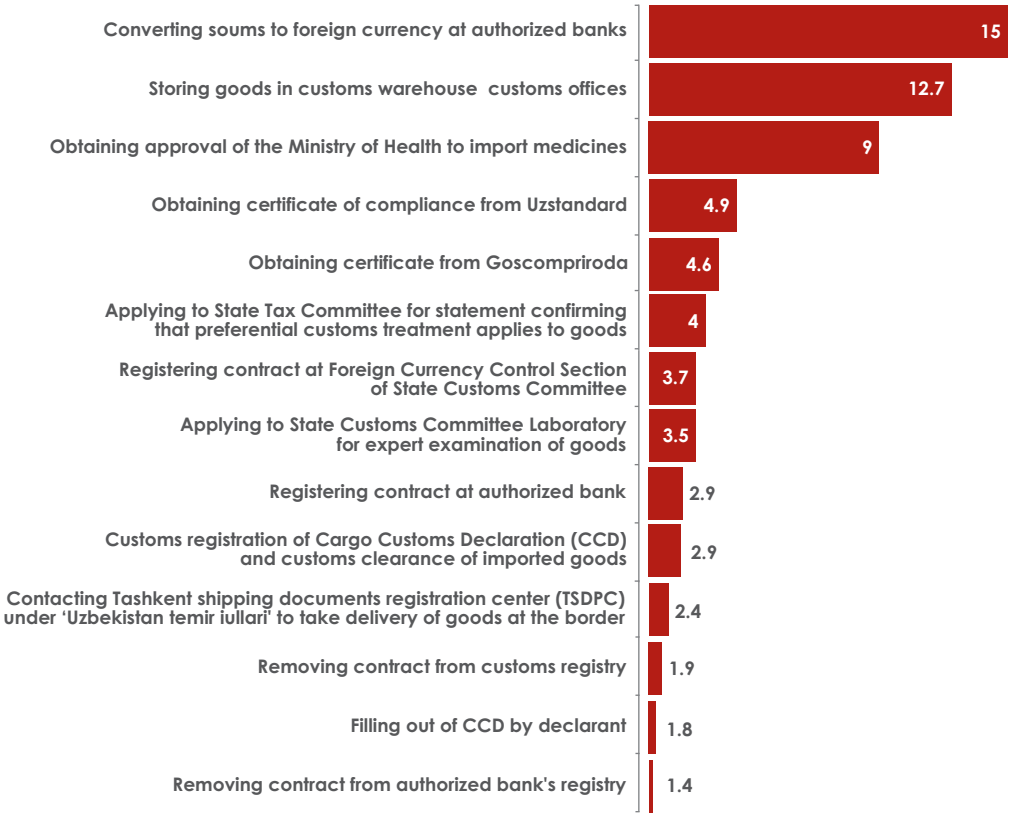


Chart 16.9
AVERAGE COST OF IMPORT PROCEDURES IN 2004
in soums

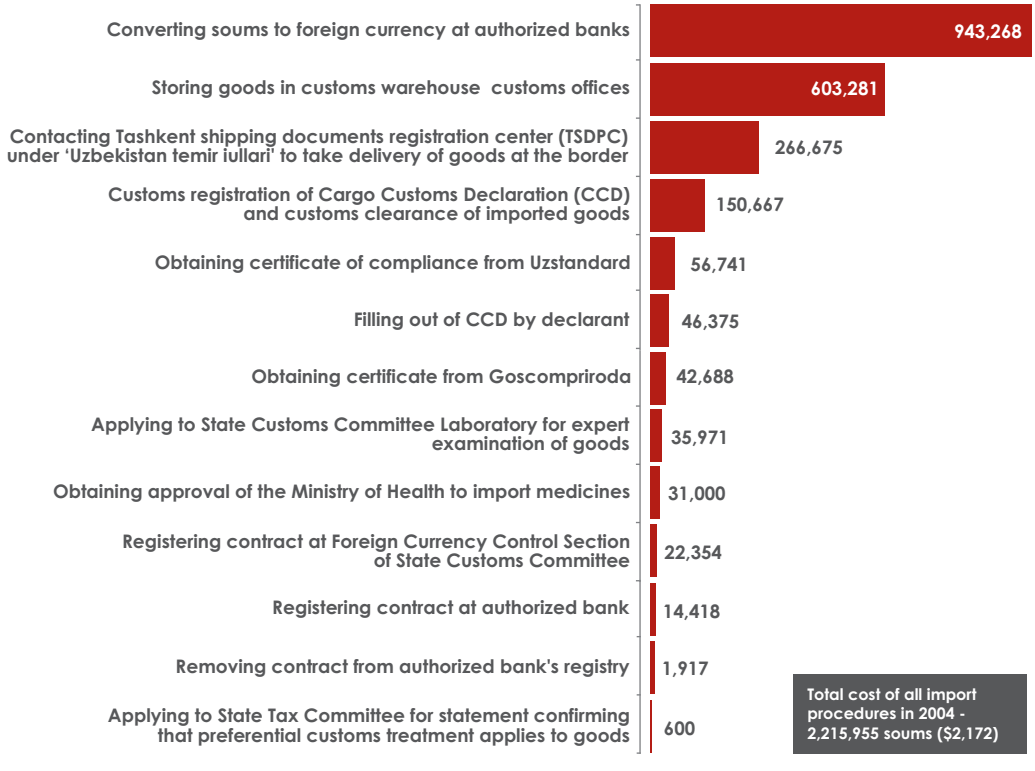


Chart 16.10

UNOFFICIAL PAYMENTS DURING IMPORT PROCEDURES IN 2004

% of importers undergoing the given procedure

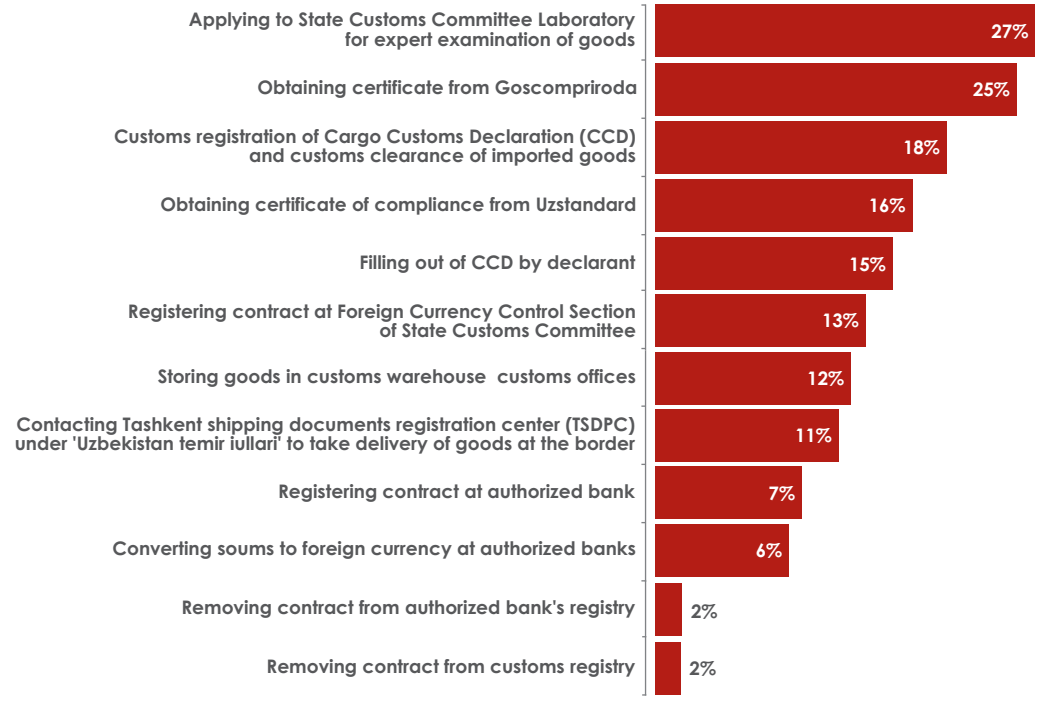


Chart 16.11

DEGREE OF DIFFICULTY OF IMPORT PROCEDURES IN 2004

% of importers undergoing the given procedure who described it as "problematic" and "very problematic"

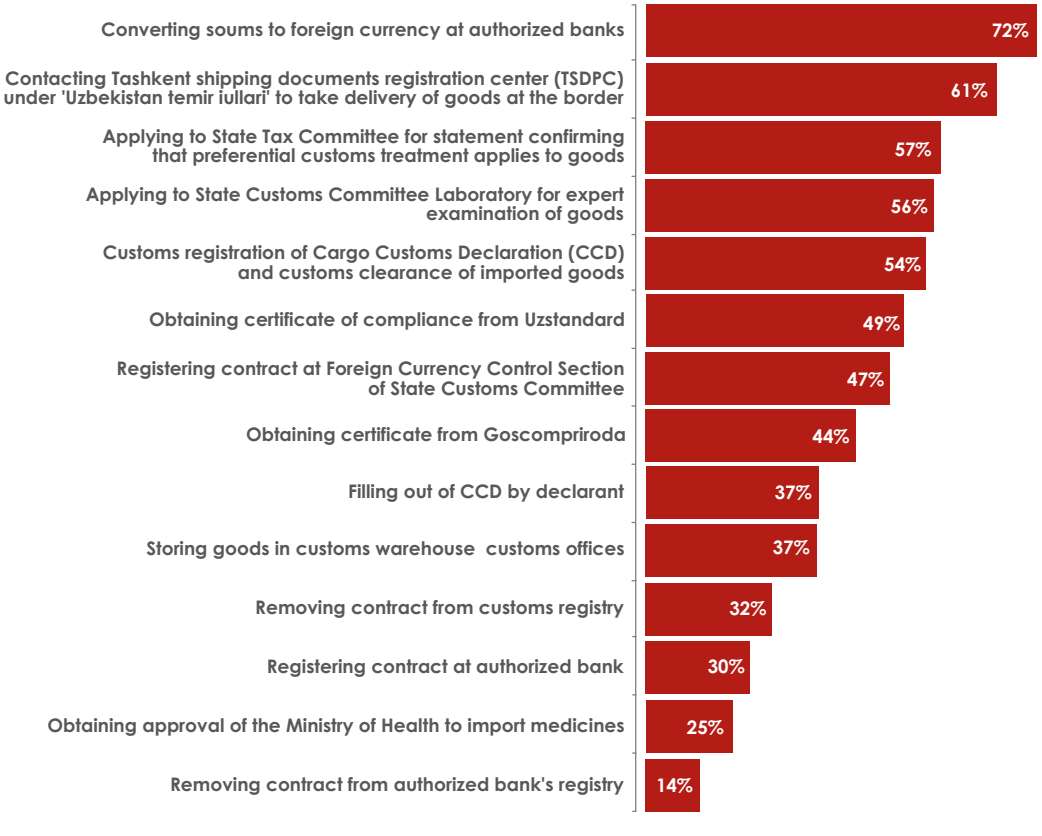


Chart 16.12
TRANSPORT USED FOR IMPORTS. 2004
% of importers

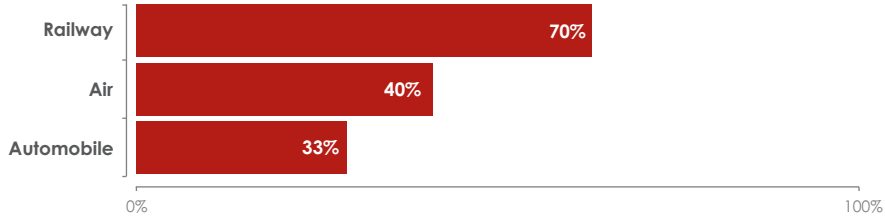


Chart 16.13
TIME REQUIRED FOR CONVERTING SOUMS TO FOREIGN CURRENCY
number of business days

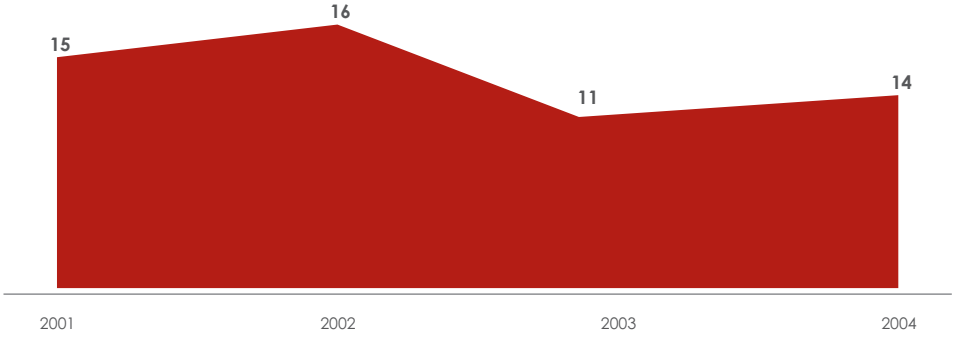


Chart 16.14
UNOFFICIAL PAYMENTS WHEN CONVERTING CURRENCY
% of importers

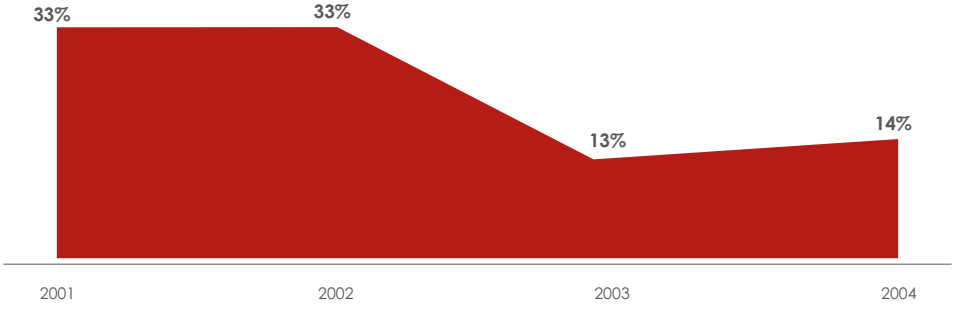


Chart 16.15
DIFFICULTY OF CURRENCY CONVERSION
% of importers describing conversion as "problematic" and "very problematic"

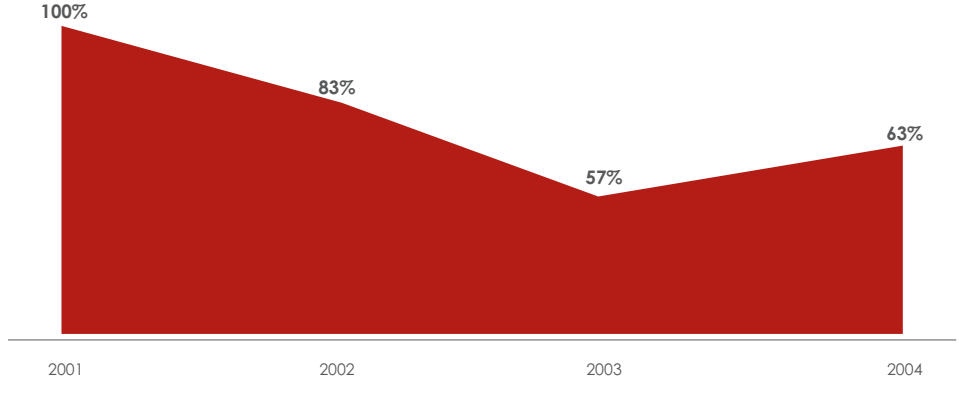


Chart 16.16
DISPOSITION OF IMPORTED GOODS IN 2004
% of importers

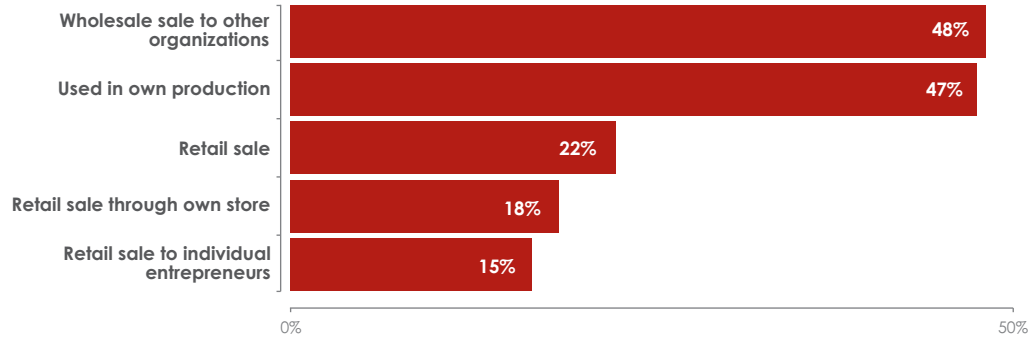


Chart 16.17
SOURCES OF INFORMATION ON PARTNERS IN 2004
% of importers

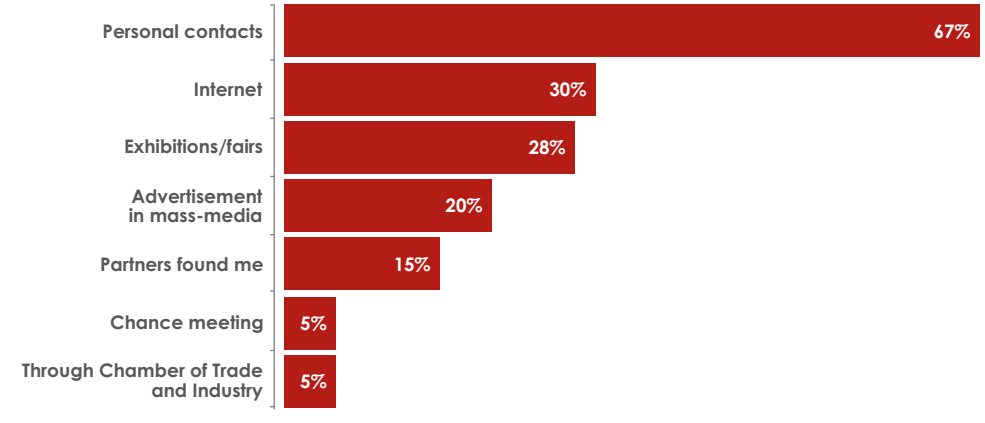


Chart 16.18
RESPONDENT'S ESTIMATE OF NUMBER OF ENTERPRISES IMPORTING UNOFFICIALLY
% of importers

Chart 16.19
ESTIMATE OF UNOFFICIAL IMPORTS
% of importers

Chart 16.12
TRANSPORT USED FOR IMPORTS. 2004
% of importers

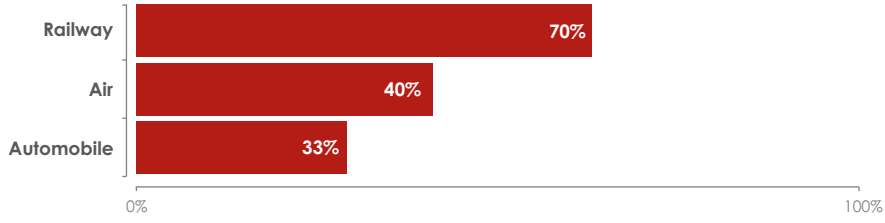


Chart 16.13
TIME REQUIRED FOR CONVERTING SOUMS TO FOREIGN CURRENCY
number of business days

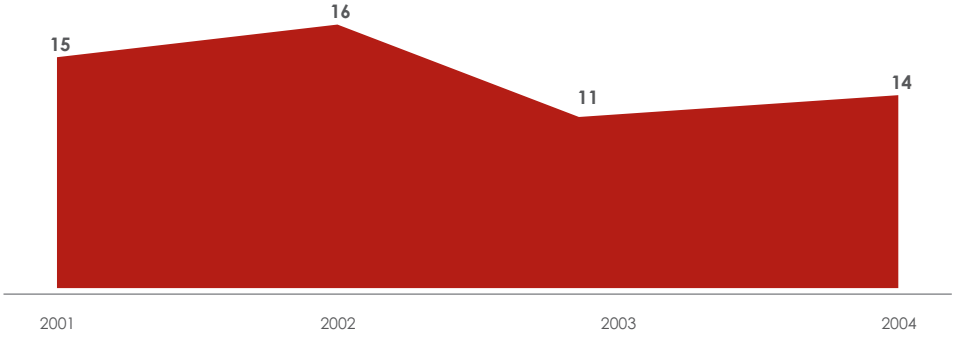


Chart 16.14
UNOFFICIAL PAYMENTS WHEN CONVERTING CURRENCY
% of importers

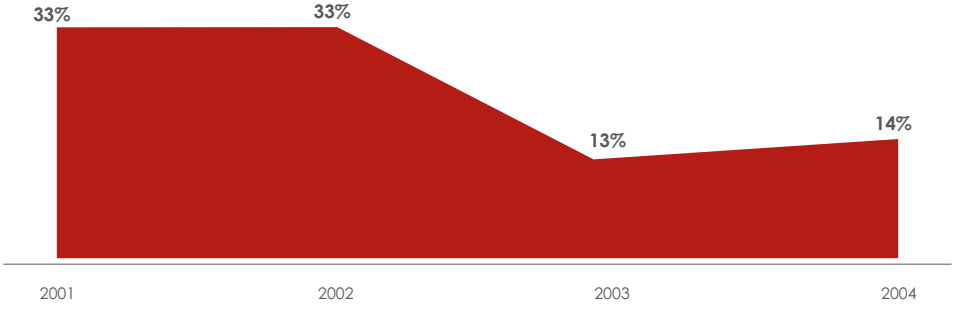


Chart 16.15
DIFFICULTY OF CURRENCY CONVERSION
% of importers describing conversion as "problematic" and "very problematic"

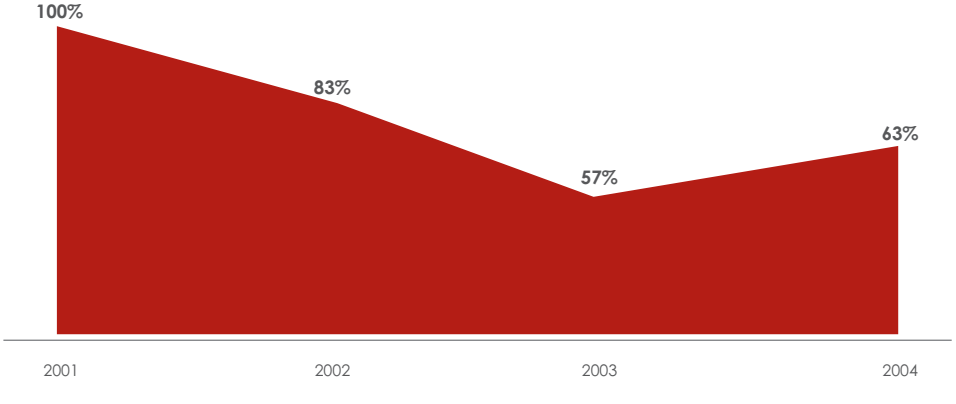


Chart 16.16
DISPOSITION OF IMPORTED GOODS IN 2004
% of importers

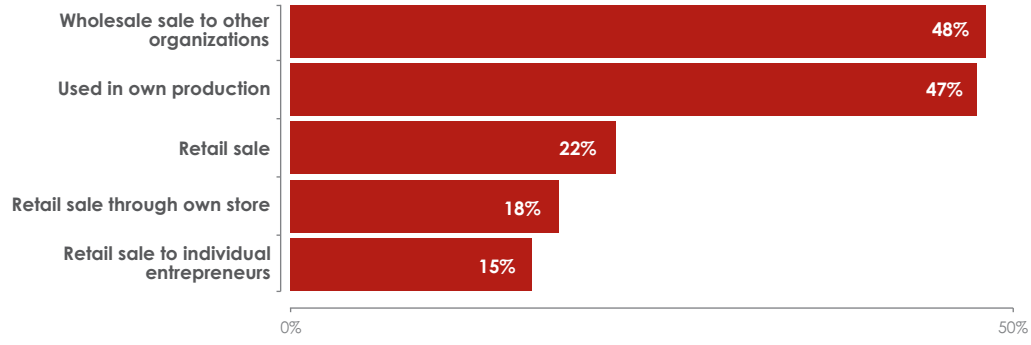


Chart 16.17
SOURCES OF INFORMATION ON PARTNERS IN 2004
% of importers

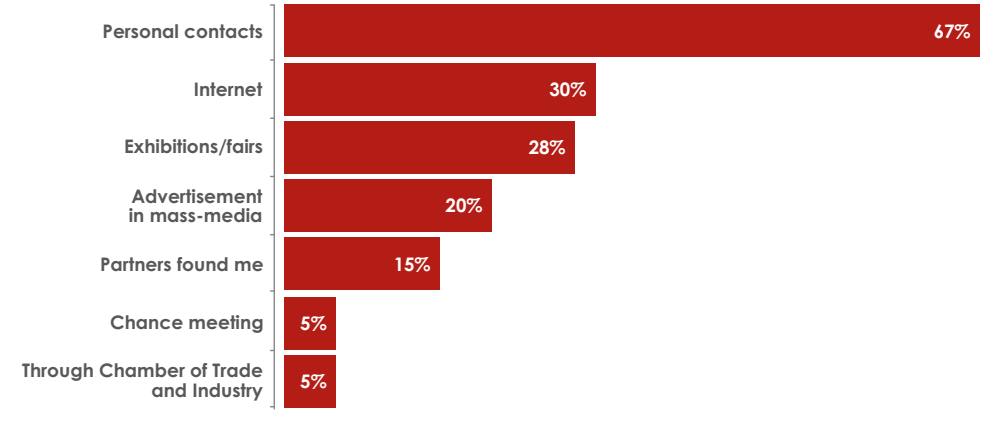


Chart 16.18
RESPONDENT'S ESTIMATE OF NUMBER OF ENTERPRISES IMPORTING UNOFFICIALLY
% of importers

Chart 16.19
ESTIMATE OF UNOFFICIAL IMPORTS
% of importers

Chart 16.20
RESPONDENTS' OPINION ON SUPPORT FOR IMPORT OPERATIONS BY VARIOUS BODIES IN 2004
% of importers

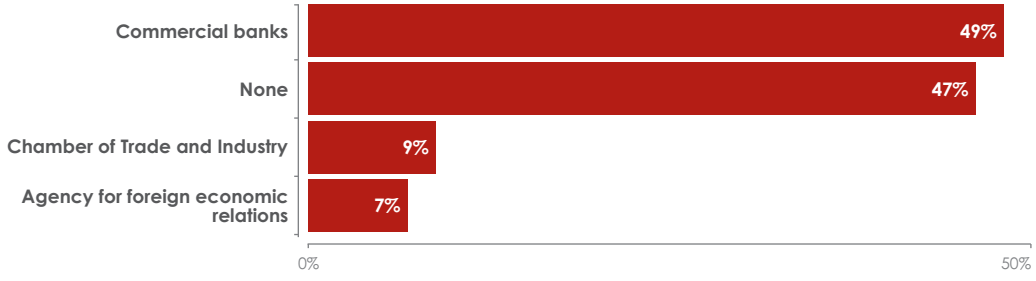
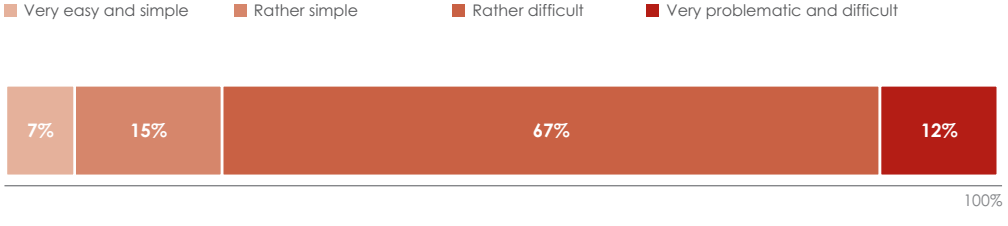


Chart 16.21
RESPONDENTS' OPINION ON IMPACT OF THE EXISTING IMPORT AND CUSTOMS PROCEDURES IN 2004
% of importers

Chart 16.22
DEGREE OF DIFFICULTY OF IMPORT OPERATIONS AT TIME OF SURVEY. 2004
% of importers



CERTIFICATION AND OBTAINING STANDARDS

Chart 17.1
RESPONDENTS OBTAINING CERTIFICATES

% of respondents

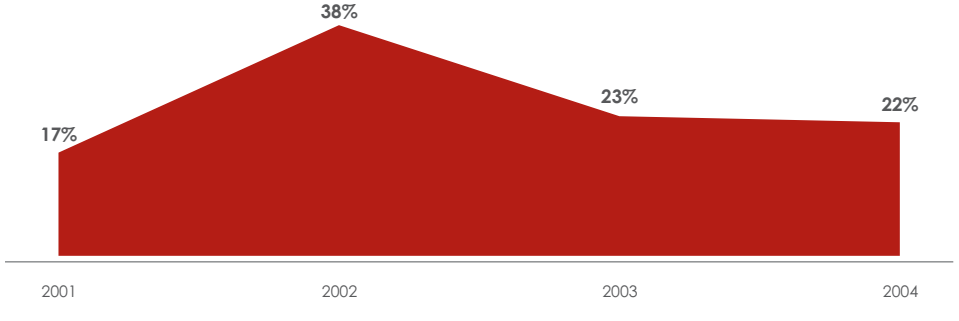


Chart 17.2
RESPONDENTS OBTAINING CERTIFICATES (BY SECTOR)

% of respondents in sector

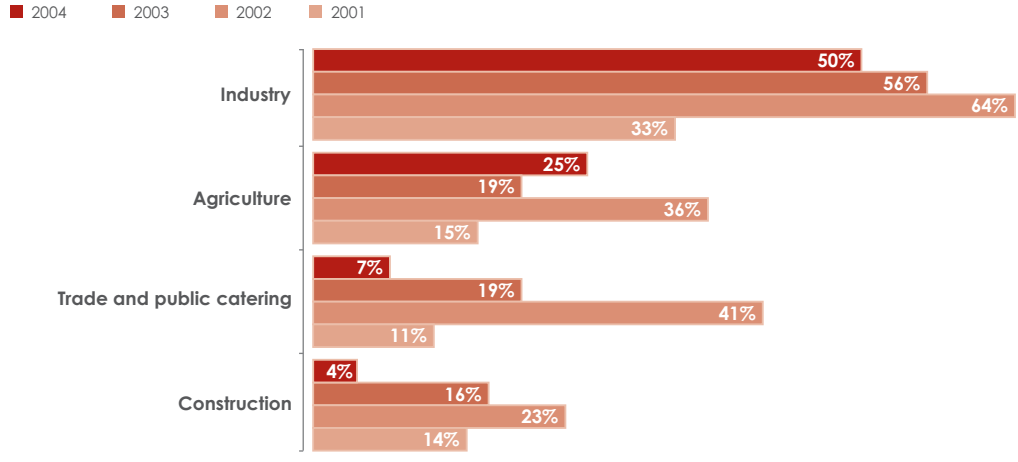


Chart 17.3
MOST FREQUENTLY ISSUED CERTIFICATES IN 2004

% of respondents obtaining certificates

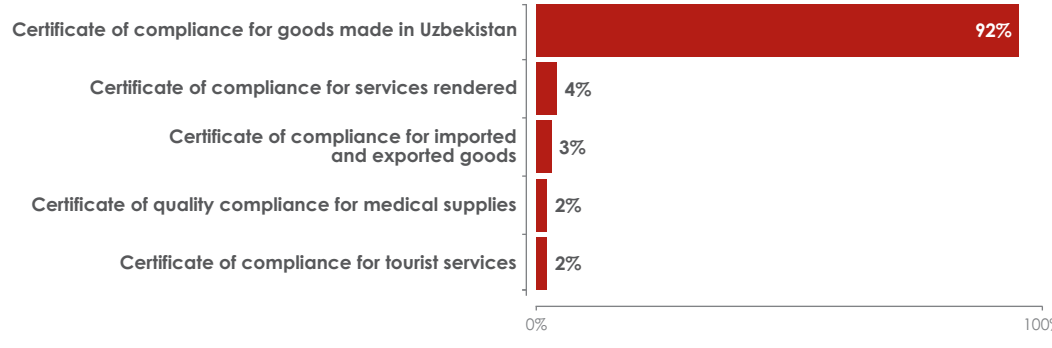


Chart 17.4
RESPONDENTS RESORTING TO UNOFFICIAL PAYMENTS IN OBTAINING CERTIFICATES

% of respondents obtaining certificates

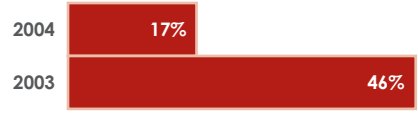


Chart 17.5
PERCENTAGE OF RESPONDENTS OBTAINING STANDARDS

% of respondents

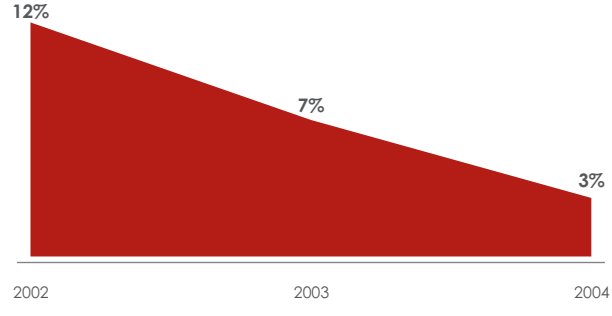


Chart 17.6
PERCENTAGE OF RESPONDENTS OBTAINING STANDARDS (BY SECTOR)

% of respondents in sector

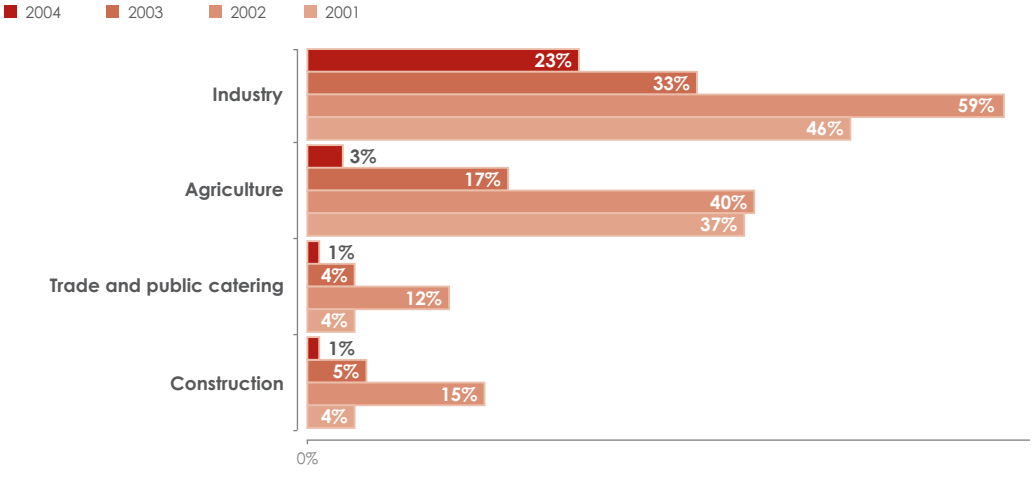


Chart 17.7
AVERAGE NUMBER OF STANDARDS PER RESPONDENT OBTAINING STANDARDS

number of standards

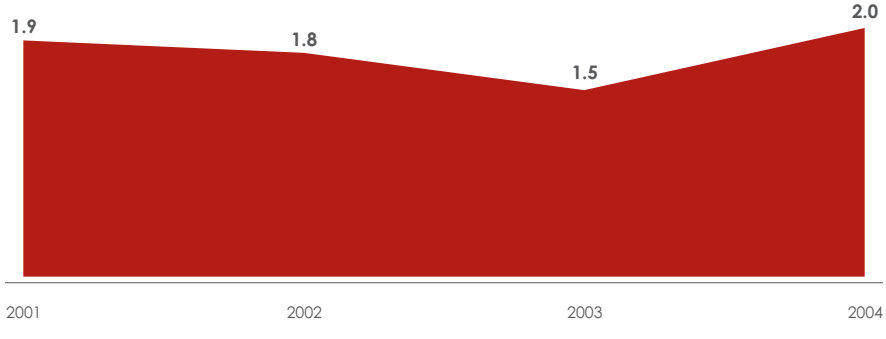


Chart 17.8
AVERAGE TIME SPENT TO OBTAIN A STANDARD

number of business days

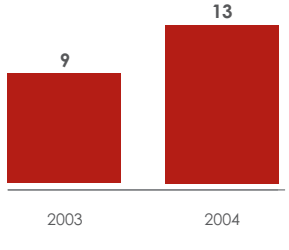
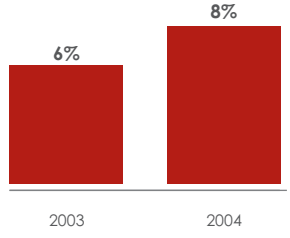


Chart 17.9
UNOFFICIAL PAYMENTS WHILE OBTAINING STANDARDS

% of respondents obtaining standards

Chart 17.10
PERCENTAGE OF RESPONDENTS WHO HAD TO DEVELOP NEW STANDARDS
% of respondents obtaining standards



LICENSING

Chart 18.1
PERCENTAGE OF RESPONDENTS OBTAINING LICENCES
% of respondents

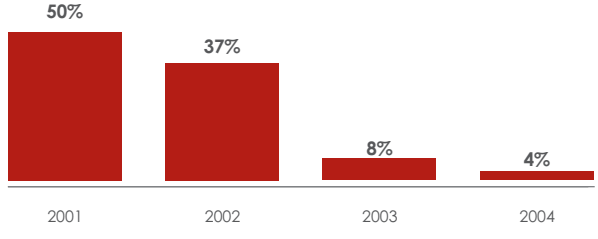


Chart 18.2
PERCENTAGE OF RESPONDENTS OBTAINING LICENCES (BY SECTOR)
% of respondents in sector

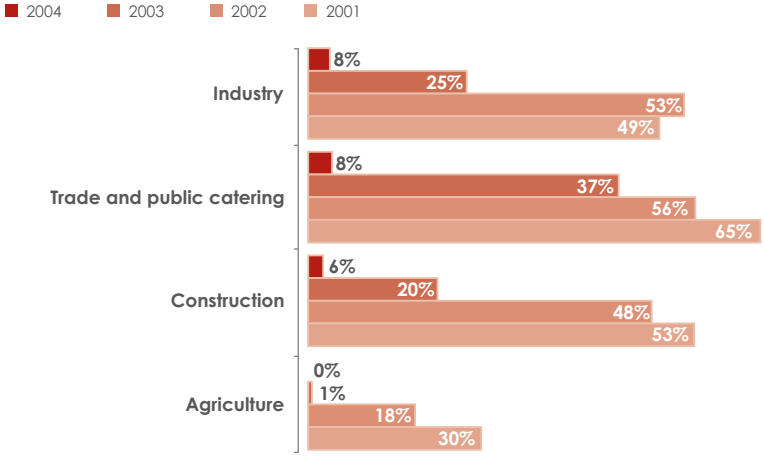


Chart 18.3
LICENSES MOST FREQUENTLY OBTAINED IN 2004
% of respondents obtaining certificates

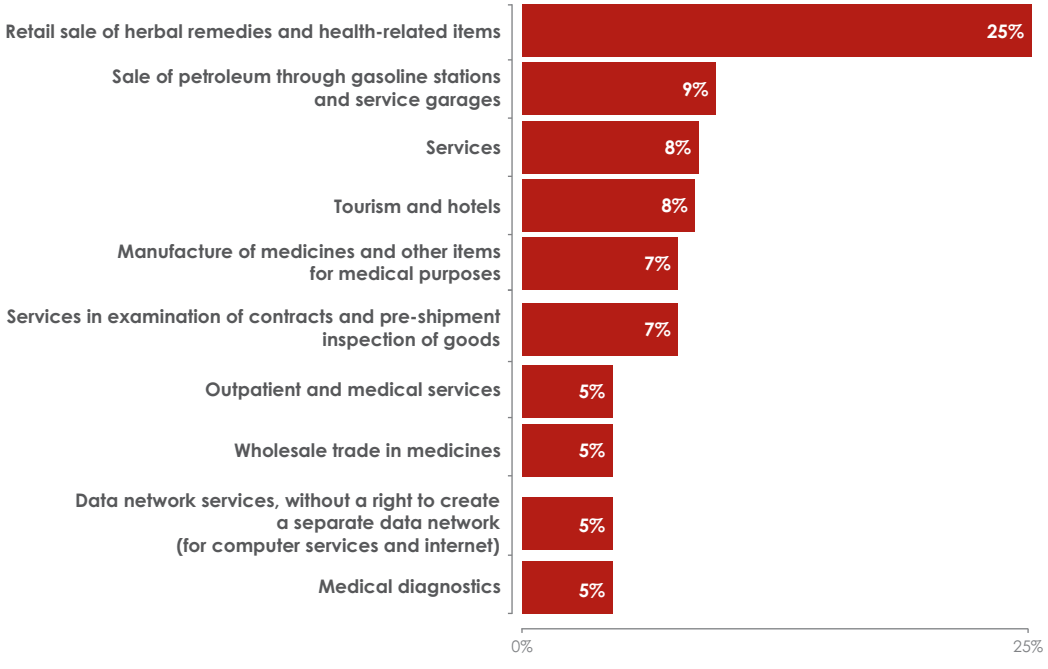


Chart 18.4
AVERAGE TIME TO OBTAIN A LICENCE
number of working days

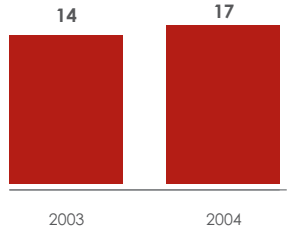


Chart 18.5
VALIDITY PERIOD OF LICENCES
% of respondents obtaining licences

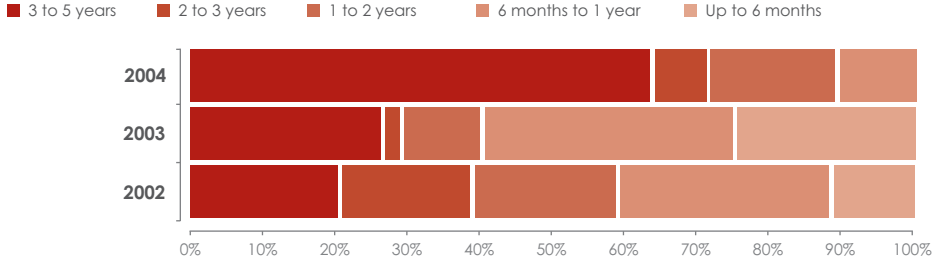


Chart 18.6
LICENCES OBTAINED, BY REGION
% of respondents obtaining licences

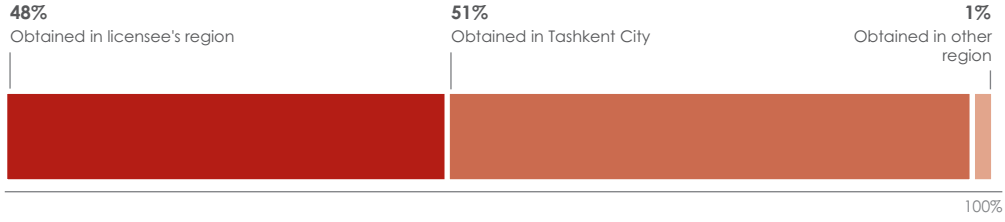


Chart 18.7
SETTING OF TERM OF VALIDITY OF LICENCES IN 2004
% of respondents obtaining licences

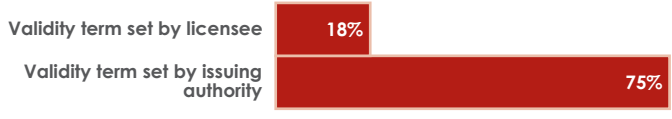


Chart 18.8
UNOFFICIAL PAYMENTS TO OBTAIN LICENCES
% of respondents obtaining licences

AGRICULTURAL ENTERPRISES

Chart 19.1
AGRICULTURAL GOODS PRODUCED BY RESPONDENTS IN 2004
% of agricultural enterprises

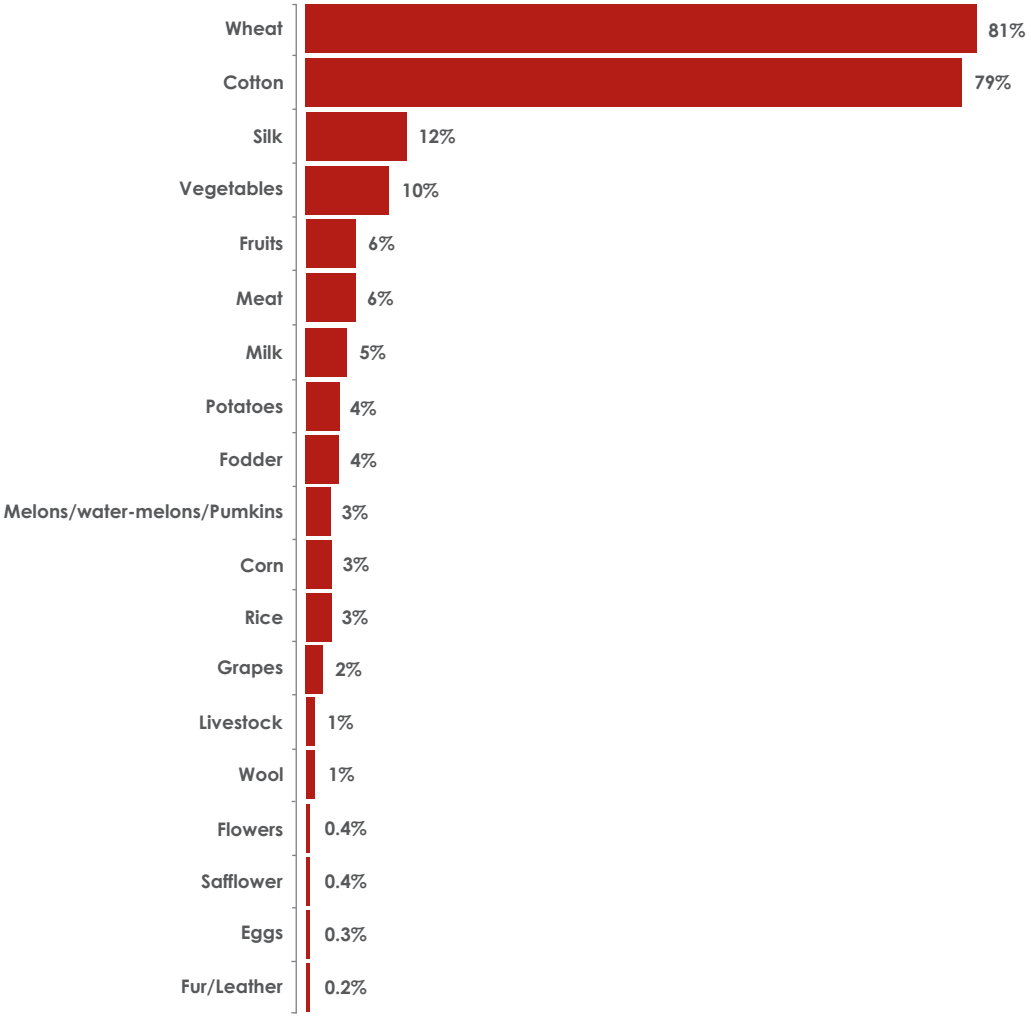
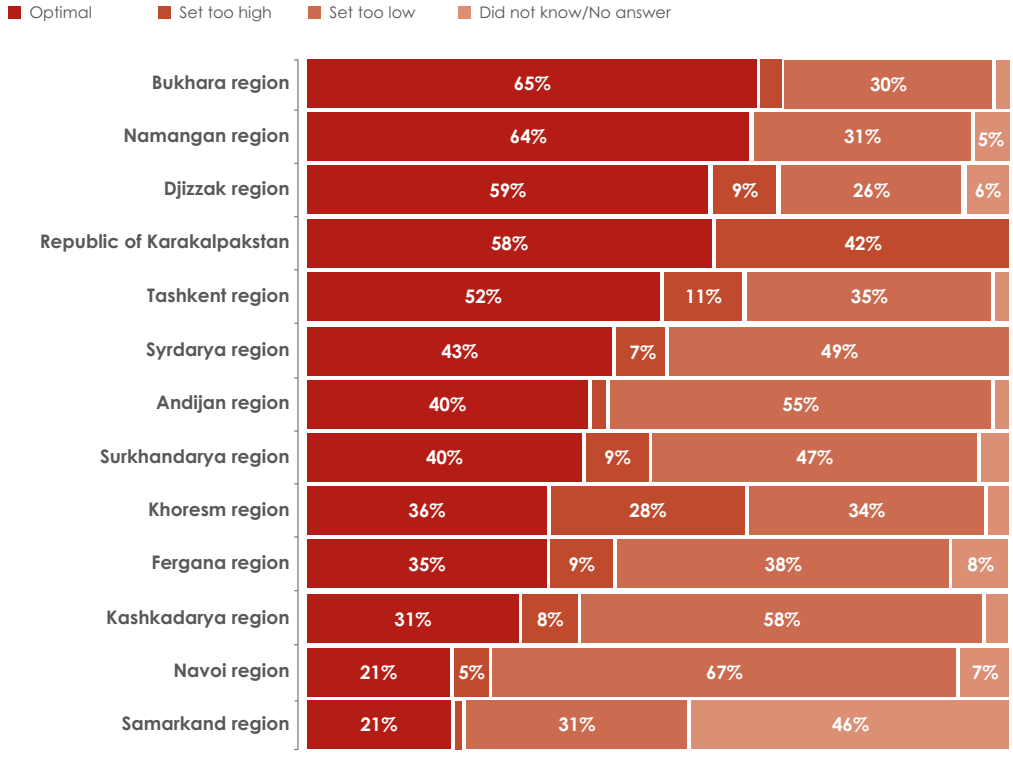


Chart 19.2

RESPONDENTS' ASSESSMENT OF SOIL YIELD CLASSIFICATION* IN 2004

% of agricultural enterprises by region



* - **Soil yield classification** - the crop capacity of a plot of land as an overall indicator of its fertility.

Chart 19.3

AVERAGE TIME TO RECEIVE PAYMENT FOR GOODS SUPPLIED TO THE STATE

in days

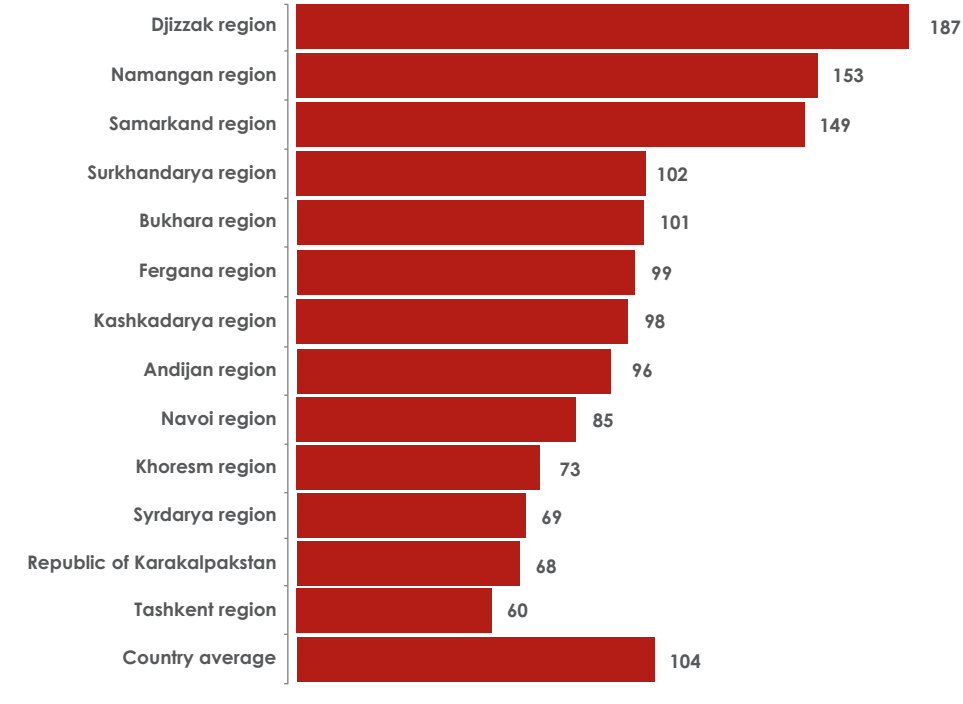


Chart 19.4

THE PRODUCER'S RIGHT TO SET THE PRICE FOR THE GOODS SUPPLIED. 2004

% of agricultural enterprises

Chart 19.5

DIFFICULTY OF PROCEDURES IN STARTING AN AGRICULTURAL ENTERPRISE AND ACCOMPANYING UNOFFICIAL PAYMENTS IN 2004

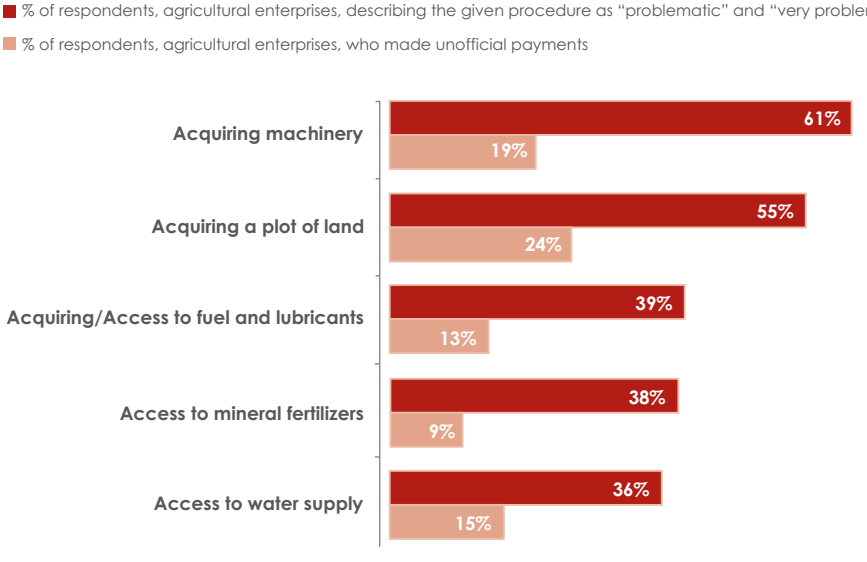


Chart 19.6

DIFFICULTY OF ACQUIRING LAND WHEN STARTING AN AGRICULTURAL ENTERPRISE AND ACCOMPANYING UNOFFICIAL PAYMENTS (BY REGION) IN 2004

- % of respondents, agricultural enterprises, describing this issue as "problematic" and "very problematic"
- % of respondents, agricultural enterprises, who made unofficial payments

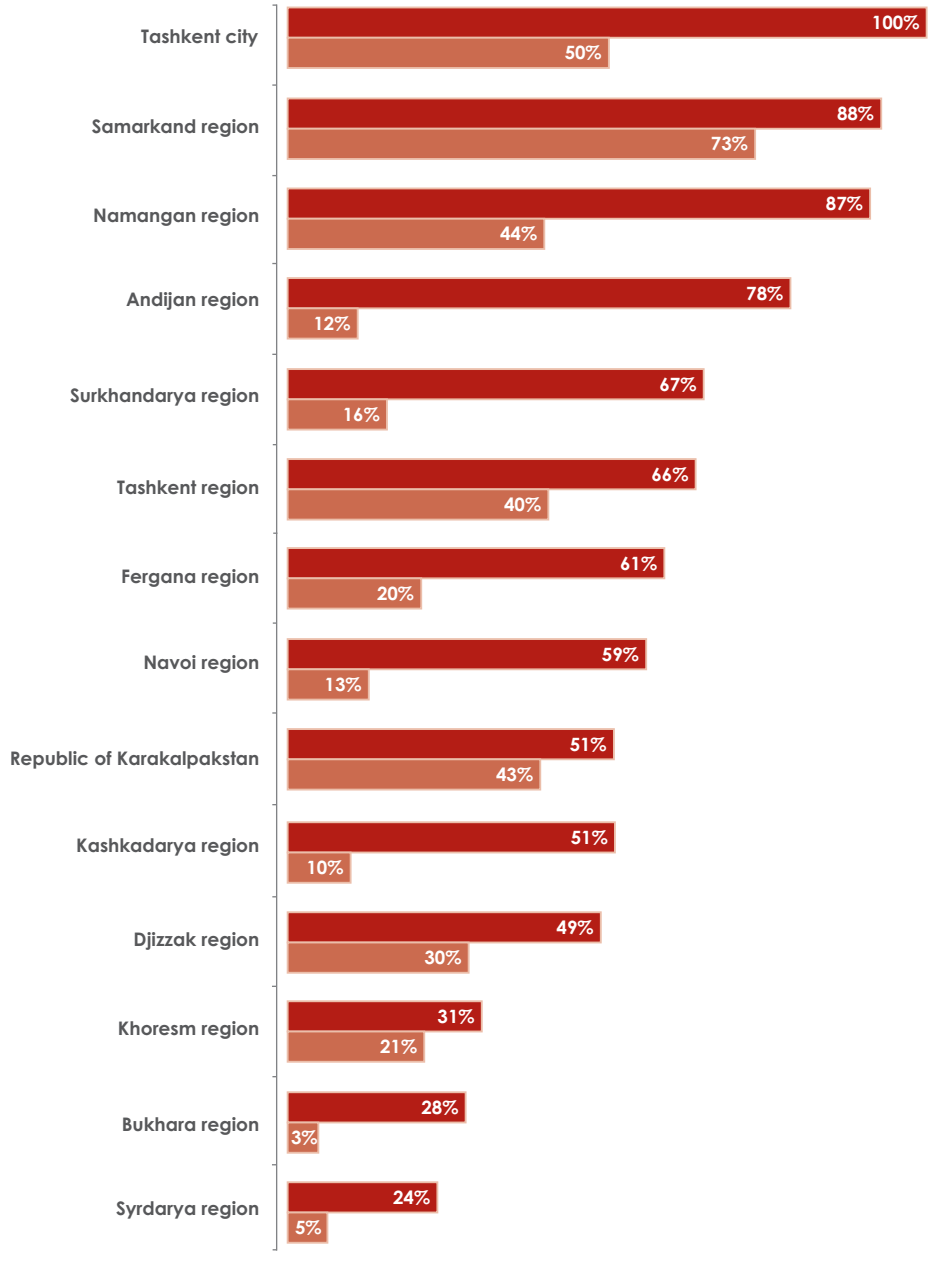


Chart 19.7

DIFFICULTY OF ACQUIRING MACHINERY WHEN STARTING AN AGRICULTURAL ENTERPRISE AND ACCOMPANYING UNOFFICIAL PAYMENTS (BY REGION) IN 2004

- % of respondents, agricultural enterprises, describing this issue as "problematic" and "very problematic"
- % of respondents agricultural enterprises who made unofficial payments

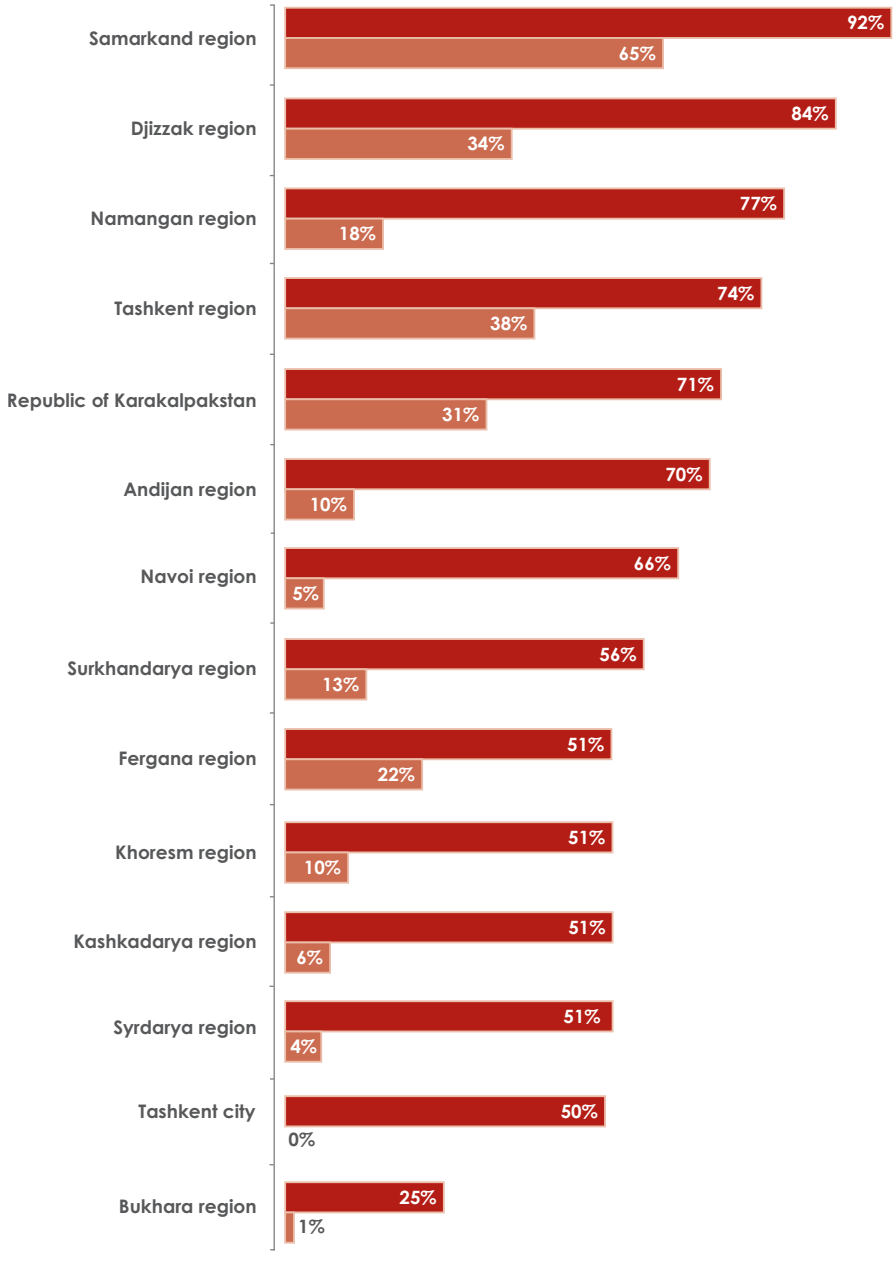


Chart 19.8

DIFFICULTY OF ACCESSING FUELS AND LUBRICANTS WHEN STARTING AN AGRICULTURAL ENTERPRISE AND ACCOMPANYING UNOFFICIAL PAYMENTS (BY REGION) IN 2004

- % of respondents, agricultural enterprises, describing this issue as "problematic" and "very problematic"
- % of respondents, agricultural enterprises, who made unofficial payments

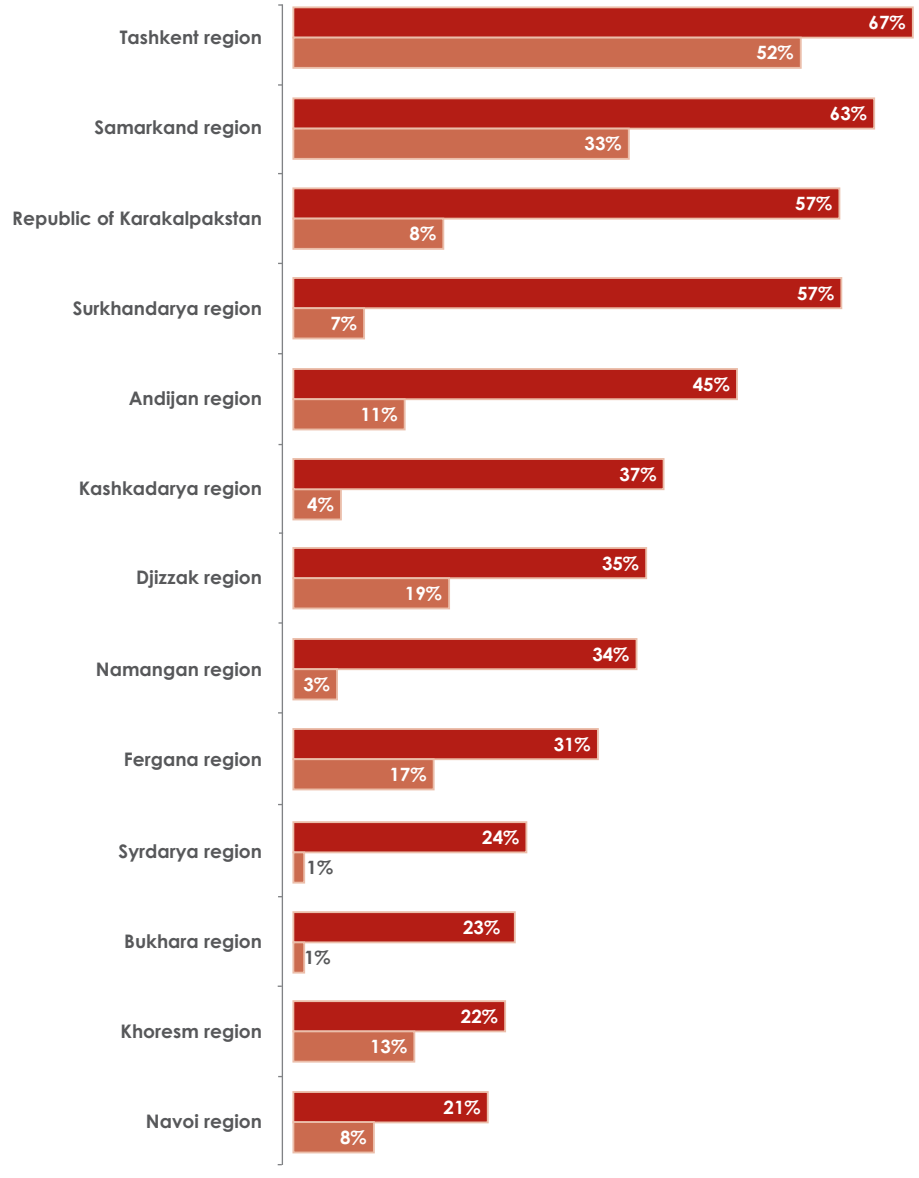


Chart 19.9

DIFFICULTY OF GETTING ACCESS TO WATER SUPPLY WHEN STARTING AN AGRICULTURAL ENTERPRISE AND ACCOMPANYING UNOFFICIAL PAYMENTS (BY REGION) IN 2004

- % of respondents, agricultural enterprises, describing this issue as "problematic" and "very problematic"
- % of respondents, agricultural enterprises, who made unofficial payments

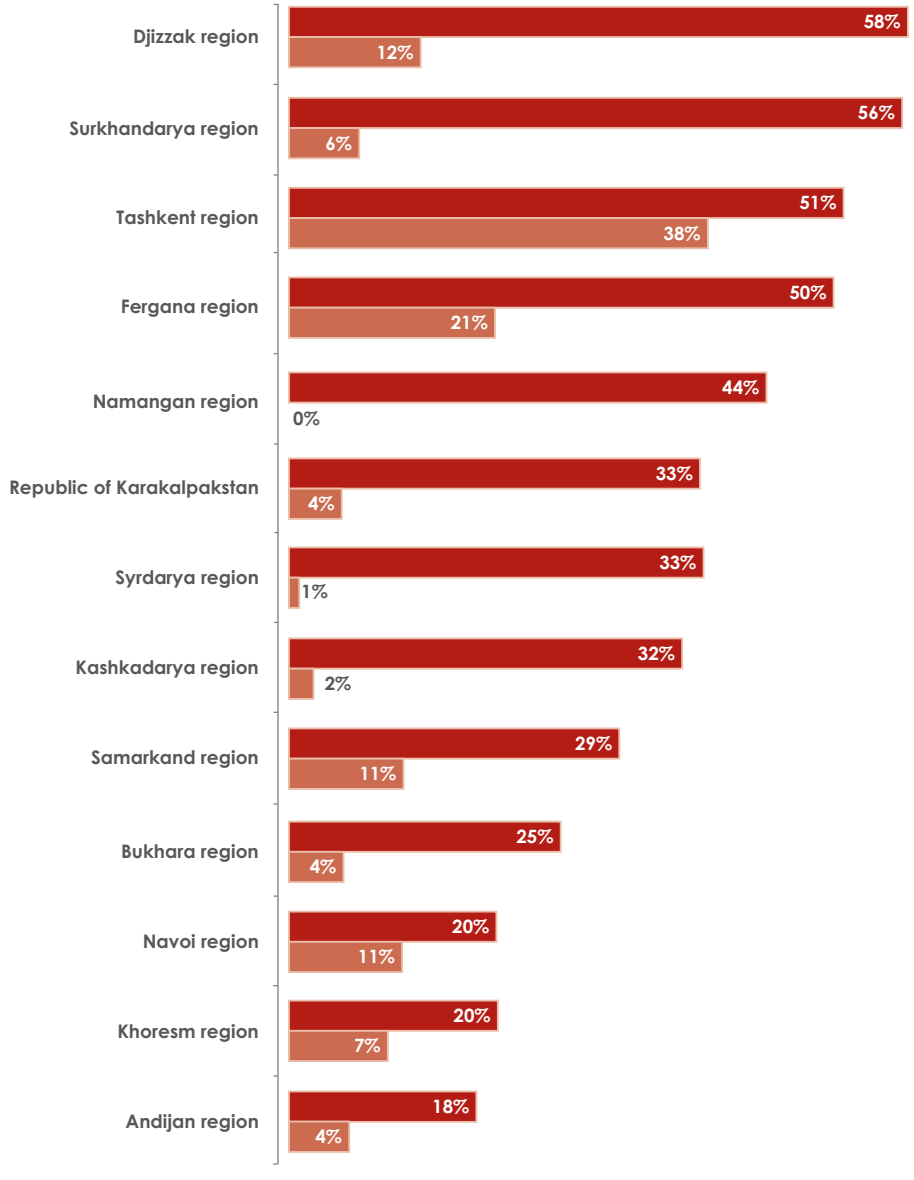
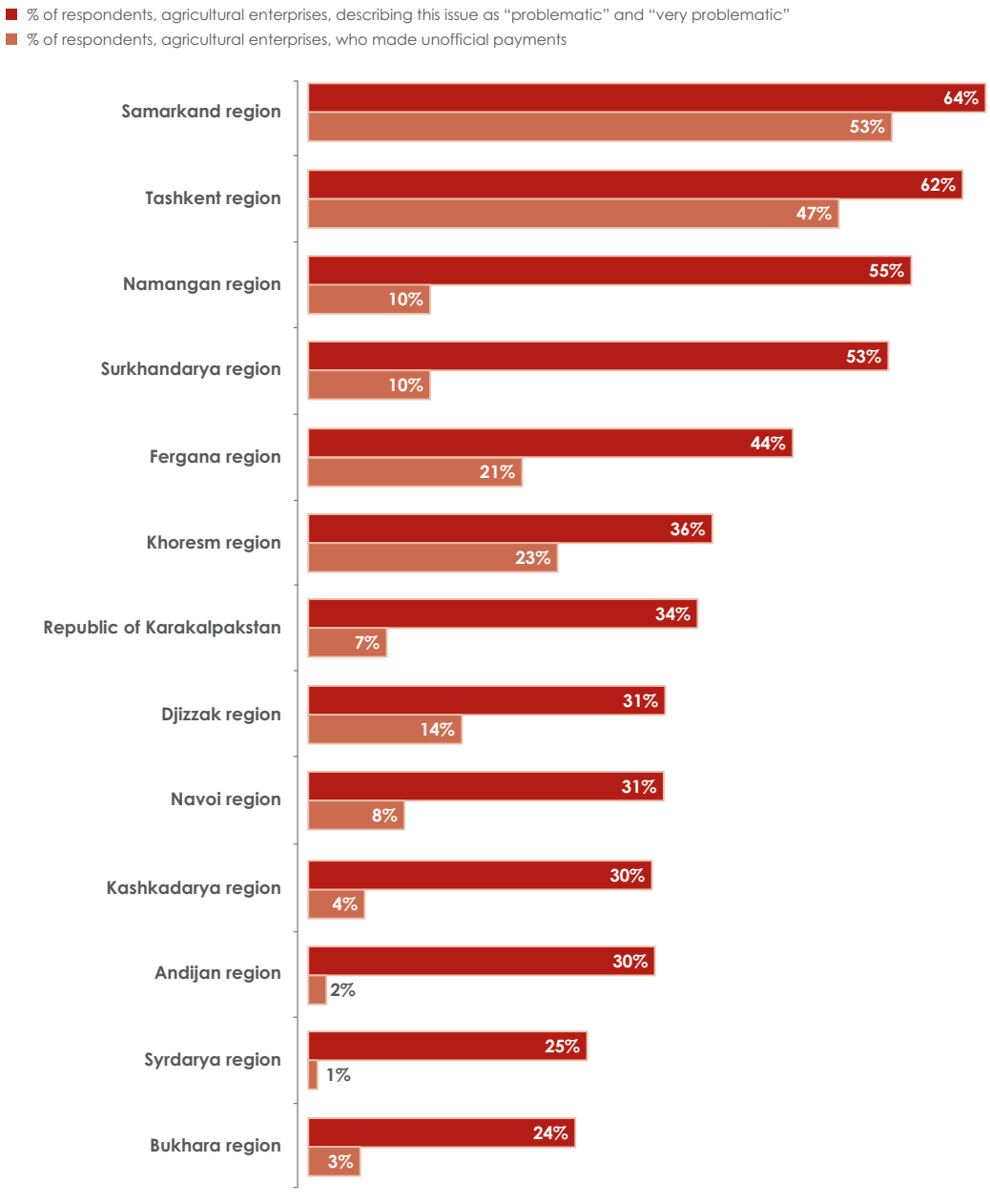


Chart 19.10

DIFFICULTY OF GETTING ACCESS TO MINERAL FERTILIZERS WHEN STARTING AN AGRICULTURAL ENTERPRISE AND ACCOMPANYING UNOFFICIAL PAYMENTS (BY REGION) IN 2004



STATISTICAL RESULTS OF THE SURVEY OF INDIVIDUAL ENTERPRISES

Profile of individual entrepreneurs

Chart 20.1
RESPONDENTS, INDIVIDUAL ENTREPRENEURS, BY REGION
% of individual entrepreneurs

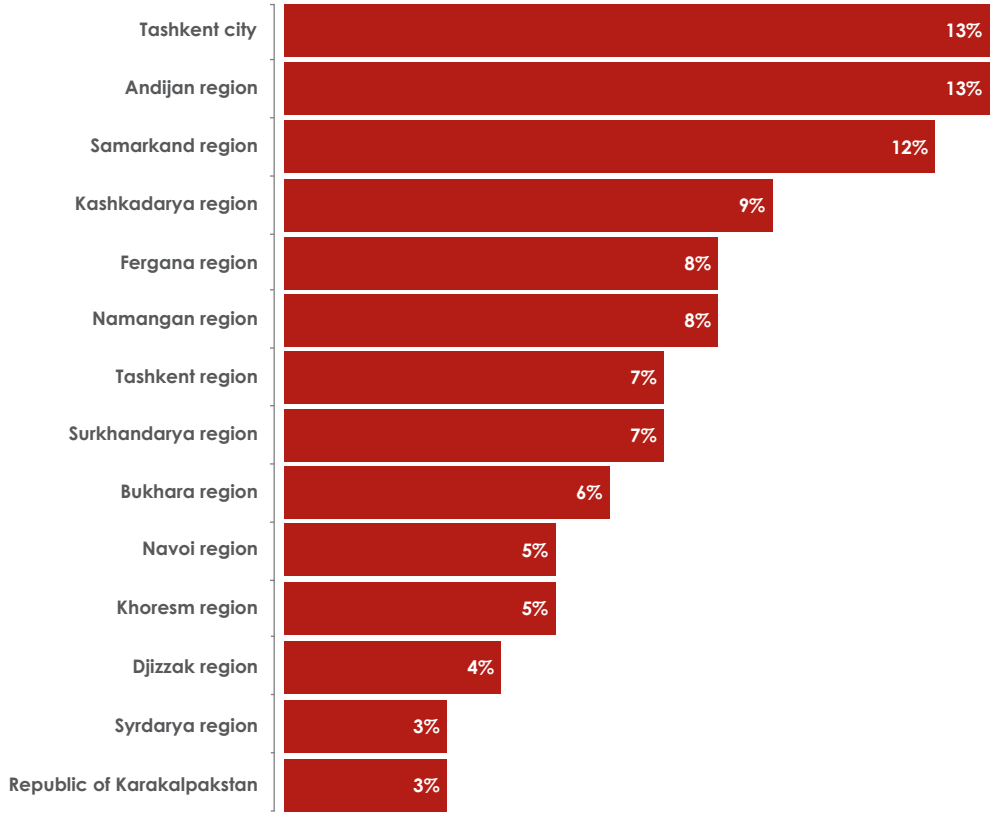


Chart 20.2
DIFFICULTY OF PROCESSES IN 2004
% of individual entrepreneurs describing the given process as "rather problematic" and "very problematic"

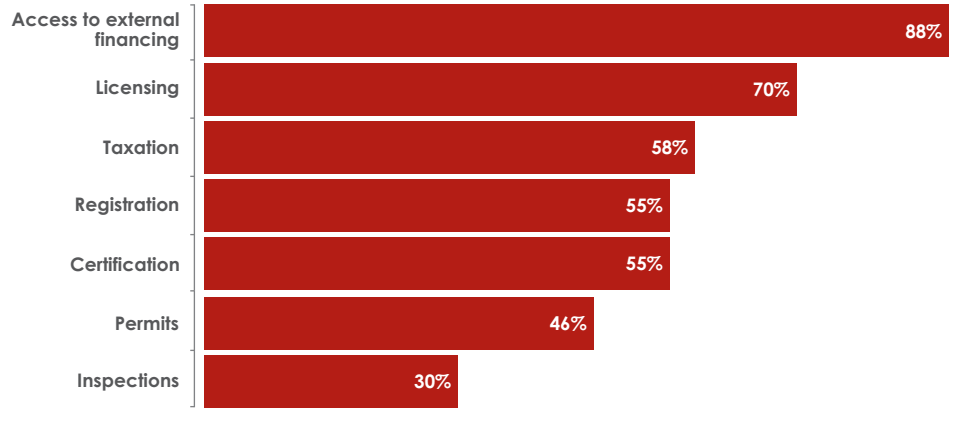


Chart 20.3
RESPONDENTS, INDIVIDUAL ENTREPRENEURS, BY SECTOR. 2004
% of individual entrepreneurs

Chart 20.4
RESPONDENTS, INDIVIDUAL ENTREPRENEURS, BY SEX. 2004
% of individual entrepreneurs

Chart 20.5
RESPONDENTS, INDIVIDUAL ENTREPRENEURS, BY SECTOR. 2004
% of individual entrepreneurs

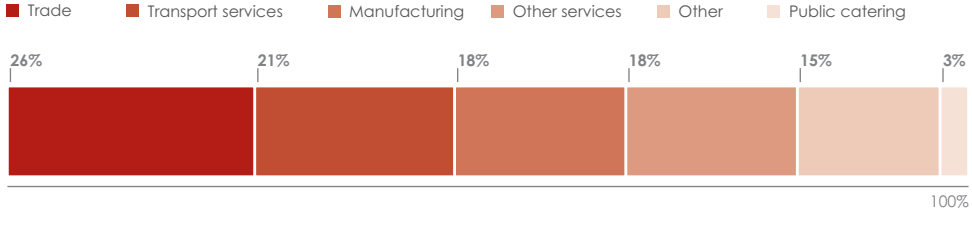


Chart 20.6
AVERAGE REPORTED SALES GROWTH, INDIVIDUAL ENTREPRENEURS, IN 2004

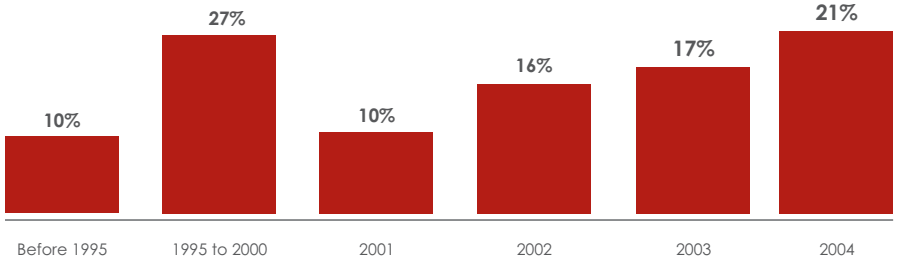
% increase over previous year, by sector

Chart 20.7
AVERAGE REPORTED PROFITABILITY OF INDIVIDUAL ENTREPRENEURS IN 2004

% increase over previous year, by sector

Chart 20.8
RESPONDENTS, INDIVIDUAL ENTREPRENEURS, BY YEAR OF STARTING ACTIVITY

% of individual entrepreneurs



Registration

Chart 20.9
INDIVIDUAL ENTREPRENEURS USING "ONE WINDOW" REGISTRATION SYSTEM AFTER ITS INTRODUCTION

% of individual entrepreneurs registered after October 2003

Chart 20.10
INDIVIDUAL ENTREPRENEURS CARRYING OUT PROCEDURES LEGALLY MANDATED AS PART OF THE "ONE WINDOW" SYSTEM

% of individual entrepreneurs who began operations in 2004

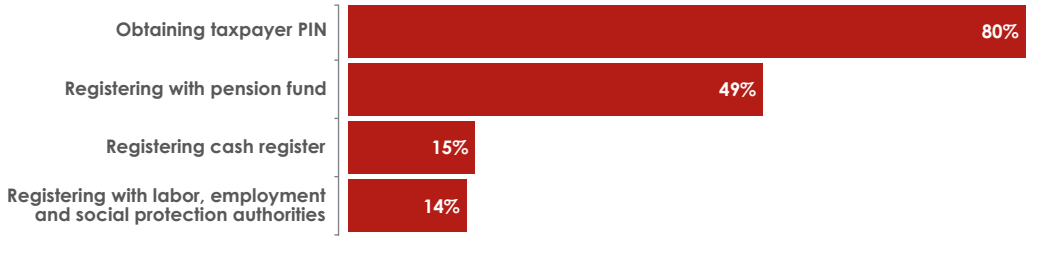
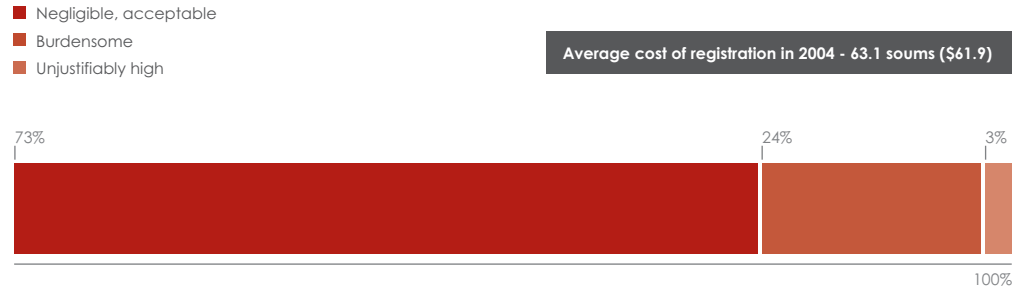


Chart 20.11
UNOFFICIAL PAYMENTS DURING REGISTRATION IN 2004

% of individual entrepreneurs who registered in 2004

Chart 20.12
RESPONDENTS' OPINION ON THE COST OF REGISTRATION IN 2004

% of individual entrepreneurs who registered in 2004



Permits and approvals

Chart 20.13
UNOFFICIAL PAYMENTS TO OBTAIN PERMITS AND APPROVALS IN 2004

% of individual entrepreneurs who obtained permits in 2004

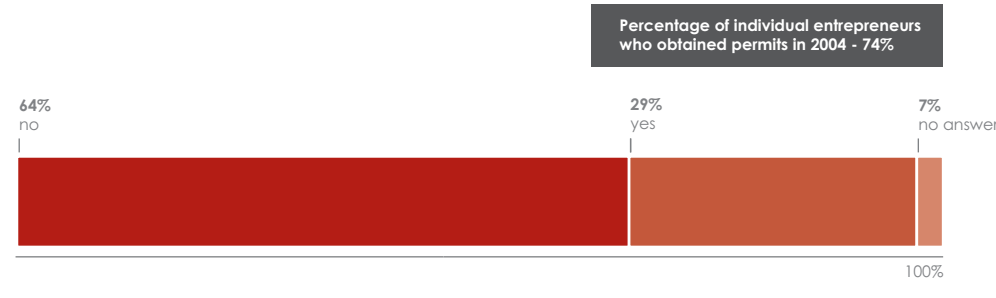


Chart 20.14
RESPONDENTS' OPINION ON THE COST OF OBTAINING ALL NECESSARY PERMITS

% of individual entrepreneurs who obtained permits in 2004

Export and import operations

Chart 20.15
INDIVIDUAL ENTREPRENEURS ENGAGED IN FOREIGN TRADE IN 2004

% of individual entrepreneurs

Chart 20.16
RESPONDENTS IMPORTING IN 2004

% of individual entrepreneurs

Chart 20.17
RESPONDENTS EXPORTING IN 2004

% of individual entrepreneurs

Taxes and tax administration

Chart 20.18
TAX BURDEN OF INDIVIDUAL ENTREPRENEURS IN 2004

% of revenue, by sector

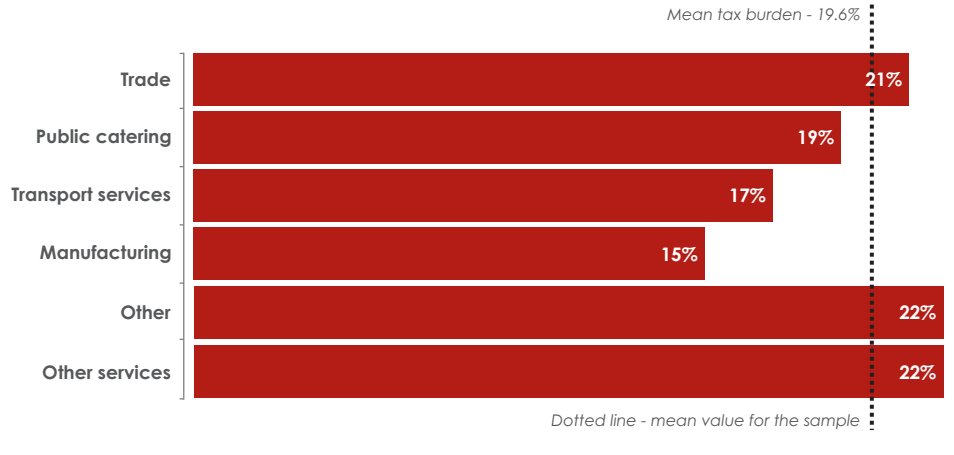


Chart 20.19

RESPONDENTS' ESTIMATE OF REVENUE CONCEALED FROM TAXATION BY INDIVIDUAL ENTREPRENEURS

% of respondents

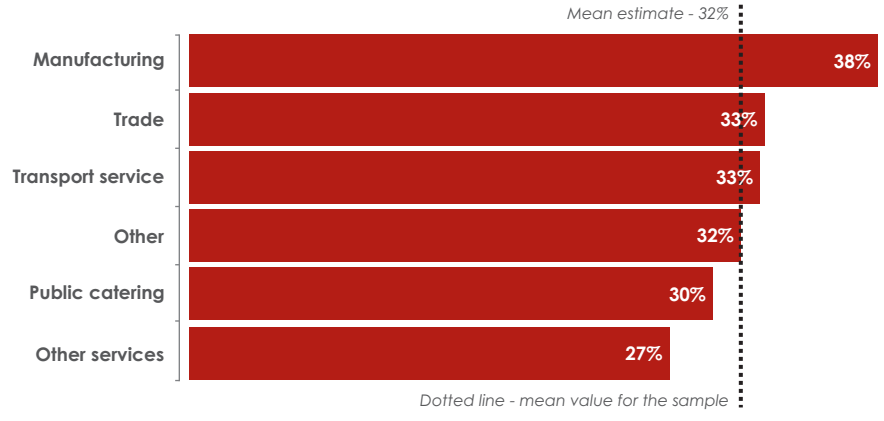


Chart 20.20

REASONS FOR CONCEALING SOME REVENUE IN 2004

% of individual entrepreneurs who admitted concealing revenue

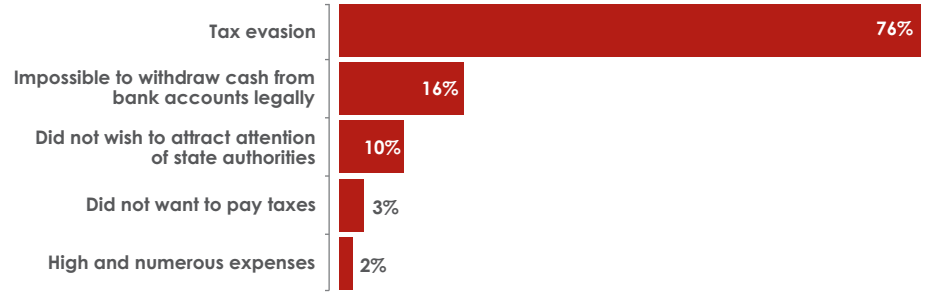


Chart 20.21

PERCENTAGE OF SALES INDIVIDUAL ENTREPRENEURS ARE WILLING TO PAY IN TAXES, IN 2004

% of sales

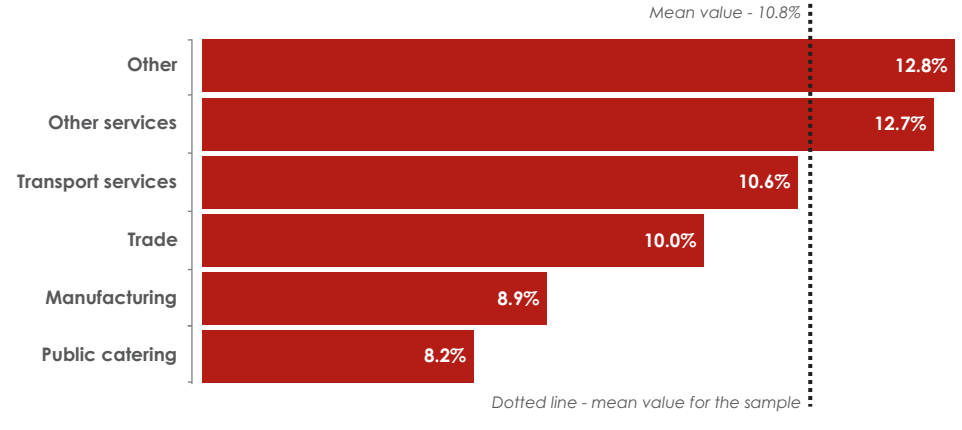
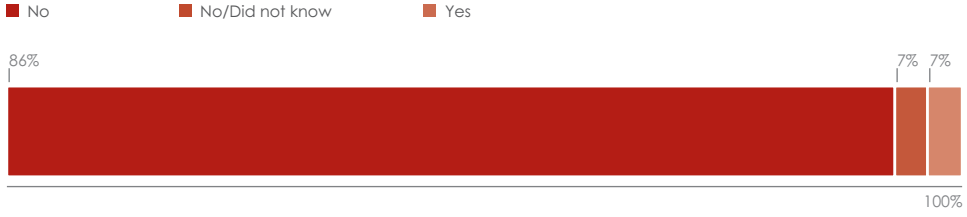


Chart 20.22
RESPONDENTS REQUIRED BY TAX AUTHORITIES TO SUBMIT ADDITIONAL INFORMATION NOT STIPULATED BY LEGISLATION

% of individual entrepreneurs



Individual entrepreneurs and banks

Chart 20.23
RESPONDENTS HAVING A BANK ACCOUNT IN 2004

% of individual entrepreneurs

Chart 20.24
DIFFICULTIES WITH BANKING TRANSACTIONS IN 2004

% of individual entrepreneurs, with bank accounts, who reported the given problem

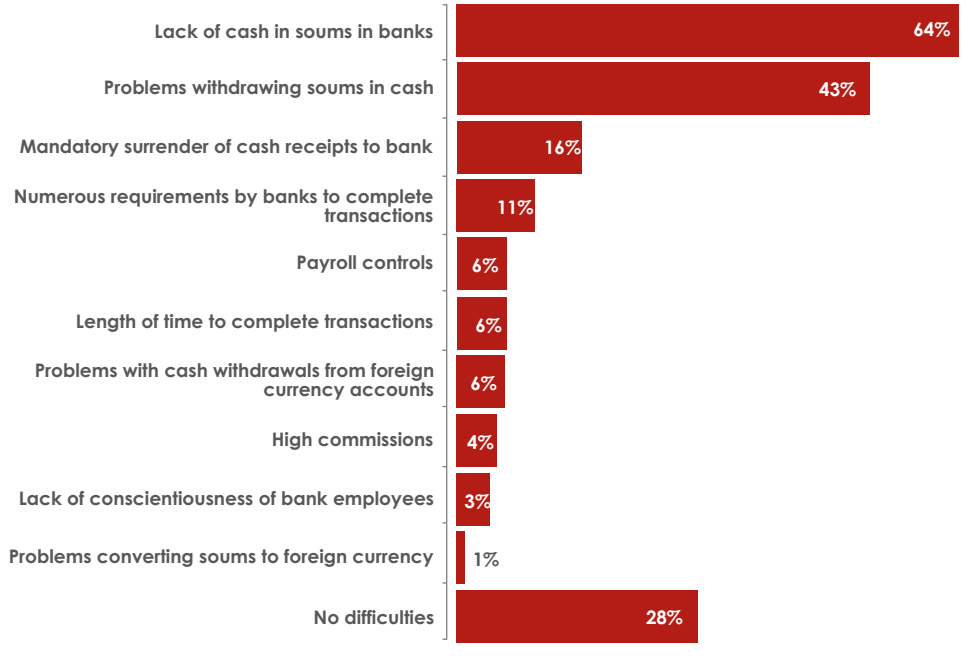


Chart 20.25
AVERAGE TIME TO COMPLETE ONE BANKING TRANSACTION IN 2004
number of business days

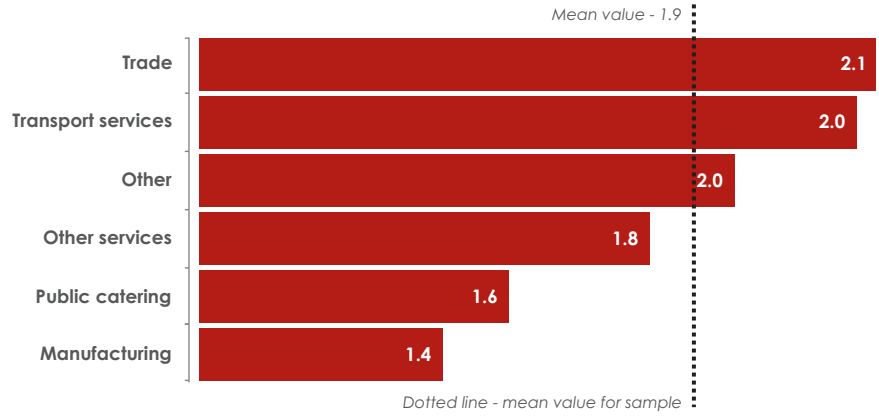


Chart 20.26
COMMERCIAL BANK CONTROL OF CASH PLAN IMPLEMENTATION AND INSPECTION OF CASH DISCIPLINE
% of individual entrepreneurs with bank accounts

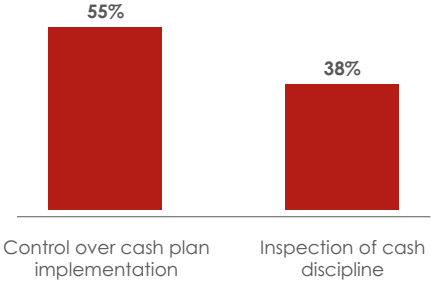


Chart 20.27
DISCLOSURE OF ACCOUNT INFORMATION BY BANKS TO OUTSIDE ORGANIZATIONS (BY ORGANIZATION) IN 2004
% of individual entrepreneurs, with bank accounts, who reported that the bank provides information to the given body

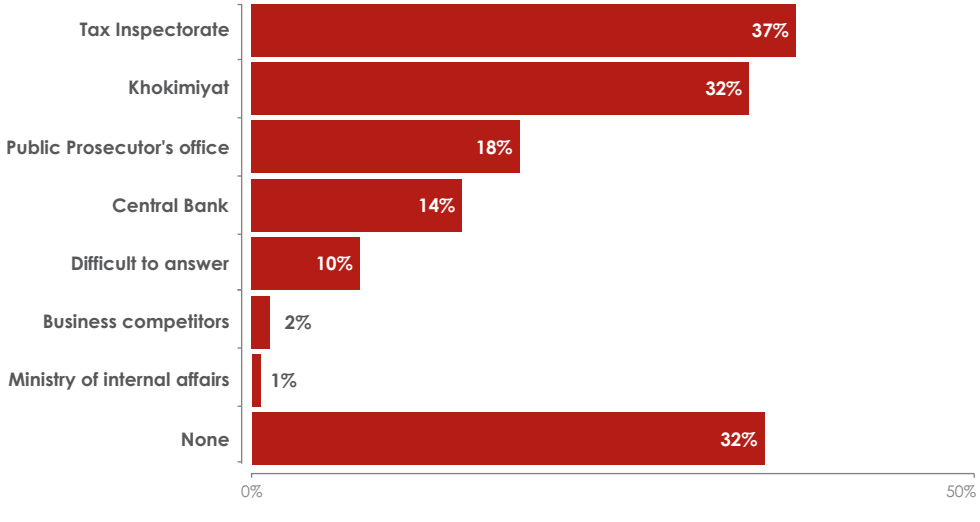


Chart 20.28
RESPONDENTS' ATTITUDE TOWARD DEBIT CARDS IN 2004
% of individual entrepreneurs

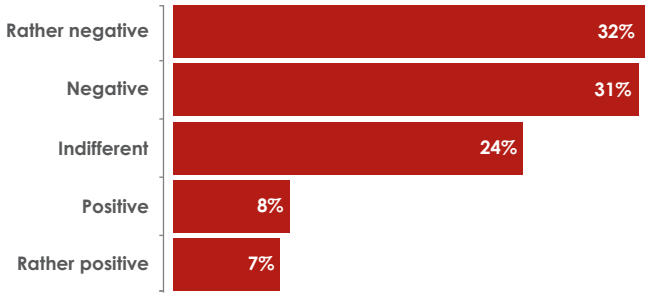


Chart 20.29
INVESTMENT IN FIXED ASSETS IN 2004
% of individual entrepreneurs

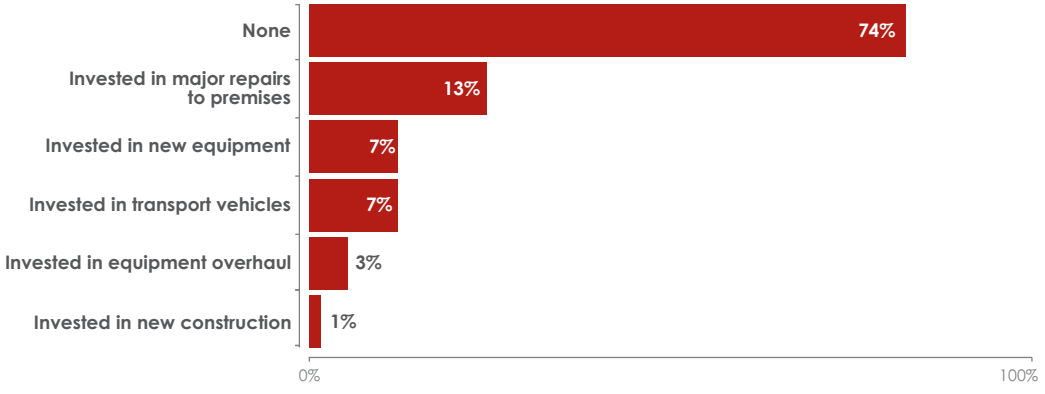


Chart 20.30
SOURCES OF FUNDS TO INVEST IN FIXED ASSETS IN 2004
% of individual entrepreneurs investing in fixed assets

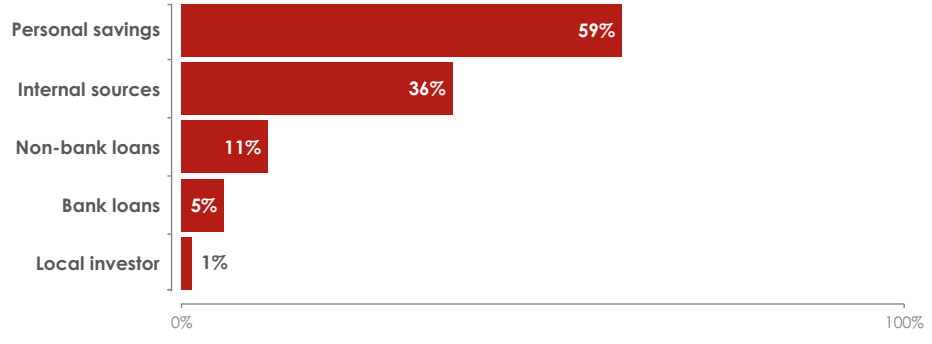


Chart 20.31
EXTERNAL FINANCING NEEDS, APPLICATION FOR BANK LOANS, AND LOANS MADE TO INDIVIDUAL ENTREPRENEURS

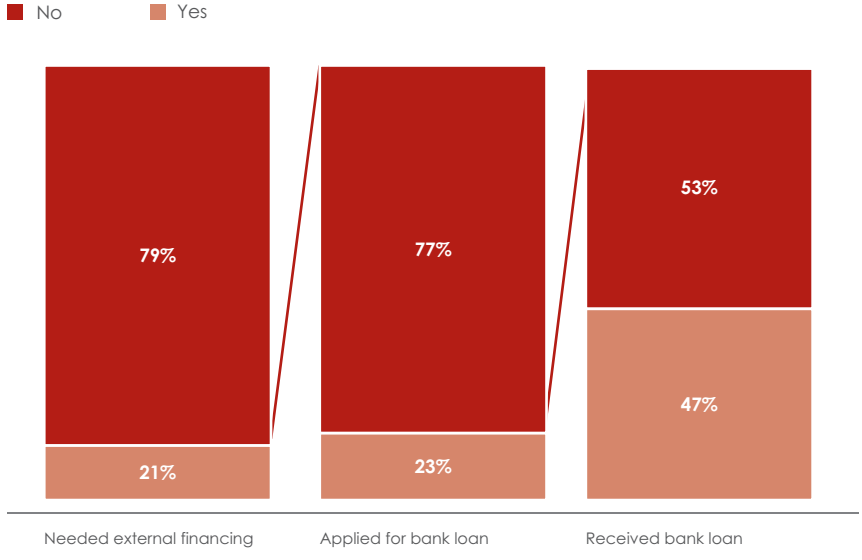
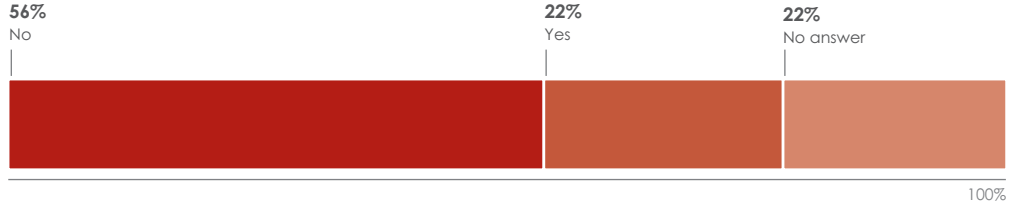


Chart 20.32
UNOFFICIAL PAYMENTS TO RECEIVE BANK LOANS IN 2004

% of individual entrepreneurs who received bank loans



Inspections

Chart 20.33
INDIVIDUAL ENTREPRENEURS' KNOWLEDGE OF LEGISLATION GOVERNING INSPECTIONS IN 2004

% of individual entrepreneurs

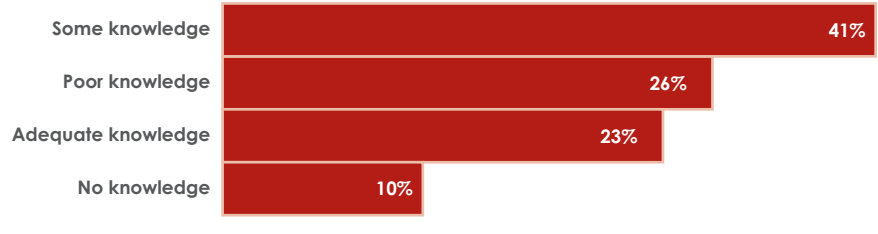


Chart 20.34
UNOFFICIAL PAYMENTS DURING INSPECTIONS IN 2004

% of individual entrepreneurs inspected

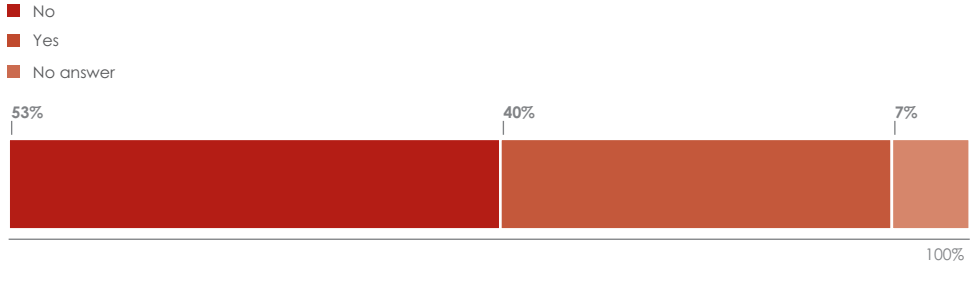
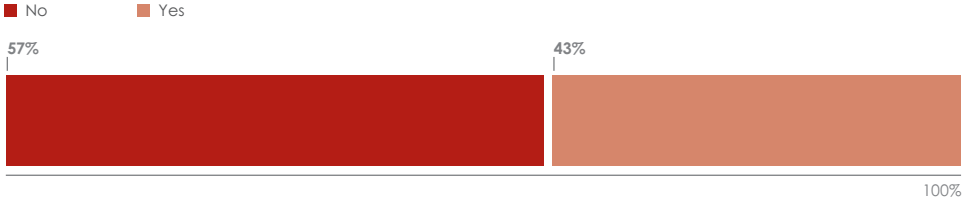


Chart 20.35
RESPONDENTS' ASSESSMENT OF THE COST OF INSPECTIONS IN 2004
% of individual entrepreneurs inspected

Chart 20.36
RESPONDENTS HAVING AN INSPECTIONS REGISTRATION BOOK
% of individual entrepreneurs



Licensing

Chart 20.37
UNOFFICIAL PAYMENTS TO OBTAIN LICENCES IN 2004
% of individual entrepreneurs obtaining licences

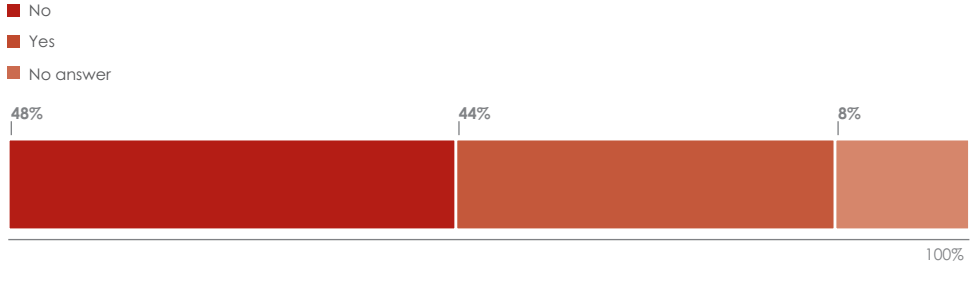


Chart 20.38
RESPONDENTS' ASSESSMENT OF THE COST OF LICENCES
% of individual entrepreneurs obtaining licences

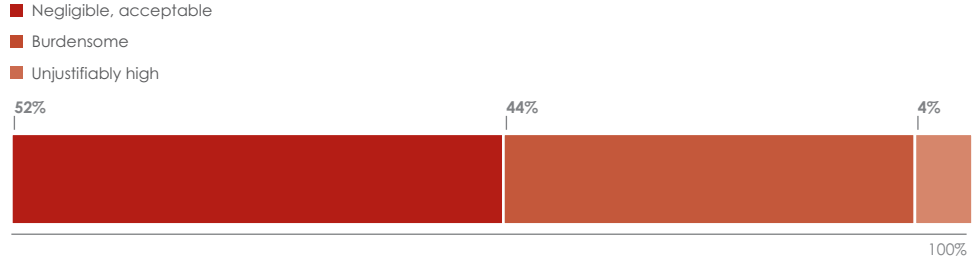


Chart 20.39
SETTING THE VALIDITY TERMS OF LICENCES IN 2004

% of individual entrepreneurs obtaining licences

Certification and Obtaining Standards

Chart 20.40
INDIVIDUAL ENTREPRENEURS OBTAINING CERTIFICATES IN 2004

% of individual entrepreneurs obtaining certificates

Chart 20.41
CERTIFICATES OBTAINED BY INDIVIDUAL ENTREPRENEURS IN 2004

% of individual entrepreneurs obtaining certificates

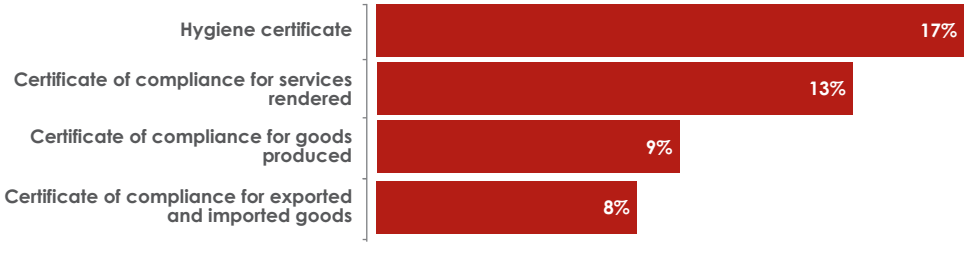


Chart 20.42
UNOFFICIAL PAYMENTS TO OBTAIN CERTIFICATION IN 2004

% of individual entrepreneurs obtaining certificates

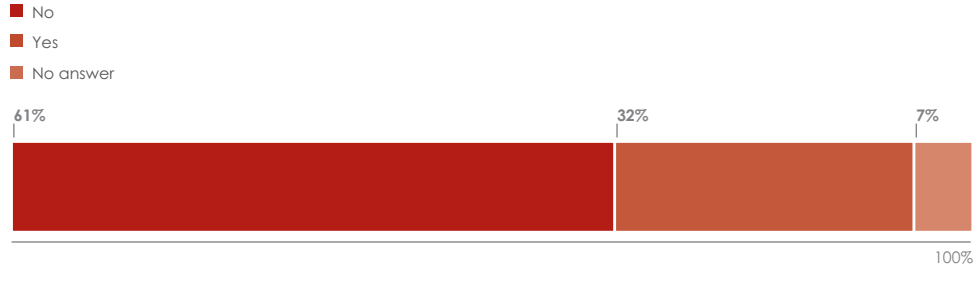
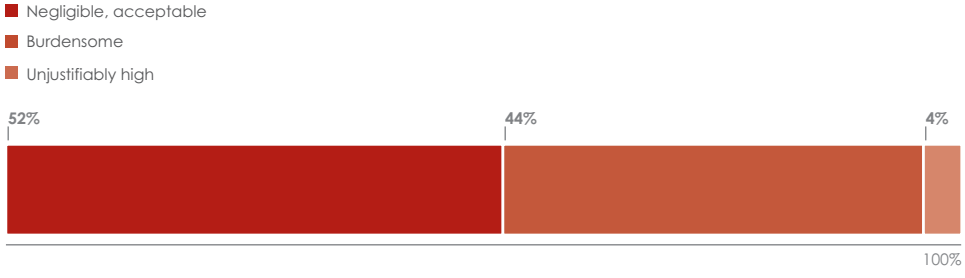


Chart 20.43
RESPONDENTS' ASSESSMENT OF THE COST OF CERTIFICATION
% of individual entrepreneurs obtaining certificates



Respondents' assessment of business environment

Chart 20.44
INDIVIDUAL ENTREPRENEURS' ASSESSMENT OF WORKING TIME SPENT TO RESOLVE ISSUES WITH STATE BODIES IN 2004
% of individual entrepreneurs

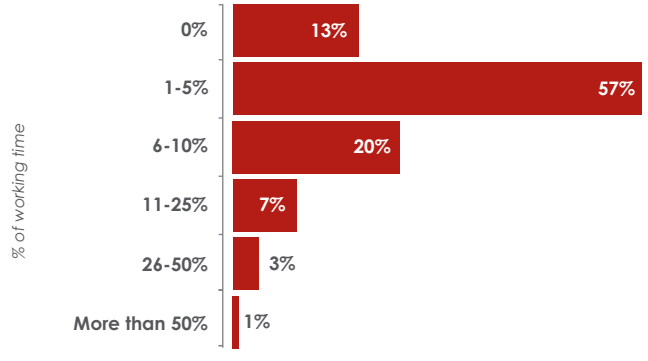


Chart 20.45
INDIVIDUAL ENTREPRENEURS' KNOWLEDGE OF LEGISLATION GOVERNING THEIR ACTIVITY
% of individual entrepreneurs

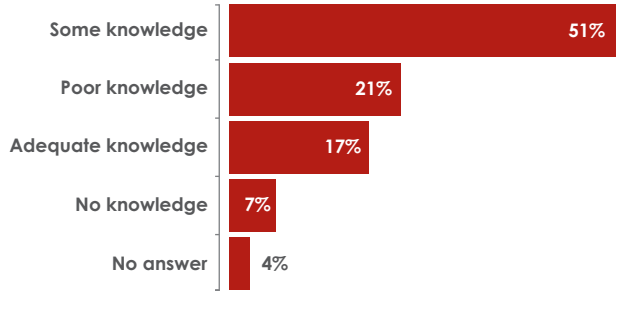


Chart 20.46
INDIVIDUAL ENTREPRENEURS' AWARENESS OF AND CONTACT WITH THE DEPARTMENT FOR PROTECTION OF RIGHTS OF ENTREPRENEURS UNDER THE MINISTRY OF JUSTICE IN 2004
% of individual entrepreneurs

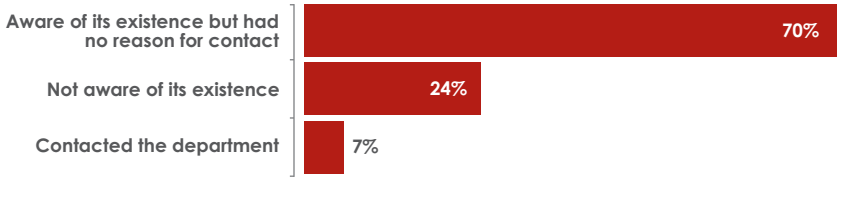


Chart 20.47
MEMBERSHIP IN BUSINESS ASSOCIATIONS AND ORGANIZATIONS

% of individual entrepreneurs

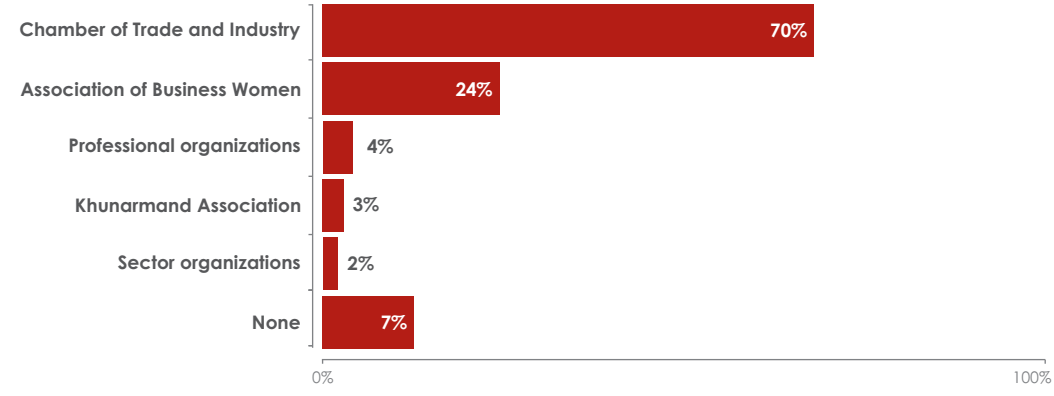


Chart 20.48
PROBLEMS FOR TRADE IN THE REGIONS IN 2004

% of individual entrepreneurs

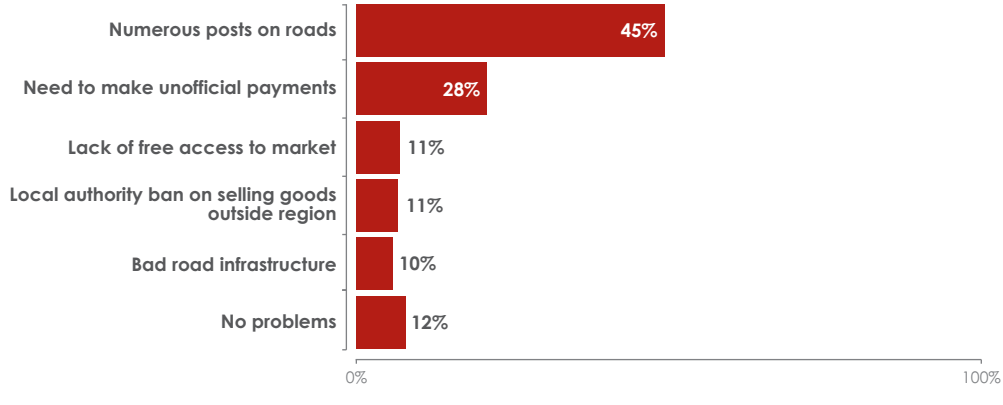
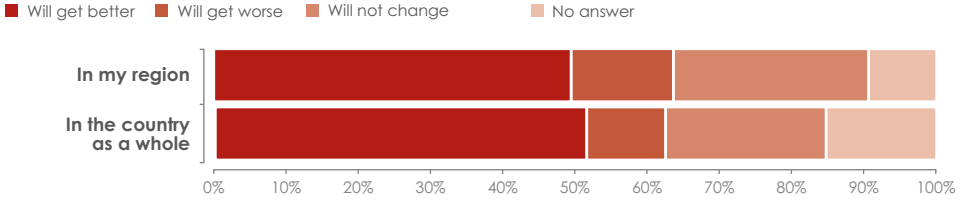


Chart 20.49
WOULD INDIVIDUAL ENTREPRENEURS, BASED ON THEIR EXPERIENCE, START THEIR BUSINESSES AGAIN?

% of individual entrepreneurs

Chart 20.50
INDIVIDUAL ENTREPRENEURS' EXPECTATIONS OF HOW THE BUSINESS ENVIRONMENT WILL CHANGE IN THE NEXT 12 MONTHS. 2004

% of individual entrepreneurs



METHODOLOGY AND KEY FACTS ABOUT THE SURVEY

This report is based on the results of a survey undertaken by an independent research firm in January-February 2005. The research firm's staff conducted on-site interviews using a specially developed questionnaire.

This year, the number of respondents was increased to 3,000 with the inclusion of individual entrepreneurs into the sample and an increase in the number of enterprises engaged in foreign trade. This category of respondents was the subject of a separate survey undertaken by the IFC in April 2005.

Respondents were classified according to the legislation that came into effect as of January 1, 2004.[1] The law says that SMEs include only micro-firms and small businesses. The definition of "medium-size businesses" that existed prior to 2004 is absent from the new classification. Detailed definitions of SMEs are presented in Annex 11.

The results of the survey were discussed in focus groups consisting of representatives of a number of state agencies, the Chamber of Commerce and Industry of Uzbekistan, and entrepreneurs. This methodology was used to evaluate the results and main findings for each part of the questionnaire. Experts provided assessments of data relating to a number of questions.

SAMPLE SELECTION

To conduct the survey a multi-tiered, a randomly selected sample of respondents was created, corrected for regional differences. The random respondent selection was based on established selection criteria for Uzbekistan's regions and economic sectors and the size of SMEs. At the regional level, the survey was conducted at region centers and neighboring settled areas. The sample consisted of SMEs from each of the country's 12 regions, the Republic of Karakalpakstan and city of Tashkent as they existed at the time of the survey. Respondents were the owners or high-level management decision-makers of enterprises.

Data, current as of January 1, 2005, drawn from official State Committee for Statistics of the Republic of Uzbekistan data on the country's entire SME community, was used to ensure that all economic sectors and regions of the country were included in the sample.

The criteria for the sample were as follows:

- Economic sectors in which SMEs were engaged;
- The country's regions in which SMEs operated;
- The number of small businesses and micro-firms by economic sector and region of Uzbekistan.

The quantitative and qualitative features of the sample, as well as the survey method, made it possible to gather data compatible with the data in the surveys IFC conducted in Uzbekistan in 2002, 2003 and 2004.

The breakdown of the entire SME community of Uzbekistan by economic sector and region is as follows:

[1] Resolution 439 of the Cabinet of Ministers of the Republic of Uzbekistan, October 11, 2003.

Chart 7.1
SAMPLE STRUCTURE
number of units

Chart 7.2
MICRO-FIRMS AND SMALL BUSINESSES, BY SECTOR

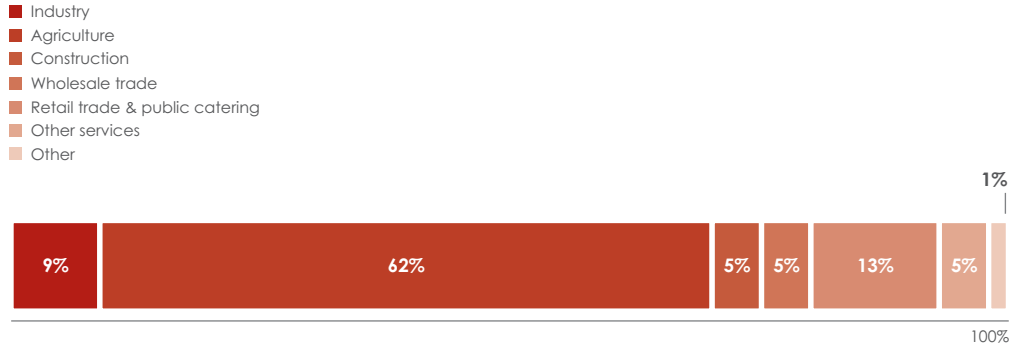


Chart 7.3
RESPONDENTS, BY MANAGEMENT POSITION

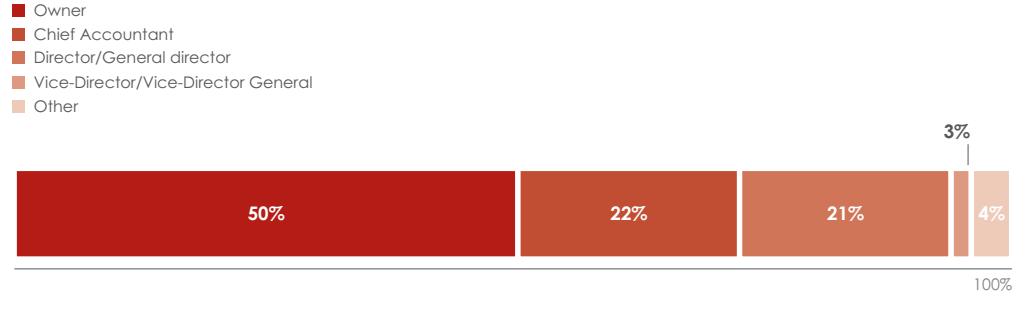
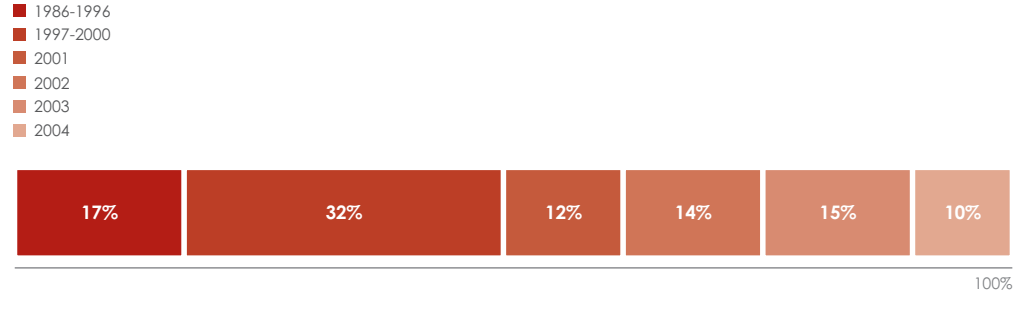


Chart 7.4
SAMPLE STRUCTURE BY YEARS IN BUSINESS



	SMEs total number	Small businesses	Micro-firms	% of total number of SMEs
Industry	**20069**	1830	18239	8
Agriculture	**146177**	7575	138602	62
Construction	**10940**	897	10043	5
Wholesale trade	**11425**	904	10521	5
Retail trade & public catering	**30481**	2497	27984	13
Other services	**12860**	1279	11581	5
Other	**5550**	561	4989	2
Total in the Republic of Uzbekistan	**237502**	**15543**	**221959**	**100**

	SME total number	Small businesses	Micro-firms	% of total number of SMEs
Republic of Karakalpakstan	**12324**	591	11733	5
Andijan region	**18613**	1130	17483	8
Bukhara region	**18856**	755	18101	8
Jizzak region	**15406**	399	15007	6
Kashkadarya region	**41678**	1079	40599	18
Navoi region	**8640**	413	8227	4
Namangan region	**12036**	938	11098	5
Samarkand region	**20836**	1408	19428	9
Surkhandarya region	**12292**	1113	11179	5
Syrdarya region	**10520**	468	10052	4
Tashkent region	**17329**	1420	15909	7
Fergana region	**18190**	1695	16495	8
Khorezm region	**12913**	623	12290	5
Tashkent city	**17869**	3511	14358	8
Total in the Republic of Uzbekistan	**237502**	**15543**	**221959**	**100**

	Total	Small businesses	Micro-firms
Industry	8%	12%	8%
Agriculture	62%	49%	62%
Construction	5%	6%	5%
Wholesale trade	5%	6%	5%
Retail trade & public catering	13%	16%	13%
Other services	5%	8%	5%
Other	2%	4%	2%
Total in the Republic of Uzbekistan	**100%**	**7%**	**93%**

Republic of Karakalpakstan

Sectors	Total	Small businesses	Micro-firms
Industry	8	0	8
Agriculture	83	4	79
Construction	9	1	8
Wholesale trade	5	0	5
Retail trade & public catering	14	1	13
Other services	8	0	8
Other	3	0	3
Total	**130**	**6**	**124**

Andijan region

Sectors	Total	Small businesses	Micro-firms
Industry	30	2	28
Agriculture	83	5	78
Construction	12	1	11
Wholesale trade	29	2	27
Retail trade & public catering	29	2	27
Other services	9	0	9
Other	4	0	4
Total	**196**	**12**	**184**

Bukhara region

Sectors	Total	Small businesses	Micro-firms
Industry	14	1	13
Agriculture	134	5	129
Construction	8	0	8
Wholesale trade	11	0	11
Retail trade & public catering	20	1	19
Other services	8	1	7
Other	3	0	3
Total	**198**	**8**	**190**

Jizzak region

Sectors	Total	Small businesses	Micro-firms
Industry	4	0	4
Agriculture	140	4	136
Construction	3	0	3
Wholesale trade	2	0	2
Retail trade & public catering	8	0	8
Other services	3	0	3
Other	2	0	2
Total	**162**	**4**	**158**

Kashkadarya region

Sectors	Total	Small businesses	Micro-firms
Industry	14	0	14
Agriculture	356	9	347
Construction	12	1	11
Wholesale trade	4	0	4
Retail trade & public catering	41	1	40
Other services	8	0	8
Other	4	0	4
Total	**439**	**11**	**428**

Navoi region

Sectors	Total	Small businesses	Micro-firms
Industry	6	1	5
Agriculture	61	3	58
Construction	4	0	4
Wholesale trade	4	0	4
Retail trade & public catering	9	0	9
Other services	5	0	5
Other	2	0	2
Total	**91**	**4**	**87**

Namangan region

Sectors	Total	Small businesses	Micro-firms
Industry	12	1	11
Agriculture	76	6	70
Construction	6	0	6
Wholesale trade	7	1	6
Retail trade & public catering	16	1	15
Other services	8	1	7
Other	3	1	2
Total	**128**	**11**	**117**

Samarkand region

Sectors	Total	Small businesses	Micro-firms
Industry	23	2	21
Agriculture	121	8	113
Construction	10	1	9
Wholesale trade	14	1	13
Retail trade & public catering	35	3	32
Other services	11	1	10
Other	6	0	6
Total	**220**	**16**	**204**

Surkhandarya region

Sectors	Total	Small businesses	Micro-firms
Industry	11	1	10
Agriculture	70	7	63
Construction	8	1	7
Wholesale trade	8	1	7
Retail trade & public catering	23	2	21
Other services	6	0	6
Other	3	0	3
Total	**129**	**12**	**117**

Syrdarya region

Sectors	Total	Small businesses	Micro-firms
Industry	5	0	5
Agriculture	83	4	79
Construction	3	0	3
Wholesale trade	3	0	3
Retail trade & public catering	11	1	10
Other services	4	0	4
Other	2	0	2
Total	**111**	**5**	**106**

Tashkent region

Sectors	Total	Small businesses	Micro-firms
Industry	17	1	16
Agriculture	107	9	98
Construction	9	1	8
Wholesale trade	5	0	5
Retail trade & public catering	32	3	29
Other services	8	1	7
Other	4	0	4
Total	**182**	**15**	**167**

Fergana region

Sectors	Total	Small businesses	Micro-firms
Industry	16	1	15
Agriculture	121	11	110
Construction	8	1	7
Wholesale trade	11	1	10
Retail trade & public catering	20	2	18
Other services	11	1	10
Other	3	0	3
Total	**190**	**17**	**173**

Khorezm region

Sectors	Total	Small businesses	Micro-firms
Industry	8	0	8
Agriculture	101	5	96
Construction	4	0	4
Wholesale trade	4	0	4
Retail trade & public catering	11	1	10
Other services	6	0	6
Other	2	0	2
Total	**136**	**6**	**130**

Tashkent city

Sectors	Total	Small businesses	Micro-firms
Industry	45	9	36
Agriculture	2	0	2
Construction	19	4	15
Wholesale trade	14	3	11
Retail trade & public catering	52	10	42
Other services	39	8	31
Other	17	3	14
Total	**188**	**37**	**151**

Individual entrepreneurs

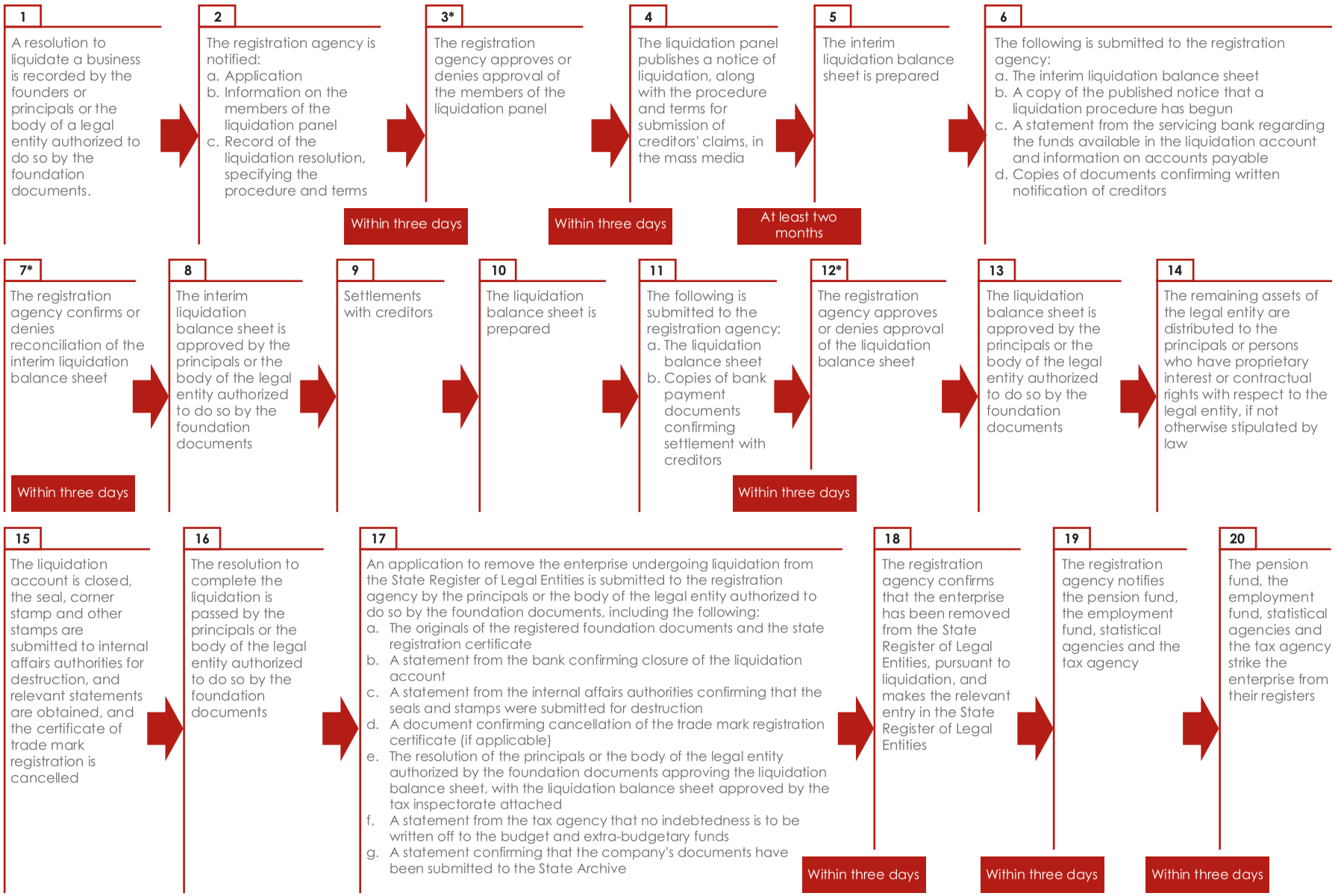
Region	Number of entrepreneurs in the sample	Retail trade	Transportation services	Consumer services	Public catering	Production of consumer goods	Butchers	Other
Republic of Karakalpakstan	10	4	3	1	0	1	0	1
Andijan region	50	10	15	6	1	9	2	7
Bukhara region	25	5	6	4	1	5	1	3
Jizzak region	16	4	3	2	1	3	1	2
Kashkadarya region	35	10	6	4	1	5	1	8
Navoi region	19	6	5	2	0	2	1	3
Namangan region	31	3	5	6	1	5	1	10
Samarkand region	48	13	14	5	1	8	2	5
Surkhandarya region	26	6	8	3	1	4	1	3
Syrdarya region	10	3	2	1	0	2	1	1
Tashkent region	29	8	5	5	1	4	1	5
Fergana region	33	7	5	5	1	9	2	4
Khorezm region	18	5	3	2	1	4	1	2
Tashkent city	50	20	2	10	1	9	2	6
Total	**400**	**104**	**82**	**56**	**11**	**70**	**17**	**60**

Participants in foreign trade

	Total	Exporters	Importers	Export Import
Tashkent city	**80**	32	32	16
Kashkadarya region	**10**	4	4	2
Samarkand region	**10**	4	4	2
Total	**100**	**40**	**40**	**20**

Annex 1 to Overview of the Business Environment in Uzbekistan

VOLUNTARY LIQUIDATION

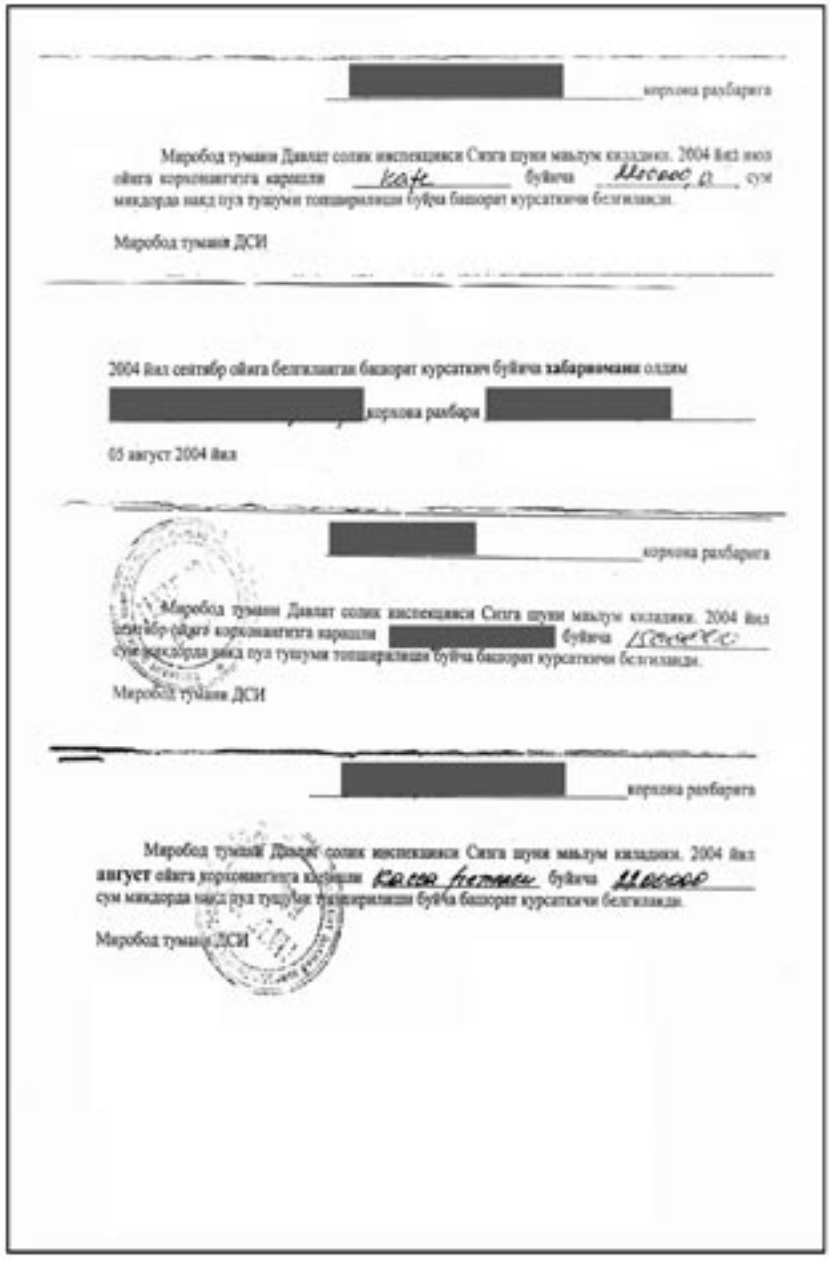


* - These approval procedures were eliminated by Annex 3 to Resolution PP-186 of the President of the Republic of Uzbekistan "On Reducing the Number of and Simplifying the Procedure for Issuing Permits to Start Entrepreneurial Activity," September 21, 2005.

Annex 2 to Overview of the business environment in Uzbekistan

THE ROLE OF LOCAL AUTHORITIES IN REGULATING CASH CIRCULATION

In discussing the "cash plan" in focus groups, participants noted that, starting in 2004, local authorities – Khokimiyats – began to play a more active role than commercial banks were. Banks have actually transferred the function of setting the plan and monitoring cash collection to Khokimiyats, which, through local tax agencies, demand that entrepreneurs fulfill the cash collection plan. Entrepreneurs said that Khokimiyats apply all means of exerting pressure on them if they refuse to fulfill the cash plan. For instance, if an enterprise fails to fulfill the plan, its trade permit can be revoked or an ad hoc or short-term inspection can be conducted by tax agencies.



Мирабод тумани Давлат солиқ инспекцияси Сизга шуни маълум қиладики, 2004 йил июл ойига корхонангизга кафе бўйича 2200000 сўм миқдорда нақд пул тушуми тақсимланиши бўйича башорат курсаткичи белгиланди.

Мирабод тумани ДСИ

2004 йил сентябр ойига белгиланган башорат курсаткич бўйича **хабарномани** олдим

05 август 2004 йил

Мирабод тумани Давлат солиқ инспекцияси Сизга шуни маълум қиладики, 2004 йил сентябр ойига корхонангизга кафе бўйича 1500000 сўм миқдорда нақд пул тушуми тақсимланиши бўйича башорат курсаткичи белгиланди.

Мирабод тумани ДСИ

Мирабод тумани Давлат солиқ инспекцияси Сизга шуни маълум қиладики, 2004 йил **август** ойига корхонангизга кафе бўйича 1500000 сўм миқдорда нақд пул тушуми тақсимланиши бўйича башорат курсаткичи белгиланди.

Мирабод тумани ДСИ

The tax inspectorate of Mirabad District informs you that the estimated amount of cash to be contributed to the account of your enterprise (café) in July 2004 is **2,200,000 soums.**

Mirabad District Tax Inspectorate

The tax inspectorate of Mirabad District notifies you that based on the estimates of the tax inspectorate your enterprise shall turn in cash to your bank account in the amount of **1,500,000 soums.**

Mirabad District Tax Inspectorate

Annex 3 to Inspections

ANALYSIS OF LEGISLATION REGULATING INSPECTION OF INDIVIDUAL ENTREPRENEURS

In practice, the legislation governing the procedure for directing and conducting inspections of economic entities does not regulate state control over the activity of individual entrepreneurs. This conclusion is based on two factors.

FIRSTLY, THERE IS THE PROBLEM OF TERMINOLOGY.

Law 717-I "On State Control over the Activity of Economic Entities," December 24, 1998, intended to regulate state control over the activity of economic entities, does not include a definition of "economic entity". The term is present in Article 3 of the law "*On Competition and Restriction of Monopolistic Activity in Commodity Markets," December 27, 1997, where it is defined as a legal entity of any organizational and legal form including a foreign entity engaged in the production, sale and acquisition of goods and provision of services, its amalgamations, as well as an individual engaged in entrepreneurial activity without the establishment of a legal entity.*

However, examining the context of the law "On State Control over the Activity of Economic Entities," the term economic entity implies only a legal entity, the activity of which it regulates, since it states that the activity of individual entrepreneurs is regulated by other regulatory acts.

The Law "On State Control over the Activity of Economic Entities"

Article 9. *Grounds for conducting a standard inspection including an audit of the activity of economic entities that are legal entities by inspectorates, with the exception of cases stipulated in Part 2 of the present Article are as follows:*

- *an excerpt from the coordinating plan of inspections of the activity of businesses issued by a special authorized agency or its relevant territorial unit;*
- *an order of a inspectorates issued on the basis of the coordinating plan or a decision of a special authorized body on conducting an ad hoc inspection including an audit, with the indication of inspection objectives, the structure of the inspecting group and the terms of inspection…*

Article 13. *Inspections of the activity of individual entrepreneurs are conducted by tax or other inspectorates within the limits of their powers and in accordance with the procedure established by law.*

SECONDLY, THERE ARE NO REGULATORY ACTS GOVERNING THE PROCEDURE FOR DIRECTING AND CONDUCTING INSPECTIONS OF INDIVIDUAL ENTREPRENEURS.

There is currently no regulatory act governing the procedure for directing and conducting inspections of the entrepreneurial activity of individuals. In effect, none of the legal and regulatory acts that govern inspections governs their relationship to individual entrepreneurs; they refer to other regulatory acts without specifying which ones.

The Law "On State Control over the Activity of Economic Entities":

Article 13. *Inspections of the activity of individual entrepreneurs are conducted by tax and other inspectorates within the limits of their powers and in accordance with the procedure established by law.*

Regulations on the procedure for conducting inspections of the activity of economic entities and keeping the Inspections Registration Book (new version) (approved by Order 917-1 of the Minister of Justice, registered by the Ministry of Justice on May 15, 2001), which is a regulatory act, refers to the regulatory documents of the Inspections Coordination Council:

Subparagraph 4, *Paragraph 13. Grounds for conducting inspections of the activity of individual entrepreneurs are regulated by the regulatory documents approved by the Council.*

Regulations "On the Procedure for Coordinating Inspections of the Activity of Economic Entities" Conducted by Inspectorates (amended), approved by Resolution 01 of the Inspections Coordination Council on April 23,2001, which is the main regulatory document of this body, also contains only a referral:

Paragraph 30. *Inspections of the activity of individual entrepreneurs are conducted by inspectorates within the limits of their powers and in accordance with the procedure established by law.*

Annex 4 to Inspections

CRITERIA FOR SELECTING ENTERPRISES FOR INSPECTIONS IN SOME FOREIGN COUNTRIES

REPUBLIC OF LATVIA:

INSPECTORATE	RISK LEVEL	CRITERIA FOR SELECTING BUSINESSES TO BE INSPECTED		FREQUENCY OF INSPECTIONS (BASED ON THE RISK LEVEL)	COORDINATION OF INSPECTIONS
State fire-fighting and rescue service	High risk/hazard (A)	Businesses where highly explosive and flammable chemical substances and chemical products (hereinafter referred to as flammable substances) are kept for at least 2 days:	Especially easily flammable, easily flammable and flammable chemical substances and chemical products in the amount of 5,000 to 50,000 tons.	Legislation does not limit inspection frequency. Based on risk assessment, each inspectorate annually compiles a plan setting its own inspections frequency (for businesses with average and low risk, no more than every two years.)	Inspections Coordination Council, whose only function is to establish information contacts between the inspectorates.
		Facilities of railway stations and railway infrastructure in which hazardous freight is carried and near which the volume of flammable substances simultaneously stored exceeds the established minimum amounts.	Liquid combustible chemical substances and chemical products, from 10,000 to 100,000 tons.		
			Explosive gases (under normal circumstances and normal pressure) from 10,000 to 100,000 m3.		
			Especially easily flammable, easily flammable and flammable chemical substances and chemical products, from 5,000 to 50,000 tons.		
		Facilities recognized by the Cabinet of Ministers as especially significant on the advice of the Ministry of Internal Affairs.[1]	Liquid combustible chemical substances and chemical products, from 10,000 to 100,000 tons.		
			Explosive gases (under normal circumstances and normal pressure) from 10,000 to 100,000 m3.		
	Average risk/ hazard (B)				
	Low risk/hazard (C)				

[1] See Attachment 1 to the Table

GERMANY:

INSPECTORATE	RISK LEVEL	CRITERIA FOR SELECTING BUSINESSES TO BE INSPECTED	FREQUENCY OF INSPECTIONS (BASED ON THE RISK LEVEL)	COORDINATION OF INSPECTIONS
State tax authority	High risk/hazard (A)	Large businesses.	No less than once a year, but no more than once in six months.	Inspections are not coordinated by a single authority. However, there are interdepartmental agreements on collaboration in the area of control (for example, in conducting inspections related to environmental protection.)
		Businesses identified for priority inspection by the tax calculation unit, as well as other inspectorates with grounds for an inspection (if there is doubts concerning the reliability of tax statements and accounting reports.) Businesses that have not been inspected for a long time.	Frequency of other inspections is not regulated by law. Based on risk assessment, each inspectorate annually compiles a plan setting its own inspections frequency (for businesses with average and low risk, no more than every two years.)	
	Average risk/hazard (B)			
	Low risk/hazard (C)			

ENGLAND, CARDIFF COUNTY:

INSPECTO-RATE	RISK LEVEL	NUMBER OF BUSINESSES TO BE INSPECTED	FREQUENCY OF INSPECTIONS (BASED ON THE RISK LEVEL)	NUMBER OF FACILITIES TO BE INSPECTED IN 2004/2005	ASSESSMENT TO IDEN-TIFY THE RISK CATEGORY OF THE BUSINESSES (BASED ON POINTS)	COORDINATION OF INSPECTIONS
Environ-mental protection and health agency						Inspections are not coordinated by a single authority. However, there are interdepartmental agreements on collaboration in the area of control (for example, in conducting inspections related to environmental protection.)
	High risk/hazard (A)	8	Once a year	8	>=186	
	Average risk/hazard (B1)	14	Every 2 years	1	171-185	
	Average risk/hazard (B2)	55	Every 3 years	10	156-170	
	Average risk/hazard (B3)	124	Every 4 years	4	141-155	
	Average risk/hazard (B4)	203	Every 5 years	34	126-140	
	Low risk/hazard (C)	968	Every 10 years	34	<=125	

CANADA:

INSPECTORATE	RISK LEVEL	CRITERIA FOR SELECTING BUSINESSES TO BE INSPECTED	FREQUENCY OF INSPECTIONS (BASED ON THE RISK LEVEL)	COORDINATION OF INSPECTIONS
Food inspection agency	High risk/ hazard	Preparation of hazardous foodstuffs (any foodstuff with the potential to develop toxin-producing pathogens.) Multistage storage and processing of foodstuffs that often cause dangerous food-related diseases. Example: Restaurant with a full assortment of dishes; large banquet halls.	No less than every 4 months (3 times a year.)	Inspections are not coordinated by a single authority. However, there are interdepartmental agreements on collaboration in the area of control (for example, in conducting inspections related to environmental protection.)
	Average risk	Preparation of hazardous foodstuffs. Preparation of non-hazardous foodstuffs in large amounts. Example: Snack bars, bakeries.	No less than every 6 months (twice a year.)	
	Low risk	No preparation of hazardous foodstuffs. Sale of hermetically sealed perishable foodstuffs. Preparation and distribution of non-hazardous products. Example: Multi-purpose general stalls, premises for storing partially prepared foods.	No less than every 12 months (once a year.)	

JORDAN:

INSPECTORATE	RISK LEVEL	CRITERIA FOR SELECTING BUSINESSES TO BE INSPECTED	FREQUENCY OF INSPECTIONS (BASED ON THE RISK LEVEL)	COORDINATION OF INSPECTIONS
Jordanian Customs Service	High risk/red line (A) Average risk/ yellow line (B) Low risk/green line (C)	The type of exported/imported products (more attention is paid to farm produce, telecommunications equipment, and manufacturing equipment.) Imported products subject to high customs duties and taxes. Products imported from certain countries, from which imported goods previously violated standards set by law. History of importer/exporter (for example, a stable business engaged in import/export for a long time.) Incidence of violations by the business. Other criteria.	Frequency of inspections is not regulated by law. Based on risk assessment, each inspectorate annually compiles a plan setting its own inspections frequency (for businesses with average and low risk, no more than every two years.)	The activities of inspectorates are coordinated solely for purpose of establishing information contacts between agencies and organizing joint inspections.

MEXICO:

INSPECTO-RATE	RISK LEVEL	CRITERIA FOR SELECTING BUSINESSES TO BE INSPECTED	FREQUENCY OF INSPECTIONS (BASED ON THE RISK LEVEL)	COORDINATION OF INSPECTIONS
Labor inspection of Mexico	High risk (A) Average risk (B) Low risk (C)	There are over 156 criteria for selecting businesses to be inspected.	Frequency of inspections is not regulated by law. Based on risk assessment, each inspectorate annually compiles a plan setting its own inspections frequency (for businesses with average and low risk, no more than every two years.)	The activities of inspectorates are coordinated solely for the purpose of establishing information contacts between agencies.

NETHERLANDS:

INSPECTO-RATE	RISK LEVEL	CRITERIA FOR SELECTING BUSINESSES TO BE INSPECTED	FREQUENCY OF INSPECTIONS (BASED ON THE RISK LEVEL)	COORDINATION OF INSPECTIONS
Radio-com-munication agency	High risk (A) Average risk (B) Low risk (C)	There are over 50 criteria for selecting businesses to be inspected.	Frequency of inspections is not regulated by law. Based on risk assessment, each inspectorate annually compiles a plan setting its own inspections frequency (for businesses with average and low risk, no more than every two years.)	The activities of inspectorates are coordinated solely for purposes of establishing information contacts between agencies.

Annex 1 to Table

FACILITIES RECOGNIZED BY THE CABINET OF MINISTERS OF LATVIA AS ESPECIALLY SIGNIFICANT (HIGHLY EXPLOSIVE, FLAMMABLE MATERIALS AND ESPECIALLY SIGNIFICANT FACILITIES):

№	NAME OF FACILITY	LOCATION
I. Riga		
1	Petroleum terminal	22 Ezer St.
2	Petroleum storage depots and storehouses	7a Tvaik St.
3	Riga Shkirotava railway station	81b Krustpils St.
II. Riga Area		
4	TPS-2 production (thermal power station)	Atsone, area around Salaspis Square
5	Olain Petroleum storage depot	16th km of the Riga-Elgava highway, Olain District
6	Underground gas storage depot in Inchukalns	Ragana, Krimulda District
III. Daugavpils and Daugavpils Area		
7	Daugavpils railway station	138 A. Pumpura St.
8	Ilukste inline production controller's office (IPCO) (petroleum storage depot)	Ilukste IPCO, Shedere District
IV. Elgava		
9	Elgava railway station	1a Statisas St.
V. Liepaja		
10	Liepaja railway station	1 Emilias St., Liepaja
VI. Rezekne		
11	Rezekne-I railway station	11 Lokomotiviu St.
VII. Saldus Area		
12	Petroleum storage depot	Druva, Torni
VIII. Ventspils		
13	Chemical substances, chemical products and petroleum products terminal	66 Dzintaru St.
14	Petroleum products terminal	90 Dzintaru St.
15	Petroleum products terminal	75 Talsu St.
16	Petroleum products terminal	1 Dzelztselnieku St.

Annex 5 to Inspections

SAMPLE CHECKLIST FOR A FIRE PREVENTION SURVEILLANCE AGENCY

The checklist consists of a list of questions, including exhaustive detail on the items to be inspected (i.e. everything that an inspector will inspect) and a direction from the controlling authority specifying the measures to be taken by the entrepreneur to correct the shortcomings found and the entrepreneur's right to appeal the inspector's actions (or omissions) and decisions if they are unlawful in the entrepreneur's opinion. The introduction of such checklists should provide for their broad distribution among businesses.

In April 2005, fire prevention surveillance agencies tested checklists at seven gas stations, and in July 2005, the sanitary-epidemiological surveillance agencies tested them at 10 retail trade enterprises. The checklists for fire-prevention surveillance agencies included the following questions: availability of the documents required, availability and good condition of fire extinguishers, availability and good condition of the equipment required, compliance of the gas station area with minimum requirements, and availability of the relevant fire safety signs. The inspectors and the entrepreneurs who participated in the experiment agreed that the checklists facilitated the inspection procedure and made it more transparent. Both parties to the inspection made practical suggestions on improving checklists and expressed an interest in their widespread implementation.

Sample checklist

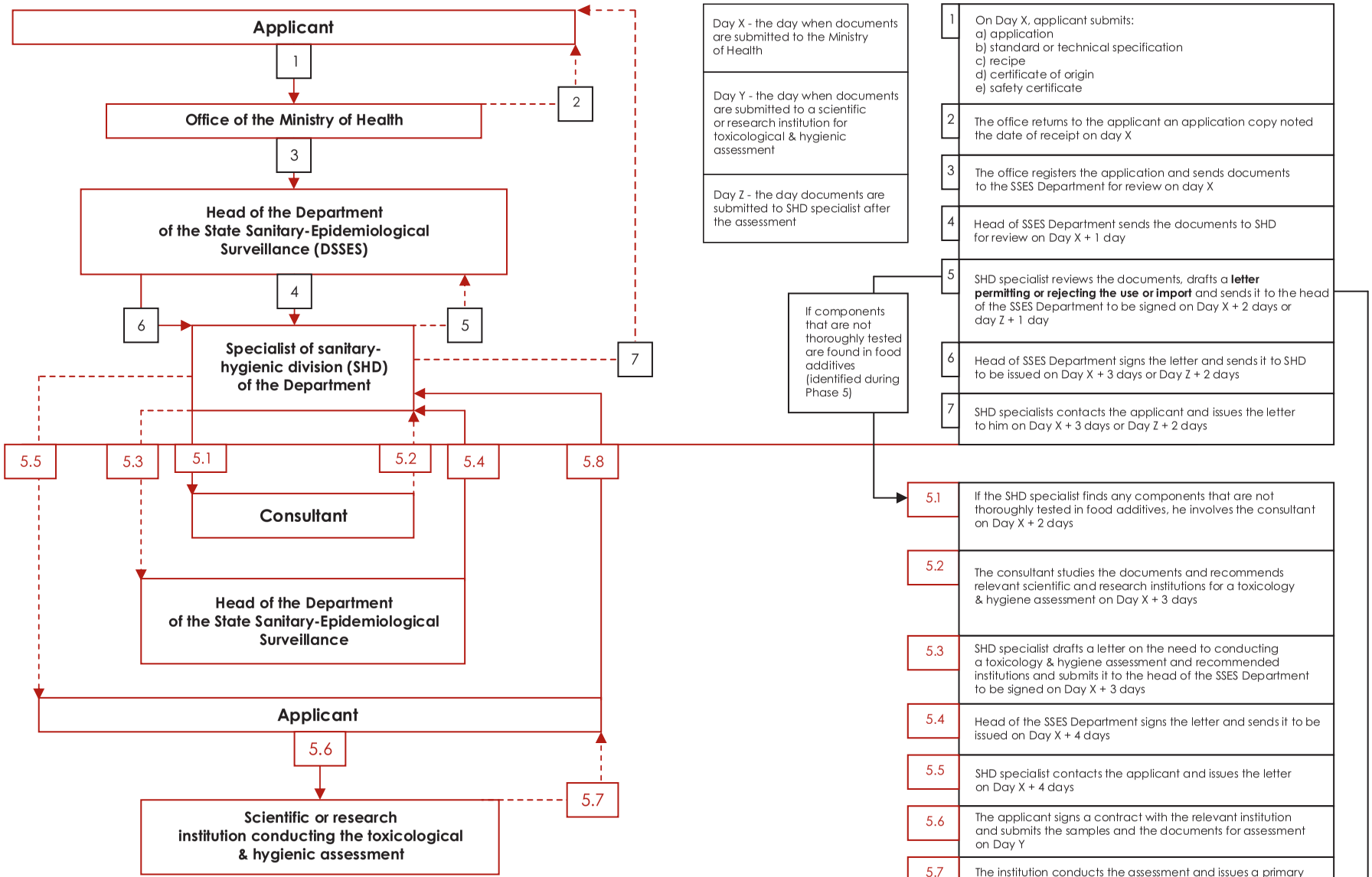
МИНИСТЕРСТВО ВНУТРЕННИХ ДЕЛ РЕСПУБЛИКИ УЗБЕКИСТАН
ГОСУДАРСТВЕННЫЙ ПОЖАРНЫЙ НАДЗОР

АКТ ПРОВЕРКИ АВТОЗАПРАВОЧНОЙ СТАНЦИИ АА 000000

КОНТРОЛЬНЫЙ СПИСОК ВОПРОСОВ

Annex 6 to Permits

PROCESS MAP[1] FOR OBTAINING PERMIT[2] TO USE IN PRODUCTION OR IMPORT FOOD ADDITIVES[3] NOT PREVIOUSLY CERTIFIED (REQUIRED TO OBTAIN A HYGIENE CERTIFICATE)



[1] The diagram was prepared jointly with the specialists of the Department of the State Sanitary-Epidemiological Surveillance under the Ministry of Health of the Republic of Uzbekistan.

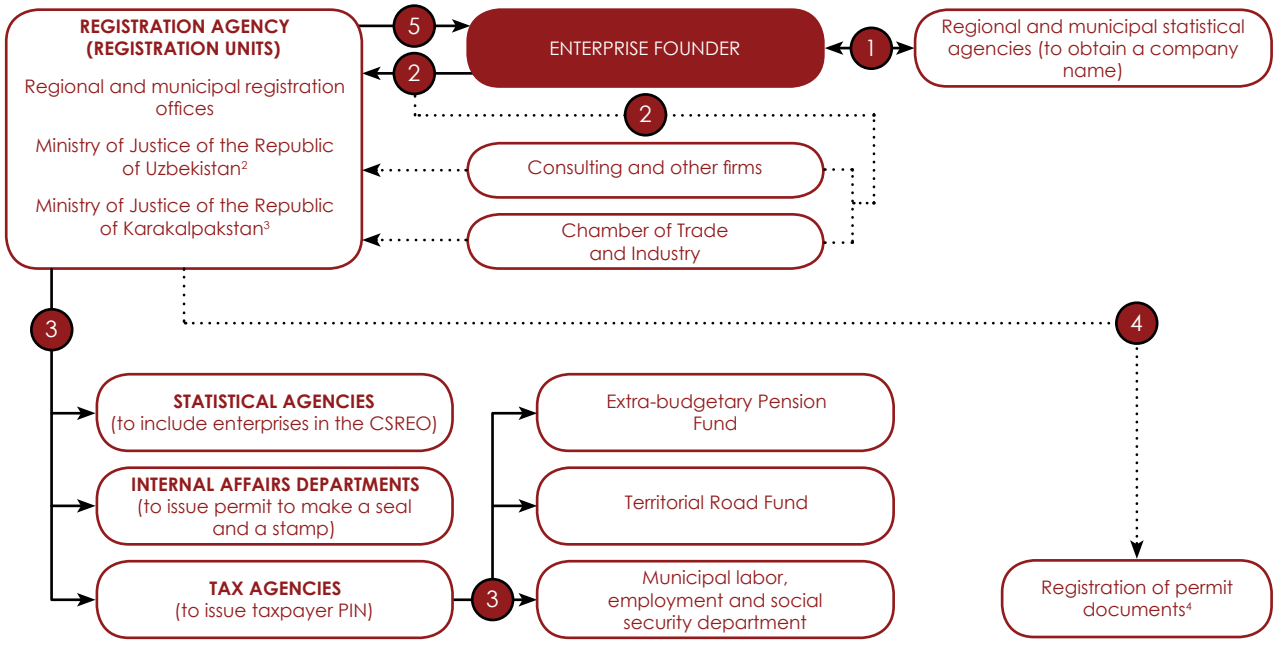
[2] The need to obtain this permit is stipulated by Para 8 of Regulations "On the Procedure for Produce Certification" (Annex 1 to Resolution 318 of the Cabinet of Ministers of the Republic of Uzbekistan, July 6, 2004.)

[3] Food additives are chemical substances used in the production of foodstuffs (substitutes, preservatives, dies, stabilizers, etc.)

To defray the costs of laboratory testing, a fee is charged, but no more than 10 times the minimum wage.

Annex 7 to Registration

REGISTRATION PROCEDURE FOR LEGAL ENTITIES[1]



SEQUENCE:

1. Submit application to statistical agencies to obtain a company name certificate:
   Time limit to review and issue certificate – 3 days
   Cost of certificate – free of charge.

2. Prepare and submit documents to the Regional or Municipal Registration Office (at the founders' option, can be done by the Chamber of Trade and Industry or by consulting or other firms):
   Registration time limit – 7 business days
   Registration cost – 5 times the minimum wage[4] (27,200 soums prior to August 1, 2004; 32,650 soums after August 1, 2004)[5].

3. The Registration Office submits documents to statistical, tax and internal affairs authorities for registration:
   – *inclusion in the CSREO*
   – *Internal Affairs department permit to make a seal and a stamp*
   – *registration as a payer of contributions to the extra-budgetary pension fund, employment fund and the road fund; taxpayer's PIN.*
   Time limit for each procedure – 2 days.
   Cost of each procedure – free of charge.

4. If applicable, the Registration Office obtains and registers necessary permits:
   Time limit – from 7 business days to one month, depending on the permit.
   Cost of each permit – from 10% of the minimum wage to 20 times the minimum wage, depending on the permit (544 to 108,800 soums prior to August 1, 2004 and 563 to 130,600 soums after August 1, 2004)[6].

5. Registration Office issues State Registration Certificate.

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1 Resolution 357 of the Cabinet of Ministers of the Republic of Uzbekistan, August 20, 2003.

2 The Ministry of Justice of the Republic of Uzbekistan registers audit and insurance firms, exchanges, and enterprises with foreign investment and markets established in Tashkent City.

3 The Ministry of Justice of the Republic of Karakalpakstan or oblast departments of justice register enterprises with foreign investment and markets established in the Republic of Karakalpakstan or oblasts.

4 Authorized bodies and public utility agencies issue permits for connection to supply lines, required for facility construction and reconstruction, and for reclassifying living quarters as non-residential property.

5 For registration of an economic entity by the Ministry of Justice of the Republic of Uzbekistan, the Ministry of Justice of the Republic of Karakalpakstan and oblast departments of justice, state duty is payable as follows:

5 times the minimum wage and $500 – enterprises with foreign investment;

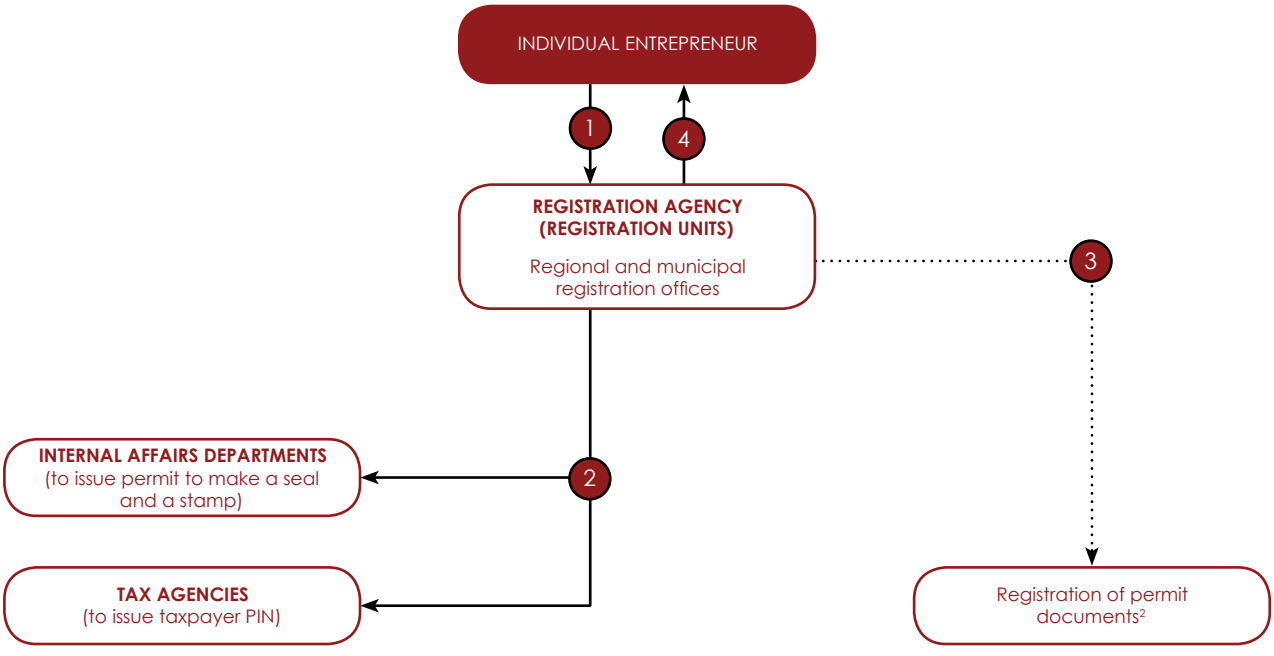
US $2,000 – enterprises with foreign investment whose authorized capital consists solely of foreign investment;

4 times the minimum wage – insurance and audit firms, exchanges, and markets.

6 The minimum wage in the first seven months of 2004 was 5,440 soums. In August 1, 2004, it was raised to 6,530 soums.

Annex 8 to Registration

REGISTRATION PROCEDURE FOR INDIVIDUAL ENTREPRENEURS[1]



SEQUENCE:

1. Prepare and submit documents to the Regional or Municipal Registration Office:
   Registration time-limit – 7 business days.
   Registration cost – 5 times the minimum wage (27,200 soums prior to August 1, 2004; 32,650 soums after August 1, 2004)[2].
2. The Registration Office submits information on the individual entrepreneur to tax and internal affairs authorities for registration:
   Time-limit for each procedure – 2 days;
   Cost of each procedure – free of charge.
3. If applicable, the Registration Office obtains necessary permits:
   Time-limit – from 7 business days to one month, depending on the permits;
   Cost of each permit – from 10% of the minimum wage to 20 times the minimum wage, depending on the permit (from 544 to 108,800 soums prior to August 1, 2004 and from 563 to 130,600 soums after August 1, 2004)[3].
4. The Registration Office issues the State Registration Certificate and hands permit to make a seal and a stamp along with other permits (if applicable) to the entrepreneur.

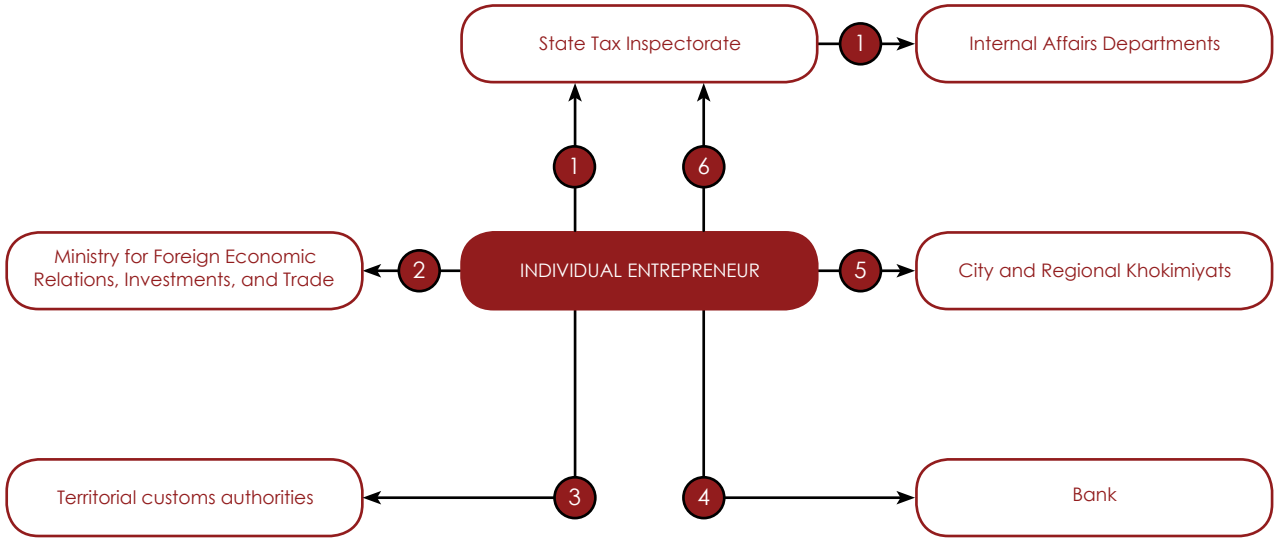
[1] Resolution 357 of the Cabinet of Ministers of the Republic of Uzbekistan, August 20, 2003.

[2] Authorized bodies and public utility agencies issue permits for connection to supply lines, required for facility construction and reconstruction, and for reclassifying living quarters as non-residential property.

[3] The minimum wage in the first seven months of 2004 was 5,440 soums. In August 1, 2004, it was raised to 6,530 soums.

Annex 9 to Registration

REGISTRATION PROCEDURE FOR INDIVIDUAL ENTREPRENEURS – IMPORTERS[1]



SEQUENCE:

1. Submit documents to the State Tax Inspectorate for state registration:
   Time-limit to review – 7 business days.
   Registration cost – 5 times the minimum wages (27,200 soums prior to August 1, 2004; 32,650 soums after August 1, 2004)[2].
   The State Tax Inspectorate issues: (a) a Certificate of State Registration of the Individual Entrepreneur; (b) registration (permit issuance) card; (c) copy of the permit of Internal Affairs Department to make a seal and a stamp.
2. Submit documents to MFER to obtain a Certificate of a Foreign Economic Relations Participant:
   Time-limit – 3 business days.
   Cost of certificate – 1 minimum wage[2].
3. Visit the territorial customs authorities to put a registration stamp in the registration (permit issuance) card:
   Time-limit – 2 business days.
   Cost – free of charge.
4. Open a bank account:
   Time-limit – 2 business days.
   Cost – no more than 1 minimum wage[2].
5. Obtain a permit to engage in retail trade from the Khokimiyat:
   Time-limit – not specified.
   Cost – free of charge.
6. Visit the State Tax Inspectorate to obtain a Registration Card of an Importer:
   Time-limit – 3 business days.
   The Registration Card of an Importer is a permit to engage in export-import transactions.

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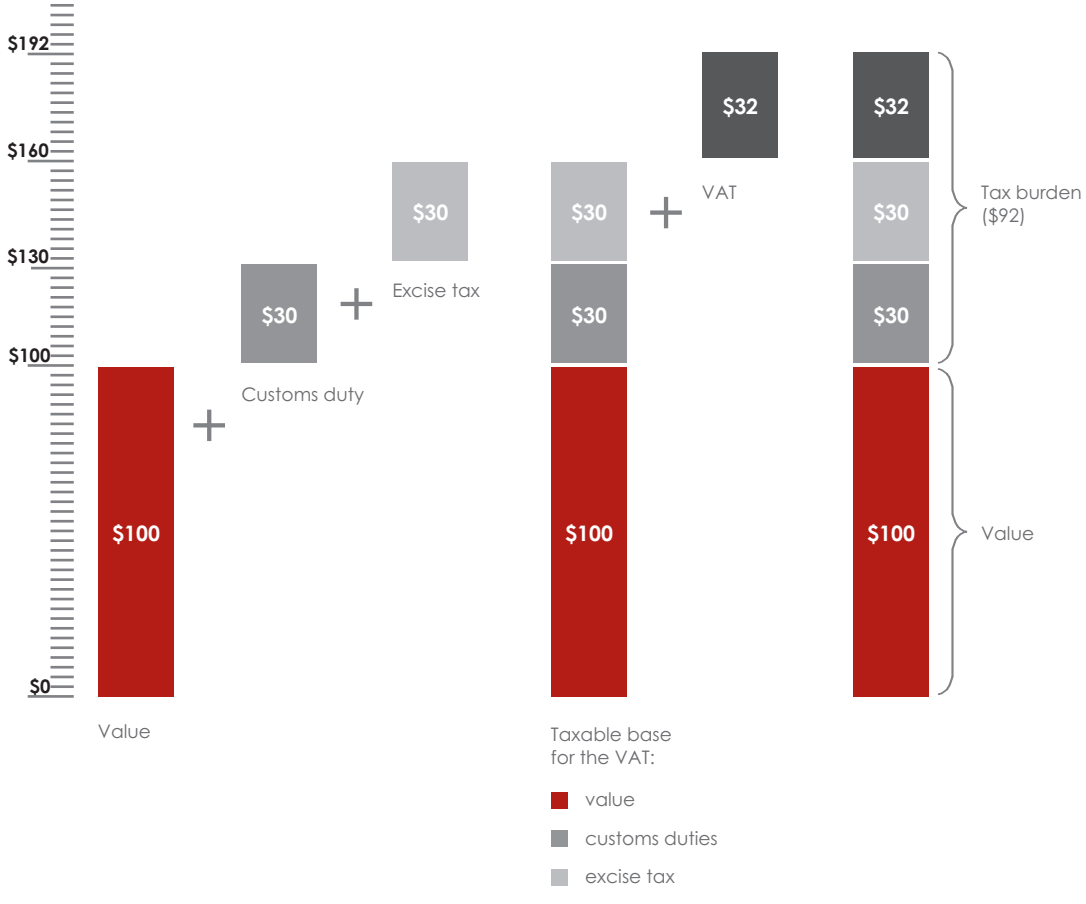
1 Resolution 412 of the Cabinet of Ministers of the Republic of Uzbekistan, September 2, 2004.

2 The minimum wage in the first seven months of 2004 was 5,440 soums. In August 1, 2004, it was raised to 6,530 soums.

Annex 10 to Taxes and Tax Administration

AN EXAMPLE OF "TAX ON TAX" IN IMPORT TRANSACTIONS

In the case of imports, VAT calculation results in "tax on tax." First, the customs duty and excise tax on the customs value of the imported goods are calculated (if the excise tax is applicable to the type of goods;) then the VAT is calculated based on the total of customs value + customs duty + excise tax.



Example. *The customs value of the goods is US $100. The customs duty on it is 30%, or US $30. The excise tax is also 30% (another US $30.) The VAT (20%) will be calculated based on 100+30+30=160, amounting to US $32. Thus, the total tax burden on goods worth US $100 will be US $92 (or 92%.)*

This mechanism for levying VAT (with the taxable base being the customs value + customs duties + other mandatory fees) is applied in a number of other countries (for example, Russia, Kazakhstan, Kyrghyzstan, EU countries.) However, as the above example shows, the practice leads to an increase in import costs. In other words, while rates for taxes and fees do not seem large when taken separately, the total tax burden on import transactions increases significantly. The government should take this into account when deciding on the rates for compulsory fees to be paid on importing goods.

Annex 11 to Methodology and Key Facts about the Survey

DEFINITION OF SME

Prior to January 2004, businesses in Uzbekistan, depending on the average annual number of their staff, were classified into micro-firms, small and medium enterprises and other enterprises not included into the SME category. Small enterprises enjoyed a number of privileges and concessions that did not apply to medium enterprises.

Effective January 1, 2004, the criteria for defining small enterprises changed, while the privileges remained, and the category of medium enterprises was excluded from the classification of SMEs.[1]

The new classification extended the range of small enterprises by placing a higher limit on the number of employees. As a result, most medium enterprises fell into the small enterprise category as of January 1, 2004. The category also includes some businesses not previously considered SMEs:

- from 30 to 50 employees – in agriculture, the agro-processing sector and other industrial and manufacturing areas;
- from 20 to 25 employees – in science, research services, transportation, communications, services (with the exception of insurance companies,) retail trade and other non-manufacturing areas.

Medium enterprises in the following sectors were not included in the small enterprise category:

- more than 50 employees – in mechanical engineering, metallurgy, fuel and energy sector and chemical industry;
- more than 25 employees – in wholesale trade and public catering.

At the same time, while the SME category had been based on the number of staff directly employed at the headquarters of the enterprise, the 2004 definition also included the average annual number of staff at micro-firms and small enterprises employed in subsidiaries, branches and representative offices.

[1] Decree of the President of the Republic of Uzbekistan "On Amending the Decree 'On Measures to Promote the Further Development of Private Enterprise, Small and Medium Businesses," April 9, 1998,' August 30, 2003.

<table>
<tr><th colspan="2">SMALL AND MEDIUM ENTERPRISES (PRIOR TO JANUARY 1, 2004)</th><th>SMALL ENTERPRISES (SINCE JANUARY 1, 2004)</th></tr>
<tr><td colspan="2">INDIVIDUAL ENTREPRENEURS</td><td>INDIVIDUAL ENTREPRENEURS</td></tr>
<tr><td colspan="2">Micro-firms with an average annual number of employees not exceeding:</td><td>Micro-firms with an average annual number of employees not exceeding:</td></tr>
<tr><td colspan="2">10 – in manufacturing sectors</td><td>20 – in manufacturing sectors</td></tr>
<tr><td colspan="2">5 – in services and other non-manufacturing sectors</td><td>10 – in services and other non-manufacturing sectors</td></tr>
<tr><td colspan="2">5 – in trade</td><td>5 – in wholesale and retail trade and public catering</td></tr>
<tr><td>Small enterprises with an average annual number of employees not exceeding:</td><td>Medium enterprises with an average annual number of employees not exceeding:</td><td>Small enterprises with an average annual number of employees not exceeding:</td></tr>
<tr><td rowspan="2">40 – in industry</td><td rowspan="2">100 – in industry</td><td>100 – in food, light industry, metal work and instrument-making, woodworking, furniture industry and construction materials</td></tr>
<tr><td>50 – in mechanical engineering, metallurgy, fuel and energy, and chemicals</td></tr>
<tr><td>20 – in agriculture and other manufacturing sectors</td><td>30 – in agriculture and other manufacturing sectors</td><td>50 – in farm produce and produce processing and other industrial and manufacturing sectors</td></tr>
<tr><td>20 – in construction</td><td>50 – in construction</td><td>50 – in construction</td></tr>
<tr><td rowspan="2">10 – in science, research services, retail trade and other non-manufacturing sectors</td><td>20 – in retail trade, services, and other non-manufacturing sectors</td><td rowspan="2">25 – in science, research services, transportation, communications, services (with the exception of insurance companies,) trade and public catering, and other non-manufacturing sectors</td></tr>
<tr><td>30 – in wholesale trade and public catering</td></tr>
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