



ICEG EC



Caucasus & Central Asia (CCA) Review

Vol. 2, No. 2

September 2008



Caucasus and Central Asia (CCA) Review

The Caucasus and Central Asia (CCA) Review regular, monthly, regional, online English language publication is a part of capacity building projects within EPIN network financed by United Nations Development Programme (UNDP) coordinated by International Center for Economic Growth (ICEG) European Center.

The project involves experts of research institutions and universities of Caucasus (Armenia, Azerbaijan and Georgia) and Central Asia (Kazakhstan, Uzbekistan, Turkmenistan, Tajikistan and Kyrgyzstan) in preparing country analyses in specific group of topics: reform of the post-communist state (i.e. public administration reform, decentralization, anti-corruption, and human rights/access to justice); spatial poverty (i.e. interactions between geography, economic policies and activities, and living standards); economic, environmental and social impact of public economic policies (e.g. migration, employment, trade liberalization, inflation and administrative prices); rural development and agricultural reforms; financial access and microfinance.

Research organizations in partnership:

Caucasus University (*Georgia*)

Center for Economic Research (*Uzbekistan*)

Economic Development and Research Center (*Armenia*)

ICEG European Center (*Hungary*)

Institute for Scientific Research on Economic Reforms (*Azerbaijan*)

Public Policy Research Center (*Kazakhstan*)

Coordinator and editor

Tamás Borkó, tborko@icegec.hu

Contact information

ICEG European Center, 6/B Dayka Gábor Street, Budapest, H-1118 Hungary. Phone: (+36) 1 248 1160. E-mail: office@icegec.hu

Disclaimer

This document is for informational purposes only. It is not intended as an offer or advice in relation to any investment decision. ICEG European Center and the authors of this document are not responsible or liable for the accuracy, completeness and correctness of the information in this document and cannot be held responsible for any damage resulting from the use of this document. The contents of this document are subject to change without prior notice.

Table of Contents

<i>Assessment of financial access and exclusion in Armenia</i> _____	4
<i>Achievements and problems of economic liberalization in Georgia</i> _____	10
<i>Influence of migration and remittances on Uzbekistan</i> _____	14
<i>Causes and consequences of corruption in CCA countries</i> _____	19

Assessment of financial access and exclusion in Armenia

Mushegh Tumasyan

Access to financial services is an important factor of economic growth. The financial access and the reasons of exclusion from the system in Armenia are assessed. Analysis shows that the population not using financial services is mainly voluntarily excluded from the system. Key reasons of exclusion from the system are low public awareness and the level of literacy. Thus, public financial education and awareness programs should get into the focus of policymaking.

General methodological Issues

While several papers address the access to finance as an important factor affecting growth and inequality, ensuring access or availability of financial services is often overlooked. Among the main reasons one can recognize difficulties in access assessment and lack of data.

Access to financial services is a multi-dimensional concept. There is no single definition in the modern bibliography, although several authors have addressed that. Access and usage are different notions and it is not necessary that services will be used as soon as they are accessible. Usage is determined by the supply and demand for financial services, whereas access mostly relates to the supply of financial services. Access is defined as supply of services with reasonable quality and price. "Reasonable quality and price" concepts are very relative and include all types of material and non-material costs.

To evaluate access and usage, population can be first differentiated for persons included in (covered by) and excluded from the financial sector. It is obvious that those not included can be voluntarily or non-voluntarily excluded. Let us present those groups of population in the schema below. (*Table 1*)

Table 1. Schema of population differentiation

Group A, <i>Included</i>	Group B, <i>Voluntarily Excluded</i>		Group C, <i>Non-voluntarily Excluded</i>	
A	B1	B2	C1	C2
Those who use financial services	Non-price factors (no need, no savings, no confidence, no compliance with preferences or principles, literacy and awareness level, cultural, religious or other personal reasons /preferences, beliefs/, Indirect access)	Price factors (no participation due to high or low market prices, high or low level of market interest rates, tariffs or fees)	Institutional or product related obstacles (physical or geographic obstacles, service /products/ existence or adequacy obstacles, tariff obstacles /non-market terms/)	Obstacles relating to the consumers' parameters (income, asset, welfare, employment, education obstacles, sex, age, ethnic and other non-economic obstacles)

Note: factors of exclusion in brackets. Source: the schema was developed by the author based on some approaches suggested by Claessens (2006).

Group B, in fact, is determined by demand factors, whereas Group C reflects the supply factors. We differentiated two sub-groups in Group B: B1 for non-price and B2 for price factors of demand. In Group C, again, we differentiated two sub-groups: institutes' (products') and customers' parameters. Above we summarized the elements of factors of included and excluded parts of the population.

It is worth noting that population in Group C (Non-voluntarily excluded) can be divided into two sub-groups: those who can be potentially included and those who cannot be potentially covered by the financial sector.

Those who cannot be potentially included are people with bad credit history and representing risks. Therefore, existing obstacles have left them outside the system. The part that can be potentially included is the group that can start using financial services once the supply of services is improved.

According to the model the following access and usage options can be found for different groups of population. There is no access in Group C, therefore, there is no usage of services; however, it is possible that part of population in this group will not be included in the system – i.e. shift to Group B.

Table 2. Schema of access and usage options for different groups of population

	Access	No Access
Usage	Group A	...
No Usage	Group B	Group C

Source: Author's analysis

In order to evaluate access one should decide on institutional aspects and choice of functional types of financial services. The first refers to, e.g. the question whether access is assessed for the formal financial sector, or whether the informal financial sector should also be included, or whether the entire financial system should be considered or its segments (e.g. only the banking sector). The second – choice of functional types – refers to the decision whether access is assessed on payment or transaction services, (current services) or savings (deposit) services or credit or borrowing services should also be included. The existing bibliography mostly focuses on the main services offered by the formal banking institutions.

The next important issue, which is not well discussed in literature, is that whether access calculations should be at population or household levels. We believe that the need for different financial services in our reality is different. For example, all adult members of the same household may see the need or necessity to use bank accounts and cards, however, it is not necessary that more than one member in the household needs or wants to use loans or savings services. In other words, to assess the access of different financial services it is necessary to use either the adult population or households in general.

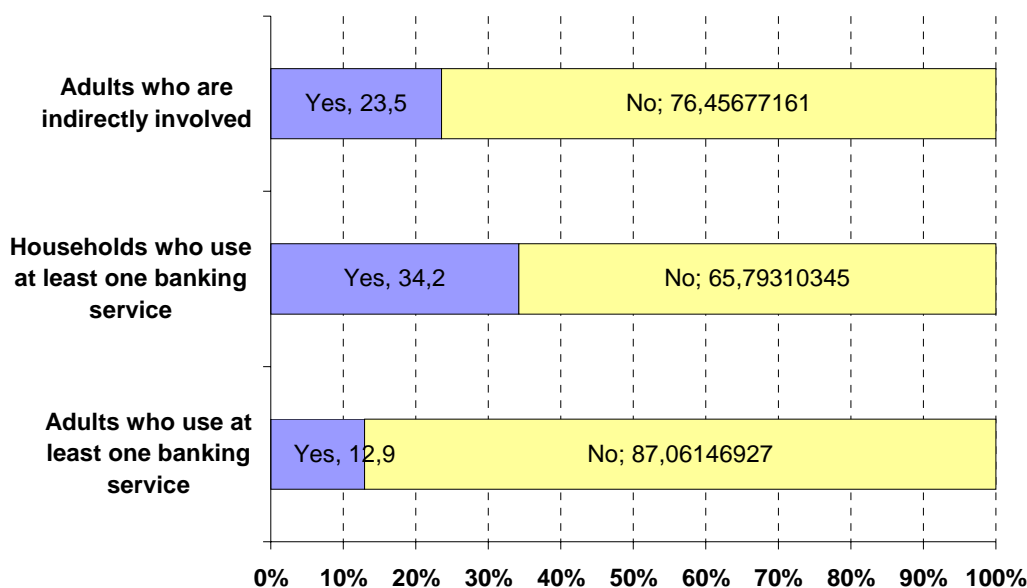
Assessment of access in Armenia

Based on the PALCAU Survey (2007) data¹, we attempted to assess the access of banking services in Armenia, as well as break down the population into included, voluntarily excluded and non-voluntarily excluded groups. Access to banking transaction services will be assessed for the entire adult population, whereas bank deposits and loans – at household level.

According to the PALCAU Survey data, only 13% of adult population of Armenia in 2007 was included in the banking sector by using one of the main banking services. Adult population that was included in the banking sector through one of the other household member (indirectly included) constitutes 24% of total. As a result, 34% of households are indirectly covered by the banking sector. (*Chart 1*)

¹ "Public Awareness, Literacy, Confidence, Access and Usage of Financial Services in Armenia", household survey database, Economic Development and Research Center (EDRC), USAID/Financial Sector Deepening Program, 2008.

Chart 1. Share of population covered by the banking sector (% of total)



Source: PALCAU Survey database, Economic Development and Research Center (EDRC), 2008

The main type of inclusion is the use of bank accounts and loans. Coverage of adult population by bank accounts is only 8% (or 21% of all households). The number of those who do not have bank accounts is very high in the regions of Armenia. Coverage by bank accounts is 15% in Yerevan with 12% and 17% in the Income Quintiles 4 and 5 respectively. (Table 3)

Table 3. Coverage of adult population by bank accounts (5)

	Group A, Included	Group B and C, Excluded
Capital city	14.9	85.1
Other urban	4.5	95.5
Rural	4.3	95.7
Quintile 1	2.2	97.8
Quintile 2	3.8	96.2
Quintile 3	6.6	93.4
Quintile 4	12.0	88.0
Quintile 5	17.0	83.0
TOTAL	8.1	91.9

Source: PALCAU Survey database, Economic Development and Research Center (EDRC), 2008

When trying to analyze the reasons for non-coverage based on the presented model and data, the following picture emerges: 98% of non-inclusion cases for the adult population belong to Sub-group B1 and about 18% - to Group C.

In other words, the main reasons for non-inclusion are non-price demand factors and that the majority of population is voluntarily excluded from the system. Nonetheless, potential customers' parameters that represent obstacles for the providers of financial services and institutional obstacles become more crucial in some regions. Obstacles determining non-voluntary exclusion are especially significant in Shirak, Aragatsotn and Syunig regions of Armenia.

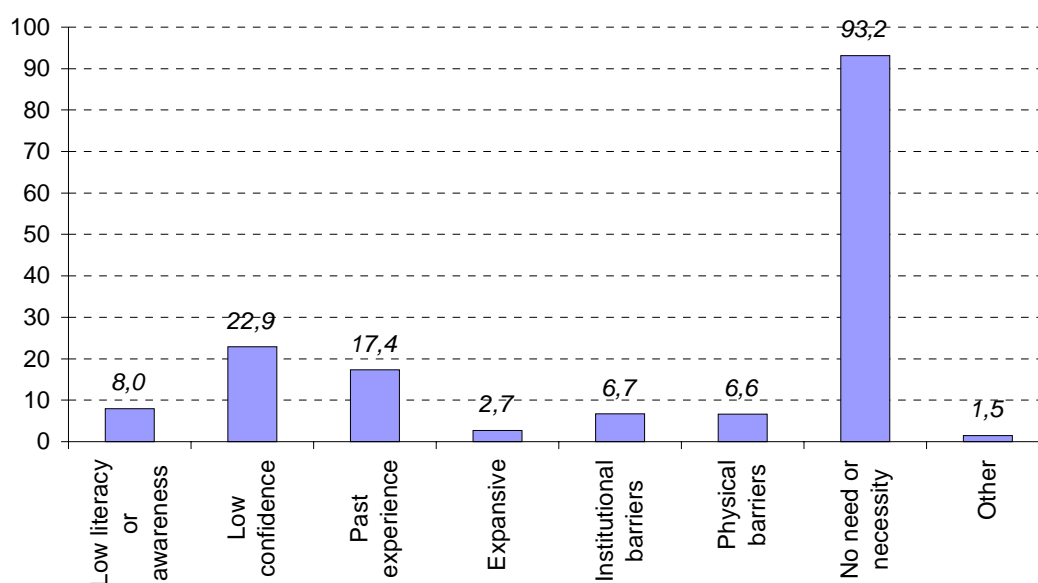
Table 4. Access of bank accounts, reasons for non-inclusion (% , multiple responses)

	Group B, Voluntarily Excluded		Group C, Non-voluntarily Excluded	
	B1	B2	C1	C2
Capital city	98.8	1.4	1.1	5.4
Other urban	98.1	5.2	3.1	15.9
Rural	98.0	1.5	18.5	8.8
Quintile 1	98.9	2.3	7.7	10.4
Quintile 2	99.0	3.0	8.9	9.9
Quintile 3	97.8	2.7	7.3	12.0
Quintile 4	98.3	2.7	6.3	9.3
Quintile 5	97.2	2.9	7.7	7.8
Total	98.3	2.7	7.6	9.9

Source: PALCAU Survey database, Economic Development and Research Center (EDRC), 2008

The major reason for not having a bank account mentioned by the respondents was “no need or necessity” (93%), as well as low confidence and previous bad experience (40%). Those are subjective evaluations, and it is clear that, in fact, they do not know how to use bank account and to what purpose, therefore, do not see the necessity to have one. I.e. the majority of non-covered population is voluntarily excluded from the system due to insufficient literacy and awareness and low culture of making transactions through formal financial institutions.

With regard to usage of bank accounts, physical access of financial institutions is a crucial factor in the regions. According to the PALCA Survey data, 62-65% of population in Yerevan and other urban areas has one bank within 1 km, while 95% - within 5 km. The picture is different in villages: for 23% of population the nearest bank is within 5 km, for 54% - within 6-10 km, whereas for 20% there is no bank within reasonable distance.

Chart 2. Reasons for not having a bank account (%)

Source: PALCAU Survey database, Economic Development and Research Center (EDRC), 2008

According to the PALCAU Survey data, the usage of Banks deposits is extremely low. Only 2.2% of households have time/saving deposits. Although the general level of savings is low in the country, this is not

the main reason for insufficient deposits. For example, 13% of households in villages in 2007 kept cash in amount of AMD 80,000 or more for 3 months (8% - in other urban areas). I.e. majority of households could have been covered by the services of the financial sector. Although, as mentioned, banks are not sufficiently accessible, the problem is not the physical obstacle, but rather low confidence. 16% of respondents were not able to answer the question “would you agree to deposit your savings with a bank, if you had additional savings”, while 35% responded negatively. The reason for choosing not to deposit savings with a bank was low confidence for 71% of households, previous bad experience – for 43% of households and physical access – for 5% of households.

Bank loans are the most widespread and largely used financial service in Armenia. Every 4th household in Armenia is covered by this type of service, with the most frequent loan being consumer loans (every 10th household has a consumer loan). In contrast to other bank services, non-inclusion in loan services is non-voluntary. Nevertheless, 16% of households are voluntarily excluded, with the following reasons: low and unstable income stream, high interest rates (40%), inconvenient terms (25%) etc. There were households that believed that loans are risky (12%), therefore they chose not to borrow.

Low and unstable income, high interest rates are basis for not borrowing also for those Households that are willing or are going to borrow soon. Institutional obstacles to borrowing for 14% of such households, 13% did not have adequate collateral, while 9% sees also financial unawareness and insufficient literacy as main obstacles to borrow.

Table 5. Access to Bank Loans, % in total

	Group A, Included	Group B, Voluntarily Excluded	Group C, Non-voluntarily Excluded
Capital city	23.5	15.9	60.6
Other urban	21.6	16.2	62.2
Rural	30.8	15.4	53.8
Quintile 1	18.8	14.3	66.9
Quintile 2	21.0	13.1	65.9
Quintile 3	27.6	17.2	55.2
Quintile 4	30.3	17.6	52.1
Quintile 5	29.1	16.7	54.2
Country	25.3	15.8	58.9

Source: PALCAU Survey database, Economic Development and Research Center (EDRC), 2008

Summary

Using the household survey data of EDRC, the access of main bank services by the population and households was estimated. Accurate assessment of access in practice is a difficult task. Nevertheless, the databases allowed us assessing the reasons and nature of reasons for non-inclusion in the financial sector, as well as assess the access of financial services.

Thus, the main reason of not using bank accounts is that population does not know how to use bank accounts and to what purpose, therefore, they do not see the need to do so. Population, thus, is voluntarily left outside the financial services. Especially in urban areas, physical access cannot be viewed as a serious obstacle for the use of bank accounts.

With regard to deposits, again, population is voluntarily excluded from the coverage of services. The reason is not so much the low level of savings, but rather the low level of confidence towards banks. Literacy and awareness also play an important role here.

Access is not a big obstacle with regard to borrowing from banks. Low or unstable income is major reasons for voluntary exclusion from the system. Nevertheless, literacy and awareness, again, are crucial, since population is not able to assess their own capacity to repay loans or believe banks are risky for borrowing.

Thus, the factors determining the demand for financial services have crucial importance for the increase of financial coverage and depth, and it should become the main focus of the policy in this field. The public polices and financial institutions need to contribute to the improvement of public demand for financial services. Thus, it is very important to develop and broadcast social advertisements and financial literacy and awareness programs via mass media periodically, and especially via television.

Achievements and problems of economic liberalization in Georgia

Giorgi Gaganidze²

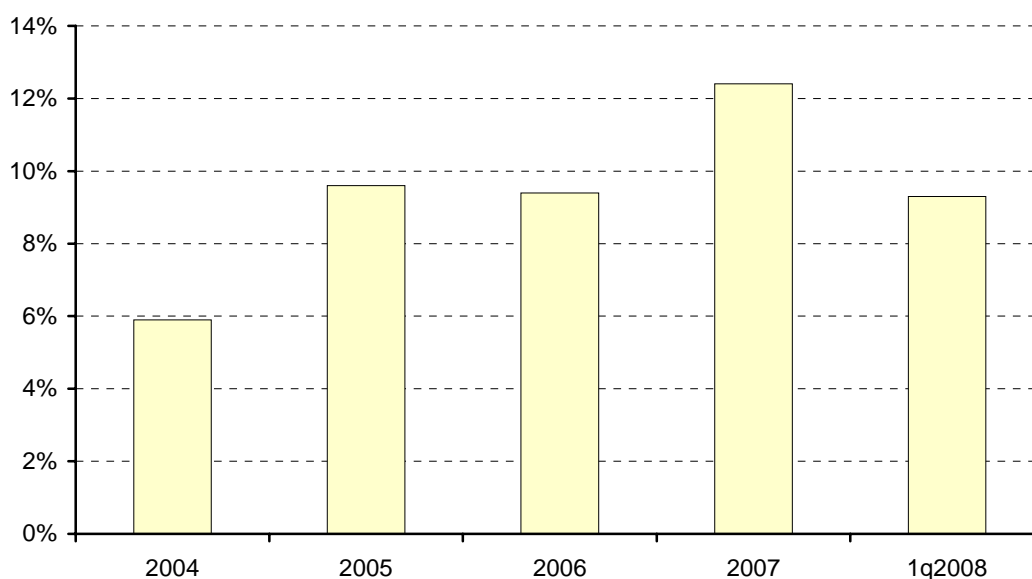
The analysis discusses the major achievements and problems of the economic liberalization policy in Georgia, in the period 2004-2008 by reviewing macro indicators, including real GDP growth, employment, FDI and external trade, among others.

Background

Georgia's moving towards Euro-Atlantic integration (NATO and EU) would require an economic model that promotes FDI, intensifies the external trade and thus fuels the development of export-oriented production. To achieve these goals, the government presented an ambitious economic development program, based primarily on the liberalization of the economy by removal of any type of administrative barriers of businesses, massive privatization and reduction of government interventions in the economy.

To some extent this liberal economic plan raised the uselessness of any other economic priorities, beside the liberalization and privatization. However, some achievements could be mentioned, as Georgia was rated as eminent economic reformer by World Bank (2006) and ranked as 18th by International Finance Corporation (IFC) in Doing Business. In 2008, Georgia was nominated by World Bank in top ten reformer countries in the world. However, these results have to be put in more complex analysis.

Chart 3. Real GDP growth, 2004-2008 (%)



The government recognized at least in some fields the need to adjust liberal economic policy and presented some economic measures in order to adjust to new challenges. On the other hand, bearing in mind that the new scheme was publicly announced before the parliamentary elections held in February 2008 it could be connected with the political maneuvers of the ruling political party. The scheme does not have any geographical or product priorities. Due to the minimal credit amount (GEL 100 thousand) it limits the accession of the medium and small enterprises to these funds. Usually medium and small enterprises are

² PhD in Economics

seeking financial resources less than GEL 100 thousand, while it is fair to mention that medium and small enterprises are usually not export-oriented.

Table 6. External trade and FDI, 2004-2005 (USD million)

	2004	2005	2006	2007	2008 Jan-July
Trade (Ex + Im)	2492.5	3355.4	4670.4	6456.9	4722.6
Export (FOB)	646.9	865.5	992.6	1240.2	965.7
Import (CIF)	1845.6	2490.0	3677.8	5216.7	3756.8
Trade balance	-1198.7	-1624.5	-2685.2	-3976.5	-2791.1
FDI	499.1	449.5	1 190,4	2014.8	430.2*

Note: *1st quarter of 2008. Source: Ministry of Economic Development State Statistics Department

The FDI figures also raise some justifiable questions. First of all, the impressive FDI growth did not lead to indirect creation of new job places. According to the *State Statistics Department of the Ministry of Economic Development*, in 2006 number of total employees in all sectors (excluding agriculture) decreased by 35401 person comparing with 2005. In 2007 number of total employees in all sectors (excluding agriculture) decreased by 59552 comparing with 2006. It is a question however what can be explained by FDI inflows and what by transitional effects of the economy.

Since 2006 former soviet republics and off-shore zones are very active investors in Georgia. In 2007 Virgin Islands appeared in the top five investors, probably covering mainly capital with Russian origins. These facts could also be considered as alarming signals and needs immediate response from the government in order to avoid any money laundering or other economic crime activities. On the contrary government proposed the creation of free economic zones (FEZs) in Poti and Batumi (both are on the Black Sea coast). FEZs could play substantial role in the economic development, but at the same time all threats connected with the creation and functioning of the FEZ should be analyzed in details.

Table 7. Top five investors in Georgia, 2006-2007 (USD million)

	2006		2007
Value (USD million) = 100%	1190.4	Value (USD million) = 100%	1681.6
United Kingdom	15.7%	Netherlands	14.8%
USA	15.3%	Czech	11.3%
Kazakhstan	12.8%	Virgin Islands	9.3%
Turkey	10.9%	Denmark	7.8%
Norway	6.5%	Cyprus	7.0%

Source: Ministry of Economic Development State Statistics Department

Coming back to the question why despite the FDI growth we do not see the creation of the new job places, we should carefully investigate the nature of the FDI. From 2005 the government used privatization as the major tool for FDI attraction. FDI based on privatization has the one-off appearance nature and could not be considered as the sustainable even in medium term. Only in some exceptional cases this type of investments are relatively stable in medium-term. In Georgian economic realities relatively stable are the investments in the export oriented sectors, such as tea and wine production.

Sustainable FDI flows in Georgia should be concentrated on the exporting sectors as the domestic market is narrow and purchasing power of population is still very low. Figures of exports are also impressive, but we should bear in mind that growth of exports could be explained by improvements in custom administration (in

other words realistic figures of exports have been much higher than officially presented ones) and on the other hand there are not new exporting products or exporting countries.

The lack of new export products is the basic reason explaining the absence of the new exports markets. In this situation the only way to intensify exports is to intensify them on the existing markets. Tensions with the Russian Federation and the latest developments are indicating that Russian market would be closed for Georgian products at least for the nearest future (2-3 year period). The only possible solution is to intensify trade relations with the EU. To start negotiations with the EU on the Free Trade Agreement (FTA) could be considered as the first step in this direction. Despite the political benefits of the FTA with EU, real economic benefits would come only after some years. Georgia enjoying the GSP benefits granted by EU, to some extent GSP could be considered as the "light FTA", unfortunately the growth of Georgian exports on EU markets is far behind of the GSP opportunities.

Evaluating results and looking forward

To summarize all achievements and problems raised by the liberalization, it would be quite difficult to make final judgment on the success of the liberalization reform. As usual there are both, pros and contras to promote reforms or stop them. Georgia as country in transition faces the same problems as other ones, lack of managerial experience, shortage of capital and etc. These factors could explain only part of the problems which are common to other countries.

The corner stone of doubtful results could be linked to the government's idea that the economic growth is the major goal and all other problems including employment, social welfare would be overcome automatically by economic growth and its consequences.

In these new realities the government should undertake the necessary steps not only in the social security sphere, but give new opportunities for the population through education policies, vocational training and investment managing activities.

FDI attraction is an important, but not the only goal of the economic policy. East and Central European states faced the same problems and in the beginning used the same liberalization tools, but by the end of 1990es, they changed investment attraction models to the investment management system. These systems do not put any burdens for the investors or additional obligations on the investor shoulder; they gave investors additional incentives if the investments would flow in specific regions or industries. Such type of tax incentives and in some cases direct subsidies played crucial role in the creation of new jobs. The Czech or Bulgarian models are sharing the same principles of the additional incentives for the investor for the creation of new jobs.

In the light of the latest developments in Georgia (Russian invasion, occupation of Georgian territories), it is difficult to make any forecasts on the expected economic development. Based on the assumption that Russian invasion would be ended in the nearest future; the renovation of the infrastructure seems to be among top priorities.

In the same time Georgia needs additional FDI even more than previously. IMF lends Georgia USD 750 million to help restore investor confidence after Russia's invasion. In any case the government should change the attitude towards FDI and start the implementation of the investment management model, with the geographical or industry priorities. For the basis, the Bulgarian model could be used taking into consideration the similarities. FDI should be most welcomed in the industries where new exporting products could be developed, in this case the government could present special tax incentives, including regressive profit tax for the exporting companies. The renovation of regions with the highest unemployment or regions mainly damaged after Russian invasion has to be another important priority.

Cheap credit scheme also should be tailored to the needs of the exporting community, it could be very useful to discuss with the business support organizations their real needs and priorities. Growing trade deficit is an alarming signal for the government and it should undertake immediate steps. For sure what Georgia does not need is the barriers for imports. In parallel with the negotiations with EU on FTA, Georgia could consider the possibility to start same negotiations with the Gulf countries. Latest trends (of FDI and external trade) are showing the growing interest of Gulf countries, particularly of the UAE to invest in Georgia. Beside this fact, company from the UAE was granted the status of the Poti FEZ developer. This background presents to Georgia good opportunity to reach the agreement on the Free Trade with Gulf countries in the short term.

Influence of migration and remittances on Uzbekistan

Rimma Muhtarova

For the last two decades the number of migrants doubled in the world. It is believed that this number will continue increasing in the future. An increasing stream of labor migration and a growing difference in average incomes of the population between countries – two basic economic factors define development of the world market of remittances. This article describes the positive and negative aspects of labor migration and remittances on the Uzbek economy.

Tendencies and reasons of migration

According to the International Organization for Migration³, for the last two decades the number of migrants doubled in the world. It is believed that this number will continue increasing in the future. If the number of migrants in 1975 was 84 million, this number reached 175 million in 2000. It is estimated that by 2050 up to 230 million migrants will be registered. Inevitably escalating level of international migration influences economy, social sphere, culture and a policy of many countries worldwide.

The reasons and purposes of migration can be various. It is clearly illustrated by the change of character of migratory streams on the post Soviet space. It is possible to allocate at least three waves of migration in the region: ethnic migration (Crimean Tatars, Germans, Jews, etc.); local and regional conflicts (refugees) and labor migration. The last category being the most active in the last two decades.

The number of irregular migrants across the Commonwealth of Independent States (CIS) varies from 5 up to 15 million (the most part from them migrate to Russia; up to 1 million seasonal workers to Kazakhstan; approximately 0.2 million illegal migrants to Ukraine).

For Central Asian countries Russia is the main target country for labor migrants, accumulating about 70-90% of all labor migrants from the CIS countries. The country sees a significant number of labor migrants from Uzbekistan (about 70% of Uzbek migrants go to Russia). It is caused primarily by high labor demand, relative freedom of enterprise activity and a visa-free entrance to Russia. A smaller percentage of citizens emigrate to Israel, Germany and the USA.

Having lost about 20% population in connection with a massive migration of Slavs, Germans and Jews in 90th, Kazakhstan, alongside with Russia, recently became main countries for labor migrants, accepting migrants for seasonal works from Kyrgyzstan, Tajikistan and Uzbekistan.

1-1.5 million Uzbek inhabitants are involved in labor migration, about 12-18% of able-bodied population of Uzbekistan. The basic migratory targets of Uzbekistan are Russia (70%) and Kazakhstan (13%).

Influence on economic and demographic processes

The reasons of labor migration are both economic and demographic. The accelerated economic growth in Russia on a background of depopulation promoted inflow of labor migrants. On the other hand, agrarian reforms in Uzbekistan, connected with the creation of farmers' class in villages, have led to replacement of significant number of countrymen from rural manufactures. Increasing population causes problems for

³ www.iom.int - World Migration Report 2003

employment, while labor migration represents an opportunity for treating employment issues and for receiving incomes in foreign currency.

There is a traditionally negative attitude which has developed to a certain extent by labor migration, both for a host country, and for the sender country. For the host country – these are questions of criminal conditions (the case of Arabs migrated from Northern Africa to the suburbs of Paris, or the case of Romanian workers in Italy). For the sending country, these are connected mainly with social aspects (incomplete and breaking families, households, overloaded women and senior child etc). Other negative aspect is, that the most dynamic, active and talented part of the population is involved. Undoubtedly, not only low qualified people, but educated part of population migrates as well, thus causing "Brain drains".

At the same time, researches, including a number of the inspections lead in Uzbekistan, testify that labor migration has a lot of winning points both for migrant importing and exporting countries. Positive pros for the migration target countries are: inflow of necessary labor, satisfaction of labor demand, and finally improvement of demographic situation in case of final settlement.

Of course positive aspects exist for countries of origin. First, migration plays a stabilizing role on a labor market, especially for those with oversupply of labor. With outflow of labor migrants the pressure on a labor market decreases and social intensity decreases. Second, significant foreign currency incomes (remittances) arrive into the sender country. Consequently, consumption and saving of the population rises. Third, knowledge about the new markets, new skills and technologies that promote occurrence of new branches and growth of GDP are acquired.⁴

At the same time, mutually, migration strengthens informal and formal communication and creates good ground for cooperation and integration of countries. Migration was and remains the basic mean providing flow of the population from village to cities, and promotion of urbanization in new areas. The process of urbanization in developing countries promotes progress of these countries, attaches new millions people to the information and cultural-civilized resources. Living conditions of population in the urbanized districts gets closer to living conditions in greater cities, which in turn promotes well-being of the population.

An increasing stream of labor migration (reasoned by global tendency of ageing in developed countries and rejuvenation in developing ones) and a growing difference in average incomes of the population between the countries – are two basic factors defining development of the world market of remittances.

Remittances in Uzbekistan

In the course of recent years, Uzbekistan has become active participant of world flow of remittances though has not entered yet the top twenty group of countries with highest amounts. As a result of external tendencies and stimulating legal base Uzbekistan improved considerably from this point of view.

Only for the period of 2002-2006 annual inflow of official remittances to the country has increased fivefold, reaching almost USD 1.4 billion or 8.2% to GDP in 2006. Remittances from Uzbekistan grew by less fast rates, increasing for the same period by 160% and having made USD 226.7 million in 2006. Thus, Uzbekistan is net addressee of remittances, and break between inflow and outflow of remittances (balance) increased. (*Table 8*)

⁴ Example: occurrence of branch of programming in India after study and training of local experts at universities and Silicon to a valley of the USA.

Table 8. International flow of remittances in Uzbekistan, 2002-2006

Year	Total (USD million)	Inflow of remittances		Outflow of remittances		Inflow per outflow %	Inflow per GDP %	Inflow per banks' capital %
		USD million	%	USD million	%			
2002	310.81	224.73	72.3	86.08	27.7	260	2.9	310.81
2003	436.33	341.71	78.3	94.62	21.7	360	3.5	436.33
2004	681.48	545.17	80.0	136.31	20.0	400	4.7	681.48
2005	957.31	789.78	82.5	167.53	17.5	470	6.1	957.31
2006	1591.6	1364.9	85.8	226.7	14.2	600	8.2	1591.6

Note: Inflow of money transfers/GDP was calculated in USD at current prices. An exchange rate of the Central Bank of the Republic of Uzbekistan at the end of the year was used in the calculations. Source: Estimates by a research group of the Centre for Economic Research based on official data of the Central Bank for various years as well as the estimates of the Centre on Improvement of Anti-Monopoly Policy under the State Committee of the Republic of Uzbekistan on Demonopolization, Support to Competition and Entrepreneurship.

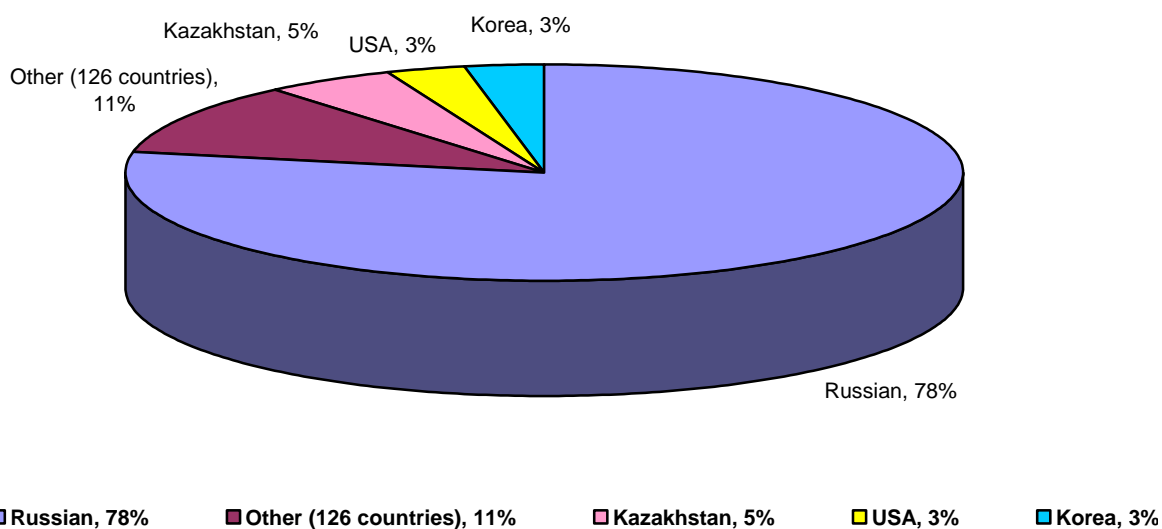
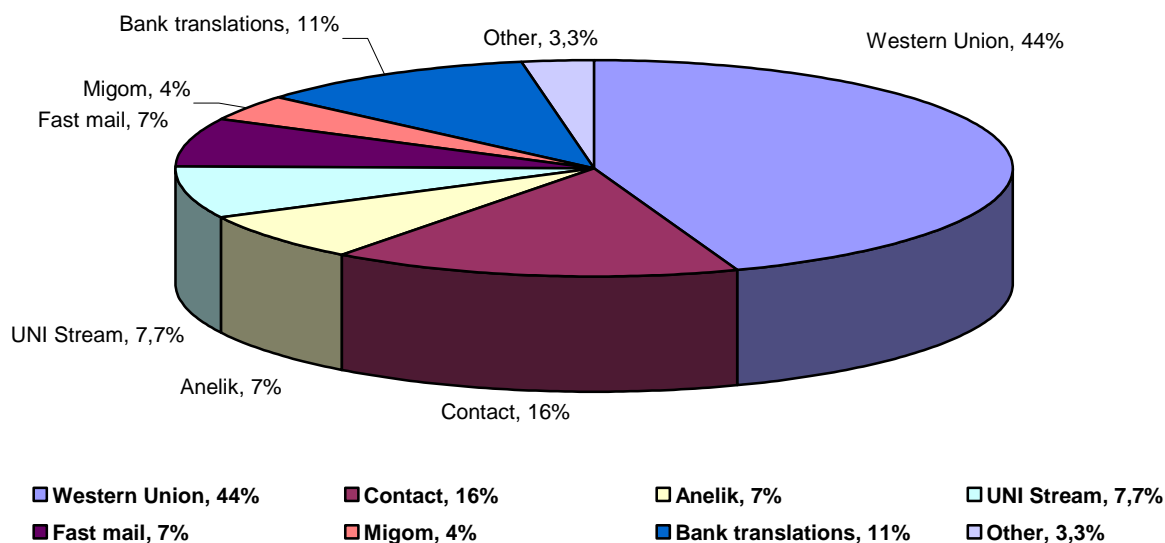
Inflow of remittances per 2006 has exceeded currency receipts from export of clap-fiber, by 130% has exceeded the size of FDI and credits, was closed to trade balance of Uzbekistan (nearly USD 2 billion) and has almost overtaken the level of capitalization of the bank sector.

Dynamic increase in inflow of remittances can be considered actually, as a new and important factor of economic growth. The new financial source reaches 7-10% of the GDP, should be taken into consideration by economic policy, social programs and by financial institutions.

In Uzbekistan, the greatest development was performed concerning remittances without opening bank account, practically by money transfer. (*Chart 4*) Bank accounts abroad in connection with the informal status of stay and work cannot be opened for the majority of labor migrants. Besides, opening a bank account entails additional charges, which people prefer to save for sending to families.

As concerning the structure of remittances by country of origin, the overwhelming part of it arrived from Russia (78%). Kazakhstan (5%), USA and Korea (3-3%) are also important sources. (*Chart 4*)

Chart 4. Structure of inflow of remittances to Uzbekistan by way of arrival into the country and by country of origin in 2006 (%)



*Note: To "another" concern: "MoneyGram", "InterExpress", "Travelex", "Express Money", "The Savings Bank of Russia" And "Blizko".
Source: Analytical paper of the Center for economic researches "Influence of remittances on economy of Uzbekistan", 2007*

Influence of remittances and policy shortages

Remittances contribute to economic growth and to the well-being of different social groups. Remittance transfers can also improve the financial sector of a country increasing financial and social inclusion. Remittances are also a stable form of external finance, and, unlike other forms of private capital inflows, remittances remain stable and often increase during times of economic hardship, thus meaning an important tool of sustainability of current account deficits.

If remittances are invested in an economy, they can contribute to output growth, and if they are consumed, they can generate positive multiplier effects through the demand side of GDP. The basic channel of influence of remittances on GDP is expansion of consumer demand of the population based on increase of disposable income. However this income of population can be spent on entrepreneurship, on investments (particularly in construction), thus generating growth of value added.

Thus policies and regulation have to be focused on promoting investments and entrepreneurship based on inflows of remittances. The improvement of business environment, the freedom of business activities have to be guaranteed. These are the key areas that have to be targeted by the economic policy.

However, steps have to be taken in order to become attractive for its own well-qualified labor force, in order to mitigate the worsening of the human potential, and competitiveness of the country. Programs have to be developed to make the country attractive for intellectual activities.

On the medium to long run however the own strategy of sustainable economic development has to be worked out and implemented, as to base an economy only on remittances is highly vulnerable. Attraction of FDI, diversification of economy, transition towards industrialization are the key factors.

Causes and consequences of corruption in CCA countries

Tamás Borkó

Most of Caucasian and Central Asian (CCA) countries face serious levels of corruption, not only in regional, but in worldwide comparison. Causes, consequences and needed measures are overviewed in this short analysis. Economic and political freedom seem to be the key factors ensuring economic systems with less incentives for rent seeking and corruption.

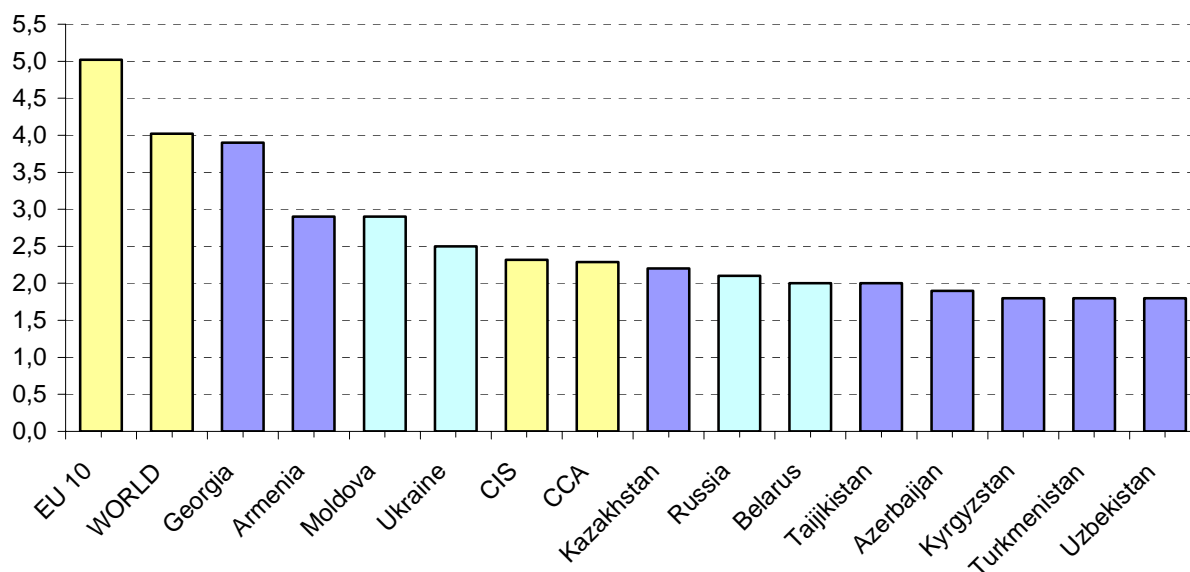
Corruption rankings

The *Transparency International* published its new 2008 ranking on corruption based on the *Corruption Perception Index (CPI)*, calculated for 180 countries of the world, among them for Caucasian and Central Asian countries. This is a determining factor of economic and social development in these two regions that perform poorly in terms of corruption measured in all sectors.

If having a look on the recent CPI scores, one can see that the CCA countries have indices worse than that of the world average, spreading between 1.8 and 3.9. Other countries of the Commonwealth of Independent States (CIS) - like Moldova, Ukraine, Russia and Belarus – perform within this range. One can see that in average Caucasian countries, and especially Georgia that made significant efforts to fight corruption, are less infected by perceived level of corruption. The new EU entrants, for comparison, are much better by the ranking, while also facing significant challenges. (Chart 5)

Among the 180 measured economies, Central Asian countries fall into the last one fifth of countries, in companionship with such failed states like Afghanistan, Sierra Leone or Iraq, but basically with countries of Central Africa. Caucasian states, with exception of Azerbaijan that belongs to the similar group, are in the middle fifth.

Chart 5. Corruption Perception Index of CIS countries and selected regions, 2008 (CPI score)

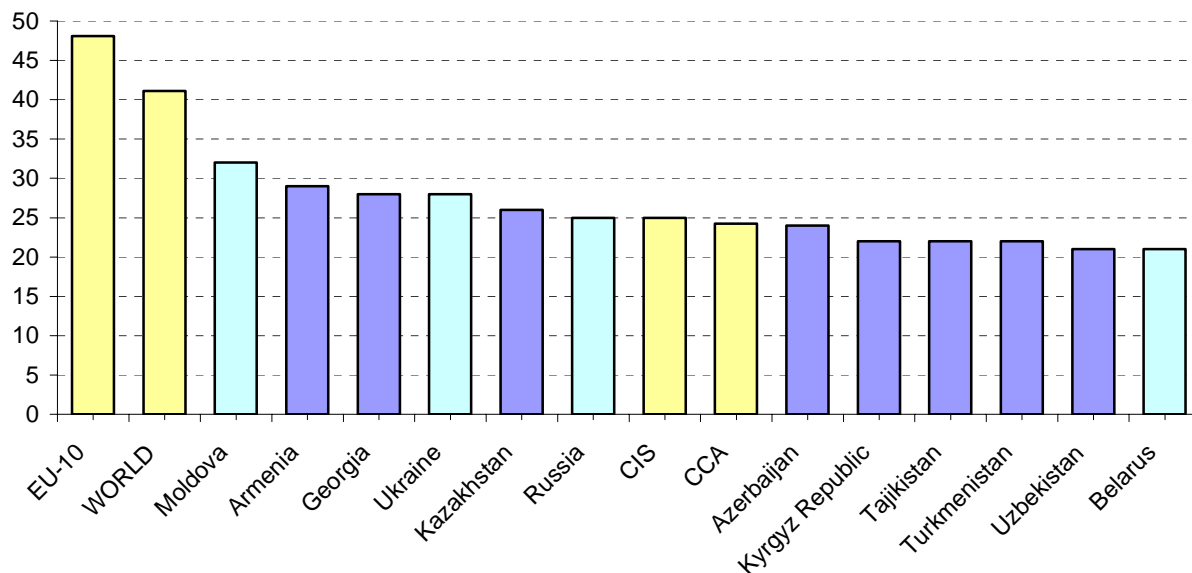


Source: Transparency International

In order to have other data sources, the *Freedom from Corruption* indices of the *Heritage Foundation* is used, calculated for its Index of Economic Freedom 2008. In order to have other data sources, the Freedom

from Corruption indices of the Heritage Foundation is used. The position of the CCA countries is almost similar, with the difference of inverse ranking of Armenia and Georgia and relatively better position of Kazakhstan. (*Chart 6*)

Chart 6. Freedom from Corruption of CIS countries and selected regions, 2008



Source: The Heritage Foundation

Origins and causes of corruption

Corruption can be defined in most simple way as “the misuse of public power for private gain”.⁵ This means with the words of other author “the malfunctioning of the state, with politicians and servants selling public goods for private gain rather than working for the goals of society as a whole”.⁶

The previously operating communist regime within the Soviet Union proved favorable environment for aforementioned phenomena. Corruption operated as a correction mechanism system balancing market distortions originated from regulated prices and production. Excessive state involvement hand in hand with its excrecent bureaucracy – during almost 80 years of the Union – made the bad for this social and economic ailment. Unfortunately, socio-cultural and political conditions before the SSSR and after the collapse of it were also unfavorable.

The main sources of corruption naturally those activities, areas that face intense government intervention.⁷ Among others, trade restrictions, government subsidies, price controls, multiple exchange rate practices and foreign exchange allocation schemes, low wages in the civil service, natural resource endowments and

5 Rose-Ackerman, Susan (1999): Corruption and Government: Causes, Consequences and Reform. Cambridge University Press, Cambridge, p. 91.

6 Anders Aslund (2007): How Capitalism Was Built, The Transformation of Central and Eastern Europe, Russia, and Central Asia, Cambridge University Press, New York, p. 249.

7 We are not talking about the so called private corruption, individuals and enterprises have to face from different organized crime structures.

sociological factors are mentioned as most important sources of rent seeking behavior and corruption.⁸ The nature and the roots of corruption varies country-by-country, however there are common reasons. (*Table*)

Table 9. The possible relative relevance of main causes of corruption in CCA countries

Causes	AM	AZ	GE	KG	KZ	TJ	TM	UZ
Trade restrictions	1	2	1	2	1	2	2	2
Government subsidies or state owned companies	2	2	2	2	2	2	2	2
Price controls directly or by state owned companies	2	2	2	1	2	2	2	2
Low wages in the civil service	2	2	2	2	2	2	2	2
Natural resource (oil and gas) endowments	1	2	1	1	2	1	2	2
Political democracy	1	2	1	2	2	2	2	2
Historical factors	2	2	2	2	2	2	2	2
Sociological-cultural factors	1	2	1	2	2	2	2	2
Overall evaluation	12	16	12	14	15	15	16	16

Source: own estimations based on data of WTO, Heritage Foundation, Statistical Offices, British Petrol, Freedom House

Effects and consequences of corruption

Costs of corruption are relatively high, and the elimination (what is practically impossible) of corruption in the poor countries *ceteris paribus* can mean even 2 percentage points higher real growth.⁹ Corruption is negatively linked to the investment and economic growth, thus more corruption means less investment and less economic growth.¹⁰ Additionally, corruption affects the composition of government expenditures. It is important, as the level and type of government expenditures do matter for economic performance by the current knowledge. Unfortunately the corruption promotes the worse composition from the viewpoint of economic growth rather favoring expenditures that are not boosting development. So government expenditures are rather chosen on the basis of the opportunity they provide for extorting bribes than on the public welfare.¹¹

Empirical evidence suggests that the economic performance is retarded because of corruption through different channels. For instance if public procurements operate in a corrupt environment this lead to lower quality of targeted areas (infrastructures, public services etc.) But corruption can lead to negative budgetary consequences (loss of tax revenues, excessive expenditures)

8 This counting is based on detailed overview of causes of corruption by Mauro, Paolo (1997): Why Worry About Corruption? Economic Issues 6, IMF, February 1997, p. 4-6.

9 Johann Graf Lambsdorff (2003): How Corruption Effects Productivity, *Kyklos*, Blackwell Publishing, vol. 56(4), pages 457-474, November

10 Based on a regression using autonomously built corruption index. If the corruption index improves by one standard deviation (by around 2.4 on the scale of score from 0 to 10), the investment rate increases by more than 4 percentage points and the annual growth rate of per capita GDP increases over a half percentage point. Mauro, Paolo (1997): Why Worry About Corruption? Economic Issues 6, IMF, February 1997

11 Mauro, Paolo (1997): Why Worry About Corruption? Economic Issues 6, IMF, February 1997

Needed measures

The higher the level of economic freedom, the lower the likelihood of encountering corrupt government practices.¹² This means the policy responses that reduce government intervention susceptible for rent seeking and corruption are needed.

The fundamental cause of corruption that corrupt incentives exist because state officials (let it be on low level or high level ones) gave the power to allocate scarce benefits and impose onerous costs.¹³ Having investigated the causes of corruption two approaches concerning its reduction can be followed.

The first collects measures targeting the incentive itself. Rational and sequenced liberalization (reduction of subsidizing economic activities), deregulation (elimination of price controls), privatization (breaking state monopolies), budgetary reforms (concentrating rather on the structure of expenditures than on the size of the budget) can be solutions on medium-long run.

The second group includes those steps that reduce the opportunity to benefit from these corruption incentives. The building up of democratic political system, free media, reforming state administration (reduction of bureaucracy and increase of wages relative to private sector) increasing accountability and transparency, reforming legislative and judicial system are crucial for measurable results in fighting corruption.

12 Chaufen, Alejandro A. – Guzmán, Eugenio (2008): Economic Freedom and Corruption in 2008 Index of Economic Freedom, The Heritage Foundation and The Wall Street Journal

13 Rose-Ackerman, Susan (1999): Corruption and Government: Causes, Consequences and Reform. Cambridge University Press, Cambridge, p. 39.