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# The Stock Market in Uzbekistan as the Backbone of Country's Economic Development

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**Abstract**--*The improvement of the stock market is becoming one of the paramount factors leading to the Uzbek economy's resilience to external shocks and the formation of a new economic development model. The study is aimed at analyzing the influence of the stock market of the Republic of Uzbekistan on the economic growth of the state. The process of development of the stock market and the need for reforms is considered to be the object of the study. The main goal of the research is to substantiate the need to create an institutional framework for the accelerated economic development of the country through a qualitative improvement of the mechanisms of functioning of the stock market, as well as form the list of references for the successful establishment of a financial center capable of focusing on a wide range of financial instruments. At work procedures, such methods as statistical and regression analyses have been applied. The study covers the period from 2016 till 2019 and is based on the analysis of data from international organizations, analytical centers, and local official data sources.*

**Keywords**---*financial market, GDP per capita, investments, market capitalization, stock market, Uzbek economy*

## Introduction

The quickened globalization of the world economy, the precariousness of prices of mineral resources, capital, and products streams indicate that the arrangement of a free financial sector in the economy is becoming one of the foremost important signs of economic competitiveness, and strengthening influence within the world is a prerequisite for economic as well as political sovereignty.

The current situation in the world financial markets, as well as the imbalance, watched within the international financial resources market in later years, confirm that there will be no prospects for long-term vital improvement without a successfully functioning device for mobilizing investors' monetary resources, forming and distributing investment capital. This is evidenced by the existing gap between the reserve funds of the population (35%) and investments within the financial sector of the economy (27%), which could be a critical unused reserve within the development of the stock market (Raberto et al., 2001; Pasquini & Serva, 1999).

## The Main Findings and Results

Economists have not yet created a consensus on the need and effectiveness of the financial sector within the advancement of the country's economy. However, an experimental investigation of our research and a number of published literatures appear the connection between the advancements of the financial sector, more particularly, the stock market and economic improvement (Cheung & Ng, 1996; Chiuri & Jappelli, 2003). To back the market reforms and the creation of favorable conditions is important, including expanding the supply and request for disobedient, moving forward the regulatory environment, correspondence, and security of the rights of members, as

well as support and modernization of the market foundation. There's a positive drift in Uzbekistan these days, and the state's consideration is expanding, but the inherent acute issues require prompting measures (Angeles, 2008).

#### *The role of the financial sector in economic development*

Many expert economists totally unique from finance as a factor in general economic growth contending the monetary segment responds to the request made by the real segment of the economy. Other economists, on the other hand, believe that a steady and created budgetary division is an unquestionable key to advancement. Be that as it may, an experimental analysis of macro-economics, industries, companies, at the interstate level states the relationship between the financial sector and economic development (Gupta & Sapienza, 1992; Sarkodie & Strezov, 2019).

There are a number of reasons for this perspective. A created financial sector permits to rapidly progress finance in companies (meet the demand for capital from companies prepared to start production or conduct research), to introduce corporate governance standards (makes duty for managers to shareholders), broaden and oversee the dangers of capital ventures, mobilize reserve funds, and make the need for data trade that improves markets (Levin, 2005). In particular, the stock market is one of the key areas of the financial sector. The interstate empirical analysis appears that the market capitalization of local companies is interconnected with the country's GDP and an increment in the market capitalization of companies will go with by overall economic growth (Table 1).

Table 1  
Economic development factors (GDP)

VARIABLES	Market Capitalization as a Growth Factor
FDI (% of GDP)	-0.00164** (0.000818)
Inflation	-0.0164*** (0.00590)
Rule of Law	-0.469 (1.027)
Log Market Cap (USD)	0.535*** (0.122)
Doing Business	-0.00198 (0.00665)
Econ Freedom	-0.0100 (0.00732)
Constant	13.76*** (3.765)
Observations	104
Number of id	26

*Source: compiled by the authors.*

These results demonstrate a statistically noteworthy impact of the market capitalization of local companies on a country's GDP. With a 1% increment of the companies' market capitalization, country's GDP increments by approximately 0.5 percentage points. For the study, data for the period between 2016 and 2019 from 26 nations collected in a panel database was used. The market capitalization and GDP have been logarithmized to a better comparison of the results. In the future, it is possible to attract more factors and increase the number of nations, but the relationship between the stock market and GDP is significant (Narayan et al., 2011; Laquatra, 1986).

Figure 1 shows a positive correlation between GDP per capita and the size of the market. This relationship is clarified by the preferences of the stock market over other components of the financial sector, such as the introduction of corporate governance standards, high liquidity, reduced risk for the company compared to bank loans, and the data exchange between companies and investors (Almenberg & Dreber, 2015; Bahrami et al., 2019).

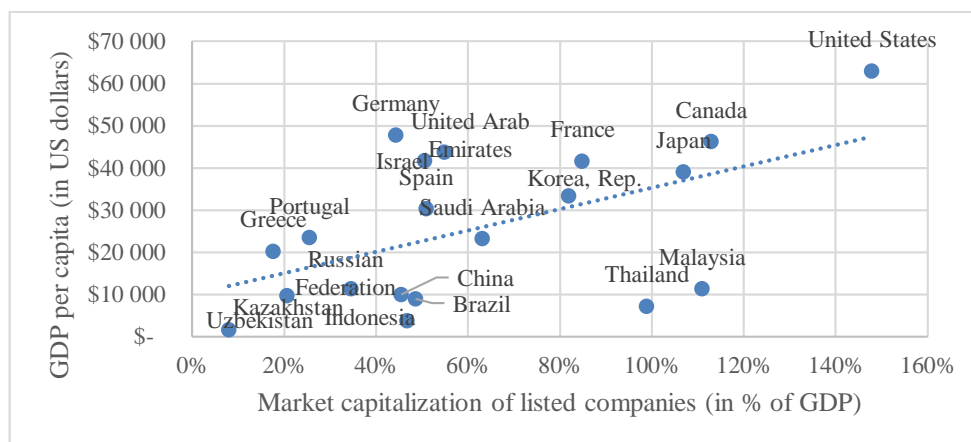


Figure 1. The stock market capitalization of countries and GDP per capita  
Source: Compiled by the authors

Overall, the study results coincide with the results of previous researches, in which a stable, exceedingly liquid stock market has matched and contributed to economic growth. One of these studies used the Granger causality test where researchers pointed to this relationship (Ake, 2010). Meanwhile, other economists have used the strategies created by Toda and Yamamoto for possible similar results (Caporale et al., 2004). Research also points to a causal relationship between a highly liquid and dynamic market and economic growth.

#### *Factors of financial sector development*

The relationship between the improvement of the financial sector and overall economic growth, in turn, raises the address of necessary conditions and reforms in the nation and within the market to guarantee this development, particularly the stock market. Theoretically, the advancement of any market within the financial sense requires a number of variables – uniformity of members, full get to information, the ability to enter and exit the market, and least transaction costs (in specific, the time required for the transaction, taxes, commissions, and infrastructure problems) (Anton et al., 2020; Amelia et al., 2021).

At the same time, practically, it is impossible to fully guarantee the above-mentioned conditions. However, many developed countries have come close to creating conditions conducive to the development of markets that developing countries do not. In economically developed countries, there is a low level of corruption, a favorable and transparent regulatory environment (which in turn is equal), institutional protection of the property, and interests of investors and companies. These conditions allow potential investors to enter the stock market with confidence, as they believe that they are protected. Companies, on the other hand, can create demand for investments in this market, since they are confident in ensuring their rights and in the debugging of processes. An empirical analysis of a number of countries indicates a statistically significant relationship between the indices of economic freedom and ease of doing business with market capitalization. Meanwhile, there is an inverse relationship between direct investment from abroad and market size, which may be due to the crowding out of the local investment as a source of finance for local companies (Table 2).

Table 2  
Stock market development factors

VARIABLES	(1) Factors for Market Growth
FDI (% of GDP)	-0.00132*** (0.000467)
Inflation	0.00115 (0.00537)
Rule of Law	-3.372** (1.484)
Doing Business	-0.0322*** (0.00915)

Economic Freedom	0.0228** (0.00898)
Constant	27.54*** (1.545)
Observations	104
Number of id	26

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Robust standard errors in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

Source: Compiled by the authors.

The results point to a statistically significant effect of the Doing Business Index, rule of law, economic freedom, and foreign direct investment on total market size. The Doing Business Index has an inverse effect due to the methodology of the index (1 is the best value). Surprisingly, the rule of law index has a negative effect on market capitalization. This may be due to the choice of data or the content of elements of the rule of law in the index of economic freedom. These indices demonstrate the level of protection of investors' rights, infrastructure issues, and institutional processes. By ensuring a transparent, equitable market, with regulated and understandable entry and exit processes, and ensuring litigation and freedom from corruption, markets will grow. The results of this study are consistent with those of similar studies from the past (de Haan & Sturm, 2003). The success of the developed country markets can be achieved by four key elements:

- Institutional powers, protection of rights, favorable and transparent regulatory environment.
- Developed infrastructure, well-established settlement and clearing processes, trading platforms.
- A ready-made base of investors, retail and institutional, created by mobilizing a large amount of savings, as well as culture and financial awareness.
- A wide range of companies in need of capital, providing securities for turnover, meanwhile following the standards of information disclosure and financial reporting.

#### *Financial sector of Uzbekistan*

In Uzbekistan, the financial sector is based on a strong banking sector whereas the stock market is lagging behind in development. At the same time, the banking sector is built on state-owned banks (85% of banks are state-owned, of which 44% are aimed at privatization) which leads to political loaning (loaning is not based on market conditions and rates, but on rates decided by officials). There are also high deposit rates (rates up to 23% are available according to the Central Bank of the Republic of Uzbekistan). In general, the collective influence of these factors puts pressure on the immature and developing stock market, and bank lending remains the dominant way of financing business in Uzbekistan.

In prospect of the current state of the stock market in Uzbekistan as an emerging one and the need for due attention to the improvement of this market in the early stages of the development of Uzbekistan, stock market participants face a number of problems. In terms of demand for securities, the number of retail and foreign investors is small (according to the Central Securities Depository, 859,550 individuals are shareholders, whereas the number of foreign investors is only 2,942), while the supply of securities on the market also clears out much to be desired. Many listed companies have large state shares that are not traded, making illiquid conditions and preventing the trading of securities attractive to investors (for example, Almalyk Mining and Metallurgical Combine JSC, whose common shares are not traded, despite the profitability and success of the company). At the moment, the market infrastructure requires development, since the Unified Software and Hardware Complex systems received from the Korean Stock Exchange in 2016 are outdated (in terms of software and in terms of physical servers and a data processing center) and are not properly supported. At the same time, many settlement and clearing processes require manual work, and it is still impossible to open accounts without a physical presence, which increases the so-called "transaction cost" and creates unnecessary barriers to entering the market. These problems are inherent in many emerging markets, and with the proper support of the state and the initiatives of the private sector and investors, they can be minimized and solved in the near future.

Despite the strong presence of the state in the financial sector in the form of the banking sector, as well as a number of problems inherent in many emerging markets in developing countries (mentioned above), there is a tendency for the growth of the stock market of Uzbekistan in terms of market capitalization, trading turnover, and market size in relation to the overall economy of the country (Fig. 2 and 3). These trends follow a number of changes

in the regulatory environment, two IPOs conducted in Uzbekistan (“Quartz” JSC and “Jizzakh Plastics” JSC), and more extensive attention paid to the market.

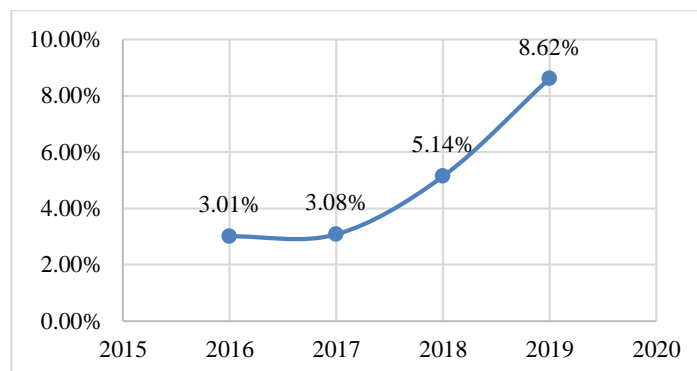


Figure 2. The ratio of the total market capitalization of the stock market to the GDP of the Republic of Uzbekistan for 2016–2019 (in %)

Source: Compiled by the authors.

The Decree of the President of the Republic of Uzbekistan “On measures for accelerated reform of enterprises with state participation and privatization of state assets” No. UP-6096, aimed at privatizing and expanding the proficiency of state-owned enterprises through transformation and listing on the stock exchange, should make an offer of securities on the stock market. Regulatory legal acts of this kind indicate the state's preparation to develop the stock market by putting huge enterprises on listing, increasing liquidity, and trading volume on the market, especially more successful enterprises.

The legislative base of the stock market of Uzbekistan mainly consists of two laws: “On the stock market” of June 3, 2015, No. ZRU-387 and “On joint-stock companies and protection of shareholders' rights” of May 6, 2014, No. ZRU-370, as well as a number of departmental provisions. The laws indicate permissible activities, protection of investors' rights (which is subject to improvement, since at the moment, according to the World Bank, the protection of minority investors in Uzbekistan has received 70 points out of 100), and indicate the types of participants, financial instruments, and other market conditions. At the same time, these laws do not regulate market processes, have a number of problems and shortcomings, and in general should be improved in more detail and often (at the moment, the last changes occurred more than 5 years ago).

The present market picture allows us to form a cautiously optimistic outlook for the market since there are positive trends and gradual improvements in all components of the market, government support is noticeable, and direct growth can be observed annually. The high presence of the state in the economy, and the dark handle of passing laws prevent the creation of full trust and confidence within the market.

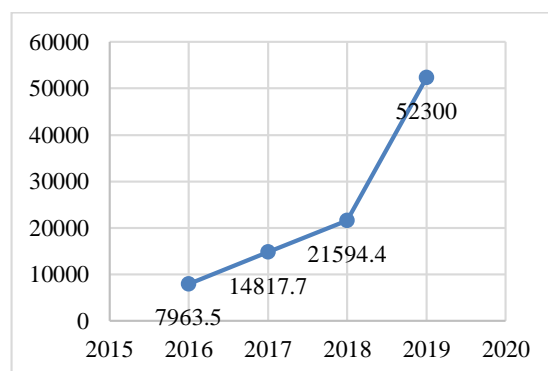


Figure 3. Total market capitalization of companies on the stock market of Uzbekistan, in billion soums

Source: Compiled by the authors.

## Conclusion

The empirical results and analyses of many economists, as well as this study, show the relationship between the developments of the financial sector on the basis of the stock market. The financial sector supports the real sector and gives access to capital whereas introducing corporate governance standards and making ways to increase savings for investors, retail, and institutions. Nevertheless, in numerous developing countries, including Uzbekistan, the financial sector still comes across a number of issues, regularly related to an expanded state nearness and a moderate, misty legislative process, as well as a lack of equality and freedom for market participants. Changes pointed at liberating and minimizing obstructions to passage to the market should contribute to the development of the stock market and the financial sector as a whole. There are positive trends in the development of the market in Uzbekistan, however, the elimination of key obstacles and continuous improvement of all components of the market still remains an acute and key problem in the field.

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