Securities Market Development in CIS Countries: Legislative and Regulatory Lessons from Kazakhstan, Russia, and Uzbekistan

Narziev Otabek Sadievich

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Securities Market Development in CIS Countries: Legislative and Regulatory Lessons from Kazakhstan, Russia, and Uzbekistan

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神戸大学大学院法学研究科

専攻: 理論法学

指導教員: 川島富士雄

学生番号: 146j007j

氏名: NARZIEV, Otabek Sadievich

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Table of Contents

ABBREVIATIONS

ADB – Asian Development Bank

CBA – Cost-Benefit Analysis

CIS – Commonwealth of Independent States

CSM – Center on Coordination and Development of the Securities Market

EAEC – Eurasian Economic Community

EBRD – European Bank for Reconstruction and Development

EMH – Efficient Market Hypothesis

FAS – Federal Antimonopoly Service (Russia)

FCSM – Federal Commission for the Securities Market of the Russian Federation

IMF – International Monetary Fund

IPO – Initial Public Offering

IOSCO – International Organization of Securities Commissions

JSC – Joint Stock Company

KZT – Kazakhstan *Tenge* (national currency)

LLC – Limited Liability Company

OECD – Organization for Economic Co-operation and Development

POE – Privately Owned Company

RUB – Russian *Ruble* (national currency)

SM – Securities Market

SMB – Small and Medium Business

SMD – Securities Market Development

SME – Small and Medium Enterprise

SMR – Securities Market Regulation

SOEs – State-Owned Enterprises

SPC – State Property Committee

TFP – Total Factor Productivity

TSE – Tashkent Stock Exchange

USD – United States Dollar

USSR – Union of Soviet Socialist Republics

UZS – Uzbekistan *Sum* (national currency)

LIST OF TABLES AND FIGURES

Tables

Figures

CHAPTER 1. INTRODUCTION

1.1. Research significance

This research is an attempt to analyze the transition reforms of certain Commonwealth of Independent States (CIS) members (namely, Russia, Kazakhstan, and Uzbekistan), and to propose some recommendations on their further improvement. Chiefly, the present study focuses on the development of one of the key institutions of the market economy – namely, the securities market in terms of its role in promoting competitive conditions in the financial services sector. Due to a variety of objective and subjective factors, banks have become the most dominant institutions in all CIS countries in terms of, both, accumulating and redistributing financial resources. Also, in all of the countries examined in the present research, a considerable part of the banking sector is owned by the state that, consequently, enjoys several privileges that are not available to its competitors. One of the leading market institutions capable of competing with banks in the financial sector is the securities market, but despite almost three decades' worth of transitional reforms, the securities market remains underdeveloped across the CIS. As a result, companies and investors are deprived of access to alternative and competitive sources of business financing, and have no option but to deal with the monopolized banking system in those countries.

Well-functioning securities markets enable and facilitate the mobilization of financial resources by bringing together those who need capital to innovate and grow, with those who have the funds to invest. More importantly, securities markets promote good corporate governance amongst their listed issuers by encouraging transparency, accountability, and respect for the rights of shareholders. The dramatic growth of stock exchanges from 50 to 160 in the last four decades alone demonstrates the important role that securities markets play in the development of economies.[1] In the case of CIS members, it is essential not only to improve the understanding of the role and function of securities markets but to also work towards creating the environments that ensure the development of well-functioning exchanges.

Taking into account the considerations mentioned above, this research examines securities market development in CIS members through enhancing its business

[1] *"The Role of Stock Exchanges in Fostering Economic Growth and Sustainable Development"*, Joint publication by UNCTAD and the World Federation of Exchanges (WFE/UNCTAD/2017), September 7, 2017, 2, https://unctad.org/en/PublicationsLibrary/WFE_UNCTAD_2017_en.pdf

financing capacity by balancing the regulatory framework of the existing banking sector with that of a functioning securities market; by diversifying the ownership structure of the market; and by implementing comprehensive legal reforms towards the further development of the market.

1.2. Problem statement

A common challenge that all CIS countries face is the absence of a mechanism to allow securities markets to fulfill their potential at the level of the national, regional, and global economy. To be more specific, currently, the securities markets across CIS members cannot be reasonably considered as providing a real competitive source of business financing, an alternative system of mobilizing savings and allocation; an effective method of ensuring corporate governance, transparency, and accountability; or as providing a reliable means of attracting foreign investment.

An analysis of the transition experience of Russia, Kazakhstan, and Uzbekistan suggests that some of the key factors behind the failure of reforms in CIS countries are institutional and legal. Moreover, even after almost three decades of reforms, these factors remain as the critical issues concerning the implementation of market economy principles in CIS countries. The problems covered by this research can conditionally be divided into two categories: namely, *structural* and *regulatory*. The fundamental issues concern systemic and institutional challenges that ought to be taken into account during the development of reforms. The present research particularly focuses on the following structural problems: the oligopolistic nature of the market; the lack of competition in the financial services sector; and the significant role of the state both in regulation and business.

There ought to be particular attention to the analysis of the *competitive neutrality* problem in business financing between the banking sector and the equity market in CIS countries. In these countries, both, the banking sector and the securities market participate in business financing, however, due to different regulative approaches, bank credits dominate in providing finance to business. Banks enjoy considerable state support, subsidies, guarantees, and privileges. Huge differences in regulation not only create the monopolistic situation in favor of banks in business financing, but also indirectly restrain an institution in its infancy, as is the securities market, to develop and provide relatively affordable, long-term, and stable funding to business. So, the root of the problem lies in the disparity between the regulatory approaches on the part of the state towards the banking sector and the securities market. Therefore, it seems unlikely that any plausible solution to the above problem could be achieved without a comprehensive examination of its causes. The regulatory issues of the development of the securities market in CIS countries are mostly connected with the drafting, adoption, and implementation of the necessary rules for the regulation of securities market relations. The content and form of the laws and regulations, along with law enforcement methods, are key issues in concerning the problems outlined earlier.

The present research also indicates that there are analogous problems in the current theoretical underpinning of securities market regulation. Notably, the research highlights the problems of excessive efficiency in the world's securities market; misbalance in theoretical supply; and *moral value* deficit syndrome. Based on the analysis of theoretical problems of securities market regulation the research proposes: the implementation of *social business theory* principles in securities market regulation, and through this the balancing of theoretical supply; and enhancing the scale and content of financial instruments in order to prevent further financial crises caused by the securities market.

Further to the foregoing, the following principal research questions arise:

- What are the main causes of the underdevelopment of the security market in CIS countries?
- Could theoretical supply be the reason behind the development or underdevelopment of securities markets?
- Does a country's financial structure matter for the development of its securities market and for striking a balance between bank and securities market financing?
- What is the role of the state in the development of the securities market in CIS countries?
- What kind of legal and regulatory reforms are capable of eliminating such causes of underdevelopment, and of promoting the development of security markets in CIS countries?

It is hoped that the above research questions may help address the main problems restraining the development of the securities market in CIS countries.

1.3. Statement of purpose

The ultimate goal of the research is to ultimately contribute to the development of a fair and functioning market economy in CIS countries through the improvement of their respective securities markets. The analysis assumes that complex legal and institutional reforms will serve the development of not only the securities market but also its effects on inclusive economic growth in the region.

It would be too naïve to assume that CIS countries' securities markets would flourish in a manner similar to those of the UK or the US. Knowledge alone of the disparities in, among other things, legal system; economic development level; and social peculiarities are sufficient to discourage any such notion or expectation, hence why the main aim of these research findings presented here is to contribute to the achievement of fairness in financial market regulation of banks, the securities market, the state, and investors; to promote real competition on business financing; to ensure market transparency; and to establish free market relations in the financial markets of CIS countries through reducing administrative rules and implementing market principles.

1.4. Methodology

This research has been conducted through the use of literature review and publication research, comparative analysis and empirical study, and other techniques, including historical, qualitative, and quantitative research. The consequent thesis relies on data from the reports and reviews of IOSCO, the World Bank, the OECD, the EBRD, the IMF, the ADB, and other international organizations and other specific research.

1.5. Structure of the dissertation

This dissertation consists of the introduction, five main chapters, and the conclusion. Chapter one, which is the introduction, presents the general features of the research, such as its significance, problem statement, statement of purpose, and its methodology. Chapter two provides background analysis on securities market genesis and its development in CIS countries. Chapter three examines the main theoretical approaches related to securities market regulation. Chapter four examines and compares the concepts of bank and securities market financing, as well as emphasizes the role of regulation in striking a balance between the role of banks and securities markets in business financing. Chapter five covers the role of the state in CIS countries, which is an issue that directly affects their securities market development. The last substantive part of the dissertation – chapter six – proposes concrete measures for the further development of securities markets in CIS countries, in reference to Uzbekistan. And, lastly, the conclusion part provides an overview and summary of the research.

CHAPTER 2. THE ORIGIN, EVOLUTION, AND DEVELOPMENT OF THE SECURITIES MARKET IN CIS COUNTRIES

2.1. Background of SM origin and development in CIS countries

This chapter provides the necessary information and analysis for understanding and considering the main research questions and discussions of the research. Notably, this section outlines the background to securities market formation and development in CIS countries through a brief history of the CIS; considers the necessity of securities market and its regulation in CIS countries; reviews the institutional and legal framework of securities market regulation, and analyzes certain problems of securities market development.

2.1.1. A brief history of the establishment of the CIS

The origin of the SM in CIS countries is directly connected to the collapse of USSR, the formation of the CIS as a regional organization, and the transition of these economies towards a market economy. In this regard, it is essential to outline the history of CIS establishment and the features of market economy transition in CIS countries.

Overall, the history of the establishment of the CIS consists of two main stages: first is the adoption of the 'Agreement of establishing the Commonwealth of Independent States' by three Soviet republics, namely, the Russian Soviet Federative Socialist Republic, Belarus, and Ukraine, on December 8, 1991, in Belovezhskaya Pushcha (Belarus). The second stage is the total expansion of CIS membership to include eight former Soviet republics, namely, Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Moldova, Turkmenistan, Tajikistan, and Uzbekistan, representatives of which signed the Alma-Ata Protocol on December 21, 1991. [2] Thus, from the first year of existence, CIS could mobilize eleven out of the fifteen former Soviet Republics. [3] The Baltic states did not join the CIS from the initial stage; Georgia joined in 1993, however, due to conflict with Russia in 2008, left the organization in 2009. [4] Ukraine [5] and Moldova [6] are also considering

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[2] "The End of the Soviet Union, Text of Accords by Former Soviet Republics Setting Up a Commonwealth", *New York Times*, December 23, 1991, http://www.nytimes.com/1991/12/23/world/end-soviet-union-text-accords-former-soviet-republics-setting-up-commonwealth.html.

[3] Some authors have summarized these stages as "[t]hree plus eight: from the USSR to the CIS". Cf., Zbigniew Brzezinski and Paige Sullivan (eds), *Russia and the Commonwealth of Independent States: Documents, Data, and Analysis*, Center for Strategic and International Studies, Washington, D.C., (Armonk, NY: M.E. Sharpe, 1997), 41.

[4] Radio Free Europe, "Georgia Finalizes Withdrawal From CIS", August 18, 2009. Available at: http://www.rferl.org/a/Georgia_Finalizes_Withdrawal_From_CIS/1802284.html

withdrawal from CIS. In 2005 Turkmenistan reduced its ties with CIS to become what is at present the only associate member of CIS.[7]

The formation of CIS was a starting point for further cooperation between member countries. Alongside the collapse of the USSR, the foundation of the CIS presented new opportunities for former Soviet states, particularly in the field of economic cooperation. Furthermore, in October 2000 Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan further signed an agreement on the establishment of the Eurasian Economic Community (EAEC); [8] in June 2001 China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and Uzbekistan signed the Declaration of Shanghai Cooperation Organization;[9] in September 2003 Belarus, Kazakhstan, Russia, and Ukraine signed an agreement on the formation of CES (Common Economic Space); and, lastly, in July 2010 Russia, Belarus, and Kazakhstan agreed on the creation of a Customs Union.[10]

Considering the aim, function, and the historical and other features of the organizations listed above, and for the purposes of this research, the CIS was selected for closer examination given that it is a key organization for describing and addressing elements of securities market regulation concerning the transitional economies of post-soviet countries. However, one ought to bear in mind that currently the CIS mostly remains symbolic – when compared to other organizations such as the Shanghai Cooperation Organization – with a few supranational powers, nominally possessing a coordinating function for the trade, finance, lawmaking, security, and cross-border crime prevention policies of its membership. It would be unfair to deny the significant historical value of the advent of the CIS, and its potential for not only strengthening collaboration but also for promoting regional development, including financial market growth. This claim is supported by statistics for the CIS region[11] in relation to the world: for instance, CIS

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[5] "Draft Documents on Ukraine's Withdrawal from CIS Submitted to Verkhovna Rada", *TASS Russian News Agency*, May 27, 2014. http://tass.com/world/733566

[6] Cristi Vlas, "Moldova refused to take over the CIS chairmanship in 2017, Russia will take it instead", *Moldova.Org*, September 16, 2016, http://www.moldova.org/en/moldova-refused-take-cis-chairmanship-russia-will-take-2017/

[7] "CIS: Turkmenistan Reduces Ties To 'Associate Member'", *Radio Free Europe*, August 29, 2005, http://www.rferl.org/a/1061002.html

[8] Agreement on Foundation of Eurasian Economic Community. http://wits.worldbank.org/GPTAD/PDF/archive/EAEC.pdf. (Last visited on February 1, 2019).

[9] Boris Z Rumer, *Central Asia: A Gathering Storm?* (Abingdon: Routledge, 2015).

[10] Evgeny Vinokurov, "The Customs Union and the Single Economic Space: Towards the Eurasian Economic Union",*Eurasian Integration Yearbook 2012*. Almaty: Eurasian Development Bank, http://www.eabr.org/general/upload/CII%20-%20izdania/Yerbook-2012/a_n5_2012_05.pdf

[11] See Table 1 below.

comprises 16% of the world's territory; 4% of its population, 4.8% of global GDP[12] (which, incidentally, is equal to Japan's GDP); and 16% of global crude petroleum production and 25% of global gas production, while the share of the most significant producer, namely, the USA, is 13% and 21%, respectively.[13] Macroeconomic and growth indicators demonstrate the significance of the CIS region and CIS studies, especially research concerning economic and social development, which may in turn encourage more contextual analyses with better insights into market economy development in the region, as for almost three decades, CIS members have been pursuing their economic development largely on the basis of the market economy as a means of reaching the levels of the developed world. The present, and other, research on the further improvement of the financial markets of CIS members aims at contributing to the achievement of developed market economies in the jurisdictions and regions of CIS members.

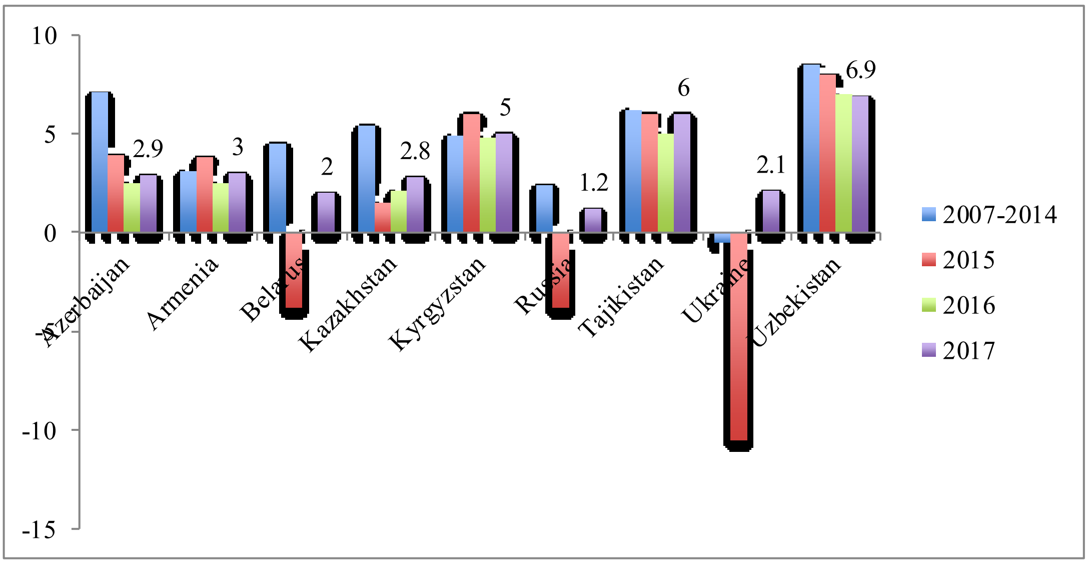
Table 1. Comparison of CIS and world indicators (in %)

	CIS	USA	China	India	Japan	Brazil	EU	Rest of the world
Territory	16	7	7	2	n/a	6	3	59
Population	4	5	19	18	2	3	7	42
GDP	4.8	17.1	14.9	6.4	4.8	3.1	18.6	30.3
Electricity production	6	18	24	6	4	2	14	26
Crude petroleum production	16	13	5	n/a	n/a	3	n/a	14
Gas production	24	22	4	n/a	n/a	n/a	n/a	29

Source: "CIS in the World 2015"[14]

[12] See Figure 1 for detailed information on GDP growth for CIS members over the last decade.
[13] *CIS in the World*, 2015. http://www.cisstat.com/rus/graphik/gr-kratkyi2016.pdf
[14] Table 1 is based on data available throughout the following report: *CIS in the World*, 2015. http://www.cisstat.com/rus/graphik/gr-kratkyi2016.pdf

Figure 1. CIS Real GDP Growth rates, 2007–2017 (in %)



Source: World Economic Situation and Prospects 2016[15]

2.1.2. A market economy is a prerequisite for SM origin in CIS

The centrally-planned economic model of the USSR and the property structure, which comprised only of state and personal property, left little if any room for the existence of not only the securities market but also the market economy as a whole. Hence why during that period in the territory of CIS countries there were no market economy institutions, such as the securities market. The only *financial instrument* of sorts, if it could be deemed as such, had been the state bond (*gosudatstvenniy zaym*), but neither its issuance and circulation nor its enforcement process were market principles applied. Instead, it was exclusively administrative methods that regulated every aspect of the economy, including the semblances of a *financial market* within the soviet model. Therefore, from an institutional and functional viewpoint, there was no commercial or legal basis for the securities market and its regulation under centrally-planned conditions.

After the collapse of the USSR, the declaration of independence by former Soviet countries, and the establishment of the CIS, former Soviet states chose a new basis for their further development. Market-based economic models were selected as such a basis to displace their hitherto centrally-planned command economic models. However, the method and content of the transition process, and the reforms pursued, varied depending on each country's political, economic, social, geographical and other features. Some states chose

[15] Figure 1 is based on data available throughout the following report: World Economic Situation and Prospects (2016),189,
http://www.un.org/en/development/desa/policy/wesp/wesp_current/2016wesp_full_en.pdf

radical (or so-called *shock therapy*) methods of transition, while others opted for gradualist approaches. [16] For instance, Uzbekistan chose the gradual way of building a socially-oriented market economy, which, according to some scholars,[17] is largely reminiscent of the *Chinese model* of development, rather than of western models.[18] While Russia[19] and Kazakhstan[20] at the first stage of transition had preferred a radical switch to a market economy, they subsequently sought to tune their policy.

The market-based economic models adopted thus provided the main cornerstones for the foundation of the securities market in CIS countries, despite the content, methods, and the different transition outcomes across the countries concerned. Such cornerstones had included *private property*, which emerged as the result of small- and large-scale privatizations; *joint stock companies*, which appeared as the consequence of securitization and company law reforms; and *securities market infrastructure*,[21] which was the product of total transition reforms. Therefore, choosing market-based economic models and conducting transition reforms were the first steps that preceded securities market formation in CIS countries. The next steps concerned privatization and denationalization, which, established multiple forms of property rights including private ownership; reduced the level of state ownership; created joint stock companies; and eventually, formed securities markets as an indispensable part of the market economy. The nature of the emergent

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[16] See in details: Richard Pomfret, *The Economies of Central Asia*. Vol. 318. (Princeton, NJ: Princeton University Press, 2014); Richard Pomfret and Richard W T Pomfret, *The Central Asian Economies Since Independence*. (Princeton, NJ: Princeton University Press, 2006).

[17] For instance, in the literature it is mentioned that "the economic success of Uzbekistan resembles the Chinese—gradual economic reforms with the strong state institutions, good macroeconomic policy, and an export oriented industrial policy…". See: Bakhtiyor Islamov and Doniyor Islamov. "The Central Asian States 20 Years After: The "Puzzles" of Systemic Transformation", *Acta Slavica Iaponica* 35 (2014): 109-134; Vladimir Popov, "An Economic Miracle in the Post-Soviet Space: How Uzbekistan Managed to Achieve what no other post-Soviet State has', *MPRA Paper* 48723 (2014)

[18] See: Ulugbek Olimov, and Yadgar Fayzullaev, "Assessing Development Strategies to achieve the MDGs in the Republic of Uzbekistan", *United Nations Department for Social and Economic Affairs* (2011): 1-55.

[19] See: Vladimir Popov, "Russia: Inconsistent Shock Therapy with Weakening Institutions" in *Transition and Institutions: The Experience of Gradual and Late Reformers* edited by Giovanni Andrea Cornia and Vladimir Popov WIDER Studies in Developmental Economics, United Nations University,(Oxford: Oxford University Press, 2001); Vladimir Popov, "A Russian Puzzle: What Makes the Russian Economy Transformation a Special Case", *World Institute for Development Economics Research Paper* No. 29 (1996).

[20] For the features of the Kazakhstan transition path see: Каренов Р.С. «20 лет экономического перехода в Казахстане и перспективы индустриально-инновационного развития стран», Экономическое Развитие, Вестник КарГУ, 2011. (Karenov R.C. 20 Years of Economic Transition in Kazakhstan and Prospects of Industrial-innovative Development of the Countries), http://articlekz.com/article/5594; and Есентугелов А. Экономика независимого Казахстана: история рыночных реформ, Под ред. К.К. Еженовой. – Алматы, 2008. – 356 с. (Yesentugelov A. Ekonomika nezavisimogo Kazaxstana: istoriya rinochnix reform. Pod.red.KK.Ejenovoy.- Almaty, 2008. 356 s.), (Esentugelov A. The economy of Independent Kazakhstan: the History of Market Reforms, (ed).K.K.Ejenova, Almaty, 2008, 356)

[21] The *securities market infrastructure* includes: securities as an object of securities market relations; market institutions (including the stock exchange, brokers and dealers, clearing, depository services etc) as a subject of securities market relations; and the legal framework as a basis to facilitate the conduct of these relations.

securities market in each CIS country mostly depended on the content and quality of privatization, company, and other, law reforms pursued in each state, hence why it is necessary to provide an overview of the initial stages of transition reforms in certain CIS countries in order to better understand the notion and specifications of their securities market regulation cornerstones.

2.1.3. Features of Transition and privatization in CIS countries

Restructuring and privatization[22] – the processes of creating a feasible financial sector, reforming state enterprises, and transferring their ownership into private hands – is one of the main ingredients of the transition process.[23] The phenomenon of privatization may be witnessed in the economic development history of most developed countries, for instance, Germany in the 1960s;[24] Chile in the 1970s;[25] the UK in the 1950s and again in the 1980s;[26] the US in the 1980s;[27] and Japan in the 1980-90s[28], all experienced privatization. After the Thatcher and Reagan reforms in the 1980s in the UK and the US, respectively, privatization spread throughout the world, particularly in the post-soviet countries that started to emerge in the early 90s. Despite the initial western inspiration, privatization in post-soviet states, including the CIS, was further conditioned by their idiosyncrasies and special features which were formative on the development of the securities market infrastructure both at national and regional level. Key features of privatization in the post-soviet republics, including in CIS, include: the absence of market institutions; the absence of an entrepreneurial class; scarcity of investment resources; and the domination of large enterprises and/or state monopolies in the structure of the economy.

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[22] This research considers the term *privatization* as the transfer of the ownership of state-owned enterprises to the private sector.

[23] The EBRD's transition indicators concern eight components: namely, three measures on privatization and restructuring, three on market liberalization and competition, and two on financial markets reform. For further details see European Bank for Reconstruction and Development, "Ten Years of Transition," Transition Report 1999 (London: EBRD, 1999), 7.

[24] Katja Fuder, A Long Goodbye: Federal Industrial Entrepreneurship and Privatization Policy in Germany 1945-1989, December 3, 2012 http://www.lse.ac.uk/economicHistory/seminars/EH590Workshop/EH590MT2012/Katja-Fuder-EH-590.pdf

[25] The Heritage Foundation Report, How Chile Successfully Transformed Its Economy, September 18, 2006, http://www.heritage.org/international-economies/report/how-chile-successfully-transformed-its-economy

[26] Chris Edwards, "Margaret Thatcher's privatization legacy", *Cato Journal* 37 (2017): 89.

[27] Report of the Commission on Government Forecasting and Accountability of Illinois State, "Government Privatization History, Examples, and Issues", October 2006, http://cgfa.ilga.gov/Upload/2006Gov_Privatization_Rprt.pdf

[28] Hiromi Tamamura, "The actual state and effect of privatization in Japan," In *East Asia Competition Policy Forum*. 2002, http://www.jftc.go.jp/eacpf/03/privatization.pdf

Privatization raises a range of ethical questions concerning how it may be socially unjust and unethical to privatize social and collective property, which had once been created and developed by the concerted efforts of several generations of the population under the previous economic model.[29]

CIS countries faced different challenges from the first stages of transition due to their distinct economic, social, and geographical features, despite similarities concerning their common past, recent history, and economic structure. Several differences may be witnessed based on the speed and content of their respective privatization reforms that mostly relate to the features of their respective transition paths. For instance, in Uzbekistan privatization was incremental and through securitization. Russia experienced *shock therapy* and usage of the voucher scheme, and Kazakhstan had initially attempted *shock therapy* before amending its policy, and relying on coupons and securitization methods in its privatization reforms. Therefore, a brief review and comparison of the transition experiences of these countries may help one to better understand the characteristics of each transition, and of the cornerstones of SM formation in these countries specifically and the CIS region more generally.

2.1.3.1. Russian transition puzzle and features of privatization in Russia

Privatization in post-soviet countries – including Russia – required the establishment of private property and the infrastructure to facilitate private ownership of previously state-owned property, which are fundamental to any economy claiming to be market-based. The Russian privatization experience was mostly characterized by high-speed reforms and radical changes which had fundamental economic, social, and political consequences. The Russian experience further contributed to the world history of privatizations with a seminal case study termed the "Russian transition puzzle" in the relevant literature. [30] The main reason that the Russian experience

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[29] For instance, such kind of issue rose during the privatization reforms in Kazakhstan, where shares of state owned JSCs distributed free of charge in exchange of privatization coupons (the document certifying the right to receive a part of state property). This was considered as the distribution of property that was earned with the efforts of every citizen, who lived in USSR. See: Есентугелов А.Е. "Экономика независимого Казахстана: история рыночных реформ" (Yesentugelov A.Ye. "Ekonomika nezavisimogo Kazakhstana: istoriya rynochnykh reform". "Esentugelov A.E. "The economy of independent Kazakhstan: the history of market reforms"). http://www.elimai.kz/malaya-i-massovaya-privatizaciya-gosudarsvetnnoj-sobstvennosti-v-kazaxstane.html

[30] The Russian transition case provided several studies on the subject. For instance, Giovanni Andrea Cornia and Vladimir Popov, (eds). *Transition and Institutions: The Experience of Gradual and Late Reformers*. (Oxford: Oxford University Press, 2001); Vladimir Popov, "Shock Therapy Versus Gradualism Reconsidered: Lessons from Transition Economies after 15 Years of Reforms", *Comparative Economic*

has been considered unique and somewhat puzzling is the fact that it yielded inconsistent results with regard to the policy recommendation and forecasts that had previously been jointly proposed by the IMF, OECD, and EBRD in January 1991. In light of those recommendations, the following year Russia initiated sweeping mass privatization reforms, the main features of which could be observed in the speed and method of privatization.

Concerning the speed of privatization, Russia tried to implement rapid and radical changes equipped with the support of the IMF and of western countries. The immediate impact of *shock therapy* included record levels of price inflation and a dramatic drop in GDP. Consumer prices rose by 1,345% in the first year of shock therapy after August 1991. Price inflation was 896% in 1993, 220% in 1994, 190% in 1995 and as much as 48% in 1996. Between 1992 and 1998, Russian GDP declined by 44%, industrial production fell by 56%, and capital investment by 80%. By comparison, the fall in Soviet GDP during World War II had been 24%.[31] The reforms quickly met with resistance. Vested interests successfully pushed for the public financing of loss-making enterprises, and large-scale monetization of public sector deficits continued for several years.[32]

All these results appealed to neoclassical economic theory to justify the overall direction of policy[33] and led to several empirical research studies[34] to analyze the reasons, consequences, and projections on Russian transition. For instance, Professor Jeffrey Sachs, a member of the group of western advisors concerning the first transition reforms in Russia, stated that structural implementation reasons, not *shock therapy* itself, as responsible for the failure of the Russian reforms.[35] In the interview to the newspaper *Novoye Vremya*, Sachs mentioned that: "when we undertook the reforms we felt ourselves

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Studies 49, no. 1 (2007): 1-31; Vladimir Popov, "A Russian Puzzle: What Makes the Russian Economy Transformation a Special Case", (1996); Vladimir Popov, "Will Russia Achieve Fast Economic Growth?" *Communist Economies and Economic Transformation* 10, no. 4 (1998): 421-449.

[31] Peter Reddaway,and Dmitri Glinski, *The Tragedy Of Russia's Reforms: Market Bolshevism Against Democracy*, (Washington, DC: United States Institute of Peace Press, 2001).

[32] James Roaf, Ruben Atoyan, Bikas Joshi, and Krzysztof Krogulski. "25 Years of Transition." (2014).

[33] Simon Deakin and John Hamilton, "Russia's Legal Transitions: Marxist Theory, Neoclassical Economics and the Rule of Law" (2015), p.17.

[34] For instance, Maxim Boycko, Andrei Shleifer, and Robert Vishny, *Privatizing Russia*, MIT Press, 1997; Vladimir Popov, "A Russian Puzzle: What Makes the Russian Economy Transformation a Special Case", (1996); Bernard Black, Reinier Kraakman, and Anna Tarassova, "Russian Privitization And Corporate Governance: What Went Wrong", *Stan. L. Rev.* 52 (1999): 1731; Vladimir Popov, "Shock Therapy Versus Gradualism Reconsidered: Lessons From Transition Economies After 15 Years Of Reforms" *Comparative Economic Studies* 49, no. 1 (2007): 1-31; Bruce Kogut, and Andrew Spicer. "Capital Market Development And Mass Privatization Are Logical Contradictions: Lessons From Russia And The Czech Republic", *Industrial and Corporate Change* 11, no. 1 (2002): 1-37.

[35] IMF economist Stanley Fischer, cited in Peter Reddaway and Dmitri Glinski, *The Tragedy of Russia's Reforms: Market Bolshevism Against Democracy* (Washington, DC: United States Institute of Peace Press, 2001), 301.

to be doctors who had been called to someone's sickbed. However, when we placed the patient on the operating table and opened him up, we found that his anatomical structure and internal organs were completely different, of a kind we never encountered in medical school". [36] Other scholars linked the unsuccessful implementation of classical *shock therapy* in Russia mostly to Russian social and cultural particularities. [37] For Joseph Stiglitz, the failure of rapid privatization in Russia "was not an accident, but a predictable consequence" of the absence of competition policies and the institutional and legal infrastructure needed to support successful reform efforts. [38] Thus, the lack of experience, the peculiarities of the social structure that had evolved in Russia within the context of the planned economy system, as well as the choice of rapid privatization methods, all contributed to the emergence of certain drawbacks concerning the privatization process.

Another feature of the Russian transition experience that deserves attention is the method of privatization: the voucher scheme had been the main privatization method, by which every Russian citizen was given a privatization voucher worth 10,000 rubles that could be sold, exchanged for shares in privatized companies, or invested in collective investment vehicles known as 'voucher funds.' It would seem that rapid, top-down, and mass privatization was successfully under way. At least, such a conclusion could be drawn based on the initial results of privatization, which involved the privatization of 47,000 state-owned enterprises (SOEs) by 1993, and 90,000 a year later. [39] However, a drawback of the voucher scheme is that it laid down the foundations for the advent and growth of financial pyramid schemes that soon spread not just across Russian territory, but also across all post-soviet countries, including the CIS region. [40] Moreover, the voucher mechanism presented opportunities for money laundering, and led to the concentration of

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[36] Jeffrey Sachs writing in *Novoye Vremya* (1995) No. 28, cited in Roy Medvedev, *Post-Soviet Russia: A Journey through the Yeltsin Era* (New York: Columbia University Press, 2000), 84.
[37] Vladimir Popov, "A Russian Puzzle: What Makes the Russian Economy Transformation a Special Case", (1996), 10.
[38] IMF, "Transition Economies: An IMF Perspective on Progress and Prospects", November 3, 2000, https://www.imf.org/external/np/exr/ib/2000/110300.htm#P159_24503,.
[39] Data derived from the following publication: Maxim Boycko, Maxim, Andrei Shleifer, and Robert Vishny. *Privatizing Russia*. (Massachusetts: MIT Press, 1997).
[40] For details about the origins of financial pyramids during the transition period see: Белянин А. В. Финансовые пирамиды» в переходной экономике с точки зрения теории игр / А.В. Белянин, О.Г. Исупова // Российская программа экономических исследований: научный доклад, 2000. №10. (Belyanin A. V. Finansovyye piramidy» v perekhodnoy ekonomike s tochki zreniya teorii igr / A.V. Belyanin, O.G. Isupova // Rossiyskaya programma ekonomicheskikh issledovaniy: nauchnyy doklad, 2000) "Financial Pyramids In The Transition Economy From The Point Of View Of Game Theory"; and Гусев А. В. «Финансовые пирамиды в России как результат несовершенства институциональной среды» // Экономические науки. №5 (90). 2012, 48 с. (Gusev A. V. «Finansovyye piramidy v Rossii kak rezul'tat nesovershenstva institutsional'noy sredy» // Ekonomicheskiye nauki.), "Financial Pyramids in Russia as a Result of Imperfect Institutional Environment".

ownership in the hands of former managers and civil servants who had previously been running most of the former SOEs and who by that point had thus become oligarchs.[41] Western prescriptions, such as those of the IMF and of *shock therapy* advocates, allowed the former nomenclature and the financial 'oligarchs' to acquire Russia's industrial and natural resources, and thus to heavily influence the country's political destiny.[42]

A brief analysis of the Russian privatization experience allows one to draw the following conclusions: the privatization timeframe turned out to be extremely brief for solving such a grandiose task that determined the quality of privatization. Also, the ownership change did not entail an inflow of foreign investment, and the privatization was not accompanied by sufficient financial, legal and structural reorganization; a significant part of the property passed into the hands of persons closely associated with the criminal underworld and with the former party nomenclature. Despite the drawbacks discussed in the foregoing, Russian privatization reforms lay the foundations of the market economy; private property institutions; private owner and shareholder class; and of the securities market infrastructure in the country.

2.1.3.2. Features of privatization in Kazakhstan

The Kazakhstan experience concerning the formation of the private property system and the establishment of market economy institutions deserves particular attention due to the unique and distinctive features of the privatization model pursued. The main features are as follows: firstly, unlike Russia, Kazakstan developed its model of privatization based on the experience of former east bloc/soviet satellite countries including Poland, Hungary, and, what had been at the time, Czechoslovakia. Secondly, Kazakhstan initially appeared to follow a neoliberal path, but the government quickly assumed a prominent role once again. [43] Thirdly, the lack of capable and robust institutions along with the dramatic economic reforms precipitated the failure of the neoliberal

[41] For further details concerning the origins of Russian oligarchs, see: David E. Hoffman, *The Oligarchs: Wealth and Power in the New Russia*, (Hachette UK, 2011); Paul Khlebnikov, "Godfather of the Kremlin: Boris Berezovsky and the Looting of the Russian State", (2000); Chrystia Freeland, *Sale of the Century: Russia's Wild Ride from Communism to Capitalism.* Crown, 2000; and Marshall I. Goldman, *Lost Opportunity: What has Made Economic Reform in Russia so Difficult* (New York: WW Norton & Company, 1996)

[42] The view of the present author as to the link between privatization methods and the emerging oligarchy in Russia is partly based on Peter Reddaway and Dmitri Glinski. *The Tragedy of Russia's Reforms: Market Bolshevism Against Democracy*. (Washington, DC: United States Institute of Peace Press, 2001), 479.

[43] Kathryn H. Anderson and Richard W. T. Pomfret, *Consequences Of Creating A Market Economy: Evidence From Household Surveys In Central Asia*, (Cheltenham, UK: Edward Elgar Publishing, 2003), 75.

attempts in Kazakhstan.[44] Fourthly, the privatization method used in Kazakhstan differs to those of the Russian and Uzbekistan privatization approaches. Fifthly, the privatization policies were associated with widespread corruption and a sense of casino or crony capitalism similar to that which emerged in Russia between 1995–96.[45] Lastly, unlike the experience of Russia and other CIS countries, in Kazakhstan state-initiated public offerings were being sold mainly to strategic investors, rather than the public at large.[46]

Below follows an analysis of the main reforms in order to gain a more precise picture of the Kazakhstan privatization experience and to draw the necessary conclusions for the subsequent research in the present thesis.

In 1991, the Supreme Council of the Kazakh Soviet Socialist Republic (SSR) adopted the resolution On the Main Directions of Denationalization and Privatization of State Property in the Kazakh SSR (of February 16, 1991) and the Law on Denationalization and Privatization (June 22, 1991). Legally, privatization was understood as the act of transferring state property to the ownership of physical and non-governmental legal entities. Later, the President of Kazakhstan approved the Program of Denationalization and Privatization of Property in the Kazakh SSR for 1991-1992 (Stage 1).[47] The program provided for the mandatory privatization of a number of specific enterprises; and reserved the opportunity to privatize enterprises on the initiative of labor collectives with the provision of benefits to labor collectives. Auction, tender, or a joint-stock company were all approved vehicles of denationalization and privatization. The participation of foreign citizens and foreign legal entities in privatization was limited. At the initial stage of privatization, 4,770 entities, including 470 state farms, were withdrawn from state ownership.

The second stage of the privatization program was launched by Presidential Decree No. 1135 on March 5, 1993.[48] It contained directions for the denationalization and privatization of the following: small-scale privatization of enterprises with up to 200

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[44] Каренов Р.С. «20 лет экономического перехода в Казахстане и перспективы индустриально-инновационного развития стран», Экономическое Развитие, Вестник КарГУ, 2011. (Karenov R.C. 20 Years of Economic Transition in Kazakhstan and Prospects of Industrial-innovative Development of the Countries) http://articlekz.com/article/5594.

[45] Richard Pomfret, *The Economies of Central Asia*. Vol. 318, (Princeton, NJ: Princeton University Press, 2014); Richard Pomfret and Richard W. T. Pomfret, *The Central Asian Economies Since Independence*, (Princeton, NJ: Princeton University Press, 2006), 6 http://press.princeton.edu/chapters/s8279.pdf

[46] Eurasian Development Bank Report, "The Securities markets of Russia and Kazakhstan: Prospects for Integration", Almaty, 2010, 12. http://www.eabr.org/eng/ publications/AnalyticalReports/

[47] Decree of the President of the Republic of Kazakhstan No. 549 of September 13, 1991.

[48] On the National Program of Denationalization and Privatization in the Republic of Kazakhstan for 1993-1995

employees (sale at auctions and competitions); mass privatization of enterprises with a contingent of 200 to 500 employees (securitization); privatization of large-scale enterprises and selected industrial projects with the participation of domestic and foreign investment. At this stage, privatization of significant and unconventional assets and enterprises was started under specific plans with the involvement of foreign legal entities and individuals. [49] Such privatizations were carried out by: sales to individual investors on specified terms; auctions or tenders; open sale of shares; or the conclusion of concessions/management contracts.[50]

The Kazakhstan privatization experience is mostly characterized by the implementation of the coupon mechanism, which was different to the Russian voucher scheme. All citizens of Kazakhstan (including children) were to receive coupon books – residents of cities were credited with 100 coupons, and rural residents 120 to partially compensate for the difference in financial position. [51] The scheme was designed in such a way that investment coupons were registered for their owners and were not subject to transfer or sale as unlike the case with the voucher privatization scheme in Russia. Coupons could only be invested in privatization investment funds[52] (PIFs), which would issue their shares in exchange for coupons. PIFs, in turn, would purchase shares in SOEs at coupon auctions. As part of mass privatization, only privatization investment coupons[53] were used as payment instruments.

Coupon privatization, the deadline for which had been shifted several times, was completed in February 1996. As a result of coupon privatization, investment funds ended up owning 10% of state property. At the same time, 66-68% coupons of the population were redeemed, i.e., one-third of the population did not use their coupons.[54]

Unfortunately, the lack of time frames for reforming the economy led to ineffective solutions. The coupon method of privatization, based on the ideas of social justice, was not brought to completion as almost a third of the population did not use its

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[49] In July 1997, amendments were made to the Law on Foreign Investments of December 27, 1994, which removed restrictions on participation in the privatization of foreign investors.
[50] 12,875 enterprises were privatized through open auctions, 1,275 commercial tenders, 694 investment contests, and 3,104 by other means.
[51] The distribution of coupon books ended at the end of 1993 through the National Bank network. In total, more than 15.5 million coupon books were issued to about 90% of the total population.
[52] Only licensed PIFs, of which there were about 170, could participate in auctions.
[53] Not to be confused with housing coupons in small-scale privatization.
[54] Суверенный Казахстан на рубеже тысячелетий, М.С. Ашимбаев (ответственный редактор), 2001. (Suverennyy Kazakhstan na rubezhe tysyacheletiy, M.S. Ashimbayev (otvetstvennyy redaktor), 2001.) (Sovereign Kazakhstan at the turn of the millennium, edit, by Ashimbaev MC., 2001.) Available at: http://bibliotekar.kz/suverennyi-kazahstan-na-rubezhe-tysjache.

coupons. Monetary privatization was not entirely focused on stimulating the real economy. 'As a result, the development of the economy was aimed at exporting raw materials -- this type of economic development is entirely reliant on the vagaries of the global commodity markets and is therefore very volatile.[55] Despite the drawbacks of the principal privatization method used in Kazakhstan, the foundations of the market economy were laid by establishing private ownership, creating private owners and shareholders, and by providing the basis for the national securities market.

2.1.3.3. The 'Uzbek Growth Puzzle' and features of privatization in Uzbekistan

The main feature of privatization in Uzbekistan is characterized by its gradualist content concerning the so-called 'Uzbek Model' of transition that was based on five fundamental principles: full *de-ideologization* of the economy; the state is the main reformer; the rule of law; robust social protection; and the gradual formation of market relations.[56] In the most populated country of the region, the prevention of a sharp fall in output, a reduction in people's incomes, and unemployment growth were the main reasons for opting for gradual privatization.[57] Considering the special development path of Uzbekistan, Spechler mentions that the Uzbek government proclaimed that it would rather seek to emulate Japan and South Korea than the liberal Western economies.[58] For instance, one of the main principles of Uzbekistan's transition to a market economy had been that 'the state is the main reformer'. This principle also could be seen in the case of Japan. According to Johnson, who has researched the 'Japanese miracle', "the Japanese state has served as a guide for economic development, e.g., through promoting technology transfer, planning the development of Japan's industrial structure and setting incentives to achieve the desired changes."[59] Other scholars have also commented on the particularities of the Uzbekistan experience and its similarities to Japanese reforms in the 1950s-70s, South Korean reforms in the 1960s-80s, and Chinese and ASEAN member reforms since the

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[55] Amangeldiev Batirlan Ramazanovich – the leading researcher of the Economic Security Department of the Kazakhstan Institute of Strategic Studies under the President of the Republic of Kazakhstan http://bibliotekar.kz/suverennyi-kazahstan-na-rubezhe-tysjache/privatizacija-v-kazahstane.html

[56] Islam Karimov, "Uzbekistan: 16 years of Independent Development", Information Agency "Jahon", Ministry of Foreign Affairs of Uzbekistan, 2-3.

[57] Ulugbek Olimov and Yadgar Fayzullaev, "Assessing Development Strategies to Achieve the MDGs in the Republic of Uzbekistan", *United Nations Department for Social and Economic Affairs* (2011): 4.

[58] Martin C. Spechler, "Hunting for the Central Asian Tiger", *Comparative Economic Studies* 42, no. 3 (2000): 101-120.

[59] Chalmers Johnson, *MITI and the Japanese Miracle: the Growth of Industrial Policy: 1925-1975*. (Stanford, California: Stanford University Press, 1982).

1990s.[60] Uzbekistan's growth performance during 1992-2001 was the best among those of the former Soviet republics.[61] This fact is also recognized by the United Nations country study Assessment Report, according to which "by 2001 Uzbekistan's GDP was 3% above the 1989 level, making the country's growth performance the best of the former Soviet Republics." [62]

The Uzbek path to economic development has attracted the attention of many scholars and institutions for more than two decades. All of these studies recognized that tightly controlled, gradually reformed, Uzbekistan was the best performer among former Soviet republics. [63] This was obvious, especially in the first decade of transition. In his paper entitled 'The Uzbek Growth Puzzle' Jeronim Zettelmeyer [64] wondered why authoritarian and non-reformist Uzbekistan was doing better than other former Soviet Union countries, contrary to the expectations of major financial institutions. [65] One of the most prominent scholars on Central Asian transition – namely, Professor Richard Pomfret – has also recognized Uzbekistan's GDP performance as being the best among other former Soviet countries, although he noted that the outcome in the second decade of transition has been less positive. [66] Professor Terry McKinley has stated that "[y]et by any standard barometers of economic performance – as well as by comparison with other low-income countries – Uzbekistan has been relatively successful over two decades of transition and development, though its achievements appear to remain a frustrating puzzle to many orthodox economists." [67] As an example, Professor Popov cites the following figures: "[i]n 2013, Uzbekistan exported about 100 thousand cars, almost as much as Russia, whose GDP is 25 times larger" than Uzbek GDP. [68] This relatively successful

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[60] See in details: Vladimir Popov and Anis Chowdhury. "What Uzbekistan Tells Us about Industrial Policy That We Did Not Know?" (2015), where the following scholars and their research are mentioned: Dollar, 1992; Easterly, 1999; Polterovich, Popov, 2004; Rodrik, 2008; Bhala, 2012.

[61] David M. Kotz and Thompson Hall, "The "Uzbek growth puzzle" and the Washington Consensus", In *A Session on 'Issues in Economic Transition'* sponsored by the Union for Radical Political Economics at the Allied Social Science Associations Convention. 2004.

[62] Ulugbek Olimov and Yadgar Fayzullaev, "Assessing Development Strategies to Achieve the MDGs in the Republic of Uzbekistan" *United Nations Department for Social and Economic Affairs* (2011): 4-5

[63] Richard Pomfret, "Lessons from Economies in Transition from Central Planning", *Australian Economic Review* 36, no. 2 (2003): 3.

[64] Jeromin Zettelmeyer, *The Uzbek Growth Puzzle*. No. 98-133, International Monetary Fund, 1998.

[65] The World Bank, *Uzbekistan - An Agenda for Economic Reform*, September 30, 1993, 1–350, http://documents.worldbank.org/curated/en/1993/09/698887/uzbekistan-agenda-economic-reform.

[66] Richard Pomfret, "Central Asia after two decades of independence", In *Economies in Transition*, 400-429. (London: Palgrave Macmillan, 2012).

[67] Terry McKinley, "The Puzzling Success of Uzbekistan's Heterodox Development", *Development Viewpoint* 44 (2010): 15.

[68] Vladimir Popov, "Can Uzbekistan's Economy Retain its High Growth Rate?" *Scenarios of Economic Development in 2015,* (2014) 30.

economic performance is even more impressive given that Uzbekistan is not a major oil and gas exporter (as is the case with Russia, Kazakhstan, Azerbaijan, and Turkmenistan) and given that it is one of two double-landlocked countries in the world. [69]

Two decades after the EBRD Transition Report 2013 'Stuck in Transition?' identified a reverse 'puzzle' – namely, the Kyrgyz 'Puzzle' – in that while Kyrgyzstan is applying almost all recommendations of the leading financial institutions its transition and economic growth seemed to have stalled. According to Islamov, "analyses of more than 20 years experiences of transition countries in Central Asia led us to the main conclusion that less radical and more gradual reforms resulted in better economic growth. In this respect, the achievements of Uzbekistan are not a "puzzle", but the logical result of its efforts to introduce gradually, step-by-step, market reforms combined with state-led industrial export-oriented policy, that was first successfully used in Post-World War II Japan."[70]

The gradual character of the Uzbekistan transition model directly reflected the speed of privatization reforms that were performed in four stages. The first stage (1992-1993) covered the state housing fund, small and medium enterprises of trade, service, light and food industries, by which 52,268 owners arose. [71] The second stage (1994-1996) mostly focused on wide-scale privatization, based on which 2 million shareholders of privatized enterprises, 3 million owners of private household plots, 85,000 owners of individual and small enterprises, and 14,000 real estate owners arose. [72] The third stage of privatization, which began in 1998, mostly focused on the privatization of industrial giants, such as oil, energy, chemical, metallurgical, and machine-building industries, with the extensive involvement of foreign investment. [73] The fourth stage, which began from 2000 and remains ongoing, is characterized with the privatization of state assets through zero redemption cost; [74] the intense attraction of FDI in the privatization process; and and better management of state shares.[75]

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[69] Vladimir Popov, "An Economic Miracle in the Post-Soviet Space: How Uzbekistan Managed to Achieve What No Other Post-Soviet State Has", *MPRA Paper* 48723 (2014).
[70] Bakhtiyor Anvarovich Islamov, "25 Years of Transition Economies Research and Three HUs" *地域経済経営ネットワーク研究センター年報= The Annals of Research Center for Economic and Business Networks* 5 (2016): 85-87.
[71] See details in the official website of the State Committee responsible for privatization in Uzbekistan https://gkk.uz/en/
[72] Ibid
[73] Ibid
[74]Zero redemption cost is the term used in the "Resolution by the President of the Republic of Uzbekistan dated July 20, 2007 No PP-672., According to this document this term means free transfer of state property to new owners under suitable investment commitments. http://www.uzbekembassy.org/e/privatisation/.
[75] "Privatization and Organization of Business Companies in Uzbekistan," 2, http://www.idosi.org/mejsr/mejsr18(1)13/20.pdf.

Another feature of privatization – unlike the voucher scheme (that was used in Russia) and the coupon mechanism (that was used in Kazakhstan) – was based on the securitization of state-owned enterprises. A further feature of Uzbek privatization involved the usage of zero redemption cost method, which, as stated earlier, involves the free transfer of state property to the new owner under appropriate investment obligations, such as the obligation to invest in new technologies, foreign currency; [76] creation of employment positions in designated regions and so on.[77]

The mass reorganization of state enterprises to joint-stock companies reached its peak after the adoption of Presidential Decree 'On Priorities for the Further Development of the Denationalization and Privatization Process in Uzbekistan'[78]This decree specified the group of stakeholders in the open joint stock companies formed by privatization. These were the state, employers, foreign partners, and other investors.

Despite all of their achievements, Uzbekistan and other CIS countries are still facing severe challenges in developing their market institutions and strengthening market-based relations. According to the latest EBRD country assessment, although Uzbekistan continues to demonstrate strong growth, monopolization of power within the executive branch, state dominance of the economy, and the failure to establish a functionally independent judiciary, have all hindered Uzbekistan's transition process. Such a phenomenon is particularly evident in the financial market, including the securities market, its infrastructure, and regulation. Following the review of two decades of the transition experience of Uzbekistan, Professor Pomfret also highlights the severe financial repression and domination of the financial sector by state-owned banks. [79] Another scholar specializing in the transition of post-Soviet countries – namely, Vladimir Popov –has predicting probable economic decrease and necessity for further reforms, recommends

[76] At the time of launching zero redemption cost scheme there was not available foreign currency exchange in Uzbekistan. Until September 2017 black market was dominant. In that situation investment in foreign currency (in cash) was considered as one of the prior forms of investment.

[77] "Resolution by the President of the Republic of Uzbekistan dated July 20, 2007 No PP-672,", http://www.uzbekembassy.org/e/privatisation/.

[78] "Ukaz o prioritetnykh napravleniyakh dal'neyshego razvitiya protsessa razgosudarstvleniya i privatizatsii v Respublike Uzbekistan," from March 15, 1994 No. UP-789.Vedomosti Verkhovnogo Soveta Respubliki Uzbekistan, 1994, (Decree on Priorities for Further Development of the Process of Privatization in the Republic of Uzbekistan, *Vedomosti* of the Supreme Council of the Republic of Uzbekistan) http://lex.uz/pages/getpage.aspx?lact_id=195995.

[79] Richard Pomfret, "Central Asia after two Decades of Independence", In *Economies in Transition*, 400-429. (London, UK: Palgrave Macmillan, 2012).

increasing the rate of accumulation by ten percentage points through the mobilization of domestic savings and attracting capital from abroad to avoid a decrease in growth.[80]

As is the case with other CIS countries, processes in Uzbekistan created private property institution, shareholders, and joint stock companies that have raised the necessity for an organized securities market, which began through the development of the securities market infrastructure and the proper legal basis for such market.

As shown in the brief analysis of the privatization experience of CIS countries, primarily Russia, Kazakhstan, and Kyrgyzstan, despite their neoliberal approach, transition reforms will not bring expected results, if there is insufficient institutional and legal infrastructure. It is as if a camper were to attempt to burn a fire just with a spark without possessing kindling, firewood or any other proper fuel. In this regard, the securities market infrastructure will serve as a source for transferring the *spark* of privatization reforms to the *fire* of the current market relations and maintain its stability and growth that would enlighten and further heat the path to development. Therefore, the present author attempts in the below section to analyze the necessity of the securities market and its regulation, and the features of the institutional and legal framework of the securities market in the CIS.

2.2. The necessity of SM and its legal regulation in CIS countries

2.2.1. Necessity and functions of the securities market

The securities market is an indispensable tool of economic development and plays a key role in today's global financial economy, where transactions are carried out electronically and across international borders.[81] It is especially crucial for CIS countries the significant parts of which comprise landlocked countries (Azerbaijan, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan).[82] Securities market supplies the economy with the mechanism that helps issuers to accumulate financial resources of investors; and investors to multiply their savings by investing funds in securities without transportation, logistics, and border issues. On the other hand, the securities market provides an effective balance mechanism with the banking industry; contributes to the strengthening of competition in the financial market; reduces costs of business financing;

[80] Vladimir Popov, "Can Uzbekistan's Economy Retain its High Growth Rate?" *Scenarios of Economic Development in 2015,* 30 (2014).
[81] J. C. Coffee, J. Seligman and H. A. Sale, *Securities Regulation*, (Harvard: Foundation Press, 2007), 82
[82] Uzbekistan is one of two double-landlocked countries of the world; the other is Liechtenstein (surrounded by Austria and Switzerland). Details at: https://www.thoughtco.com/landlocked-countries-1435421.

supports the improvement of capital allocation and distribution; facilitates price formation; and provides a further monitoring system for the economy.[83]

The necessity of the securities market would be more apparent by considering its primary functions. The securities market has some tasks that can be conditionally divided into two groups: *general market functions* that are inherent in each market, and *specific functions* that distinguish the securities market from other markets. General market functions include commercial, price, information, and regulatory functions. The general market function allows participants of the securities market to generate revenue from their operations in a given market. The price function of the market provides the system and the process of price formation, their constant movement. The information function produces and brings to its participants market information about financial instruments, subjects, and permitted content of their relations. And lastly, the regulatory function of the market which creates rules of trade and participation in it, sets the procedure for resolving disputes between the parties, sets priorities, and controls the management of the market.

The specific functions of the securities market include insurance, redistribution, infrastructural, and investment functions: the insurance function assists the reduction of price and financial risks in transactions with financial instruments; the redistribution function provides reallocation of funds between branches and spheres of the economy, directing capital to important sectors and industries; the infrastructural function performs the creation of trade networks;[84] and, lastly, the investment function provides alternative sources of investing to banks, brokers, dealer companies, and investment funds.[85]

In the transition countries of the CIS, the full potential of the securities market is rarely used due to the fact that not all of the various functions of the securities market have developed at all. Consequently, the securities market cannot be considered as an alternative source of business financing to the banking sector. There is also a serious lack of the fulfillment of the securities market's investment, capital allocation and distribution, price formation, information, and regulatory functions. Conversely, the banking sector fulfills these functions by occupying this vacuum. The actual conditions under which the

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[83] Ana Carvajal and Jennifer A. Elliott, *Strengths and Weaknesses inSsecurities Market Regulation: A Global Analysis*. International Monetary Fund, 2007, 4

[84] Bernard Dumas and Blaise Allaz, *Financial Securities: Market Equilibrium and Pricing Methods*, (Springer, 2013), 385

[85] D. Banerji, and R. Das (2014) "Understanding the Impact of Securities Markets Reform on the Economy of Brazil", in *Handbook of Research on Economic Growth and Technological Change in Latin America*, B. Christiansen (Eds.), 21, 339-349

securities market functions perform, and their main causes in CIS countries will be the subject of the next subsection.

2.2.2. The necessity of SM regulation in CIS countries

This subsection considers the issue of why proper regulation is crucial for the further development of securities markets in CIS countries. According to the existing consensus[86] a sound legal framework, property rights, shareholder protection, enforcement of contracts, and the rule of law are capable of attracting relatively higher investment levels and therefore have larger financial markets. Furthermore, regulation is necessary in ensuring company transparency that, in turn, is essential for investor protection and to inspire the confidence of market participants, especially investors, on the activity and behavior of managers and controlling shareholders. According to Professor Bernard Black, a country whose laws fail on this issue cannot develop an active securities market.[87]

The necessity of regulation for the securities market is key since imbalances and crises in the financial sphere can become a dominant destabilizing factor for the economy of any country. The disruptive effects of the recent financial crisis patently demonstrate the necessity of appropriate regulation in the securities market for strengthening investors' protection, ensuring competition, and guaranteeing fairness in market relations not only at the national level but also within regional and global contexts. Thus, one of the main aims of securities market development reforms in CIS countries should be to take appropriate lessons from existing cases and not to repeat mistakes.

One of such lessons could be the most recent financial crisis, the roots of which go to the US financial and particularly the mortgage markets, and the consequences of which affected almost every country of the world. According to 'The Financial Crisis Inquiry Report' which was prepared by a special National Commission of the US, "scant regulation" was one of the main reasons that led to the full-blown crisis in 2008.[88] Another point in the Commission's conclusion was that the financial crisis was avoidable, and it

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[86] Douglas W. Arner, *Financial Stability,Economic Growth, and the Role of Law*. (Cambridge, UK: Cambridge University Press, 2007), 14.
[87] Bernard S. Black, "The legal and institutional preconditions for strong securities markets", *UCLA L. Rev.* 48 (2000): 781.
[88] For further details, see: The Financial Crisis Inquiry Report, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, Official Government Edition the Financial Crisis Inquiry Commission, submitted by Pursuant to Public Law 111-21, January 2011. https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf, 17.

was the result of human action and inaction: “failures in financial regulation and supervision proved devastating to the stability of the nation’s financial markets.”[89]

Therefore, regulation is necessary for securities markets, especially for emerging ones, for protecting investors against losses, for ensuring freedom and fairness of market relations, and for stimulating growth and development. Perhaps the most convincing argument proving the need for regulation of the securities market is the presence of developed regulatory structures of the securities market in so-called free-market countries that only theoretically heed Adam Smith’s notion of the corrective ‘invisible hand’. According to a prominent scholar in political economy – Ha-Joon Chang – there is no so-called ‘free market’ – every market has some rules. [90]

The regulation of securities market relations is much more necessary in transition economies, [91] such as CIS countries, where nascent securities market infrastructure cannot fulfill its regulatory and other functions; market participants are not professional, and a shadow, than the legal or conventional, market is developed. These specific features of transition economies make it necessary for there to be a proper regulatory framework for CIS securities markets particularly aimed at giving effect to the stabilizing, protecting, and stimulating functions of the securities market.

After clarifying the necessity and importance of regulation for securities market relations, the next issue to be considered in the following section is the nature of the institutional and regulatory framework of the securities market in CIS countries.

[89] Ibid, 28-29.
[90] For further details, see: Ha-Joon Chang, *23 things They Don't Tell You About Capitalism.* (Bloomsbury Publishing USA, 2012), 1-10.
[91] For the legal features of the securities market of transition countries, see: Katharina Pistor, “Law as a Determinant for Equity Market Development: The Experience of Transition Economies”, *Assessing the value of law in transition economies* (2001): 249-87; and Edward Stringham, Peter Boettke and Jeff R. Clark, “Are Regulations the Answer for Emerging Securities markets? Evidence from the Czech Republic and Poland”, *The Quarterly Review of Economics and Finance* 48, no. 3 (2008): 541-566.

2.3. An institutional and legal framework of CIS countries' securities market

2.3.1.Development of institutional and legal bases of the Russian securities market

2.3.1.1. Overview of Russian securities market infrastructure

Russia possesses the largest securities market and the most developed market infrastructure not only across the CIS but also across the entire post-soviet and satellite region. One of the main reasons for this is based on the model of the financial market applied in Russia. According to Golovnin, who conducted comprehensive research on the securities market infrastructure development in EAEC countries, Russia applied the Anglo-Saxon financial model, which is oriented towards the securities market, whereas Kazakhstan, Uzbekistan, and other CIS countries adopted the continental European model that is focused upon the banking system. [92] However, this is only a structural characterization, given that the existing banking system of Russia as it has developed since the collapse of the USSR, with the high degree of state involvement in it, does not entirely fit within the conventional Anglo-Saxon model.[93] That is the reason why other scholars characterize the Russian securities market as a mixed, polycentric, model, whereby commercial banks, the stock exchange, and other financial institutions participate simultaneously yet with a disparity of influence. The roots of such divergence are to be found in the transition history and privatization methods of the Russian experience, briefly discussed in the previous subsection.

The Russian securities market infrastructure is relatively developed in comparison to the other post-Soviet countries both in terms of financial instruments and institutions. Compared to other CIS countries, in the Russian securities market a maximum variety of financial instruments are traded, [94] including shares, federal loan bonds, regional and corporate bonds, sovereign and corporate Eurobonds, depositary receipts, investment shares, mortgage participation certificates, and exchange investment funds. [95] In 2016

[92] See: Michael Golovnin, *Outlook for the Joint Development of Stock Market Infrastructure in EurAsEC Countries,* EDB Eurasian Integration Yearbook 2009, 142-150
[93] Regarding bank dominance, Libman and Vinokurov mention the notability of the Russian stock market for its considerable commercial bank activity. For further details, see: Alexander Libman and Evgeny Vinokurov, *Holding-Together Regionalism: Twenty Years of Post-Soviet Integration*. (Springer, 2012), 131
[94] NB., with some exceptions in Kazakhstan where financial instruments are relatively diverse than in Russia and Uzbekistan.
[95] For further details, see the website of the Moscow Stock Exchange: http://www.moex.com/s10

variety of new bonds was launched which boosted market liquidity. In particular, the most short-term bonds, known as *overnight bonds*, issued 49 times in a year for a total of 1.4 trillion rubles (RUB). Another new type of bond – namely, Russian law-governed foreign currency bonds – appeared on the market as an alternative to borrowing from global markets. In 2016, three issuers offered foreign currency bonds worth a total of USD 1.4 billion.[96] Moreover, the futures market of the Moscow stock exchange organizes trading with: futures contracts for indices (MICEX index, RTS index, RVI volatility index); futures on Russian and foreign shares, Eurobond Russia-30, currency pairs, interest rates; futures for oil and sugar; option contracts for some of these futures. No other CIS country can boast of trading in such variety of financial instruments, as Russia does.

Despite such established trading in a wide range of financial instruments, "the real investment potential of the stock market still fell short of the countries' need for financial resources",[97] low public and investor confidence being the reason behind the departure of private investors from the securities market that consequently lead to the dominance of state and quasi-state institutional investors, including the Pension Fund, Sberbank, VTB, and other development institutions. This can explain the prominence of government securities in the Russian securities market, which represent the most advanced market means of public debt. However, such investments of budgetary funds are not entirely acceptable means from the viewpoint of market economy principles.

Stock exchanges play an essential role in the securities market infrastructure as they provide the primary platform for trading with securities at the national, regional, and global levels. In Russia, the Moscow Stock Exchange serves as such a central platform. It is included in the list of the largest exchanges of the world (the second for bonds, the third for the number of derivatives contracts, the twenty-fourth in terms of the volume of share trading).[98] The main feature of the Moscow Stock Exchange is its multifunctional and consolidated character that is not present in other CIS countries, including Uzbekistan. Firstly, the Moscow Exchange Group manages the only multifunctional stock exchange in Russia for trading stocks, bonds, derivatives, currency, money market instruments and commodities. Secondly, its function is not limited only to the organization of securities trading. It also includes the central depository (namely, the National Settlement

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[96] Moscow Stock Exchange, Equity and Bond Market Report 2016. http://2016.report-moex.com/en/review/markets/equity-and-bond-market

[97] Alexander Libman and Evgeny Vinokurov, *Holding-Together Regionalism: Twenty Years of Post-Soviet Integration*. (Springer, 2012),130.

[98] Moscow Stock Exchange, Equity and Bond Market Report 2016, http://2016.report-moex.com/en/review/markets/equity-and-bond-market

Depository), as well as the clearing center (namely, the Bank National Clearing Center), which performs the functions of the central counterparty in the markets, which allows the Moscow Exchange to provide customers with a full cycle of trading and post-trading services.

2.3.1.2. Securities market regulatory structure in Russia

The organizational structure of securities markets is one of their main institutional attributes. Hence why the effective functioning of the securities market is impossible without state regulation and supervision. In the last three decades, the Russian securities market organizational structure underwent several stages. The reforms on structuring the regulatory architecture of the securities market during this period can be broadly divided into three phases. In the first phase of changes (1993-2004) the Securities and Exchange Commission was established under the President of the Russian Federation (1993).[99] In 1996 this Commission became the Federal Commission for the Securities Market of the Russian Federation (FCSM),[100] and further legislation that defined its legal status and authority was adopted.[101]

In the second phase, which covered the period from 2004 to 2012, several structural reforms directed toward strengthening the legal status and powers of the regulator were carried out. In 2004 the FCSM was abolished and another authority – the Federal Service for Financial Markets – was established which took over the functions of control and supervision of the abolished FCSM and of other bodies.[102] Further reforms were connected with the position of the regulator within government. The regulator`s name and status were changed several times since 1993; de jure the regulator was under the President of the Russian Federation. However, from 2004 it was transferred to the jurisdiction of the Prime

[99] Order No. 163-rp of March 9, 1993 President of the Russian Federation 'On Securities and Exchange Commission under the President of the Russian Federation'.
[100] Presidential Decree of the Russian Federation of July 1, 1996 No.1009 'On the Federal Commission for the Securities Market',
[101] Federal Law of April 22, 1996 No. 39-FZ 'On the Securities Market'; Presidential Decree of April 3, 2000 No. 620 'Matters of the Federal Commission for the Securities Market', which approved 'Regulations of the Federal Commission for the Securities Market' in new edition. In Uzbekistan legislative practice the term "new edition" means complete replacement of law by a new one.
[102] Namely, it took over the functions of the abolished Ministry of Labor and Social Development, on control and supervision in financial markets; and functions of control the activity of exchanges of the Ministry of for Antimonopoly Policy and Support of Entrepreneurship; and the functions of control and supervision in the field of formation and investment of pension funds of the Ministry of Finance. See, Presidential Decree No. 314 of March 9, 2004 'On the System and Structure of Federal Executive Bodies'. http://graph.document.kremlin.ru/page.aspx?781146

Minister.[103] In 2011 the Russian Federal Insurance Supervision Service annexed the Federal Service for Financial Markets.[104]

The third phase of reforms was more crucial than the previous phases due to its form and content. It was connected with the idea of creating a mega-regulator in the financial sector as a part of reforms aimed at making Moscow an international financial center. The creation of a mega-regulator in Russia began to be actively debated in 2012 when the UK, whose capital is a principal global commercial center, shifted from the single regulator[105] to a twin peaks approach.[106] According to the vice-president of the Russian Bank Association, Yuriy Kormosh, the idea of creating a mega-regulator in Russia was first proposed by the British company Cadogan Financial[107] in 1999.[108] However, today the discussion on the creation of a mega-regulator in Russia is settled, given that since September 1, 2013 the Federal Financial Markets Service has been abolished and its powers transferred to the Bank of Russia.[109]

Moreover, by March 3, 2014, the Financial Markets Service of the Bank of Russia was abolished about two years earlier than planned. The authority to regulate, control and supervise the financial markets, previously carried out by the Financial Markets Service was transferred to subdivisions of the Bank of Russia. Consequently, the Bank of Russia has become the state regulator in the securities market in Russia.

The Ministry of Finance possesses some residual limited powers to determine the procedure for the issuing of federal government securities, and is responsible for registering government, municipal and regional bonds, and bonds issued by insurance companies. Federal Antimonopoly Service of Russia is authorized to take measures to protect investor rights, and to oversee merger and acquisition deals concerning JSCs.

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[103] Resolution of the Government of the Russian Federation dated April 9, 2004 No. 206 'Issues of the Federal Service for Financial Markets' http://www.rg.ru/2004/04/14/fedrinok.html

[104] Presidential Decree No. 270 'On Measures to Improve State Regulation of Financial Markets of the Russian Federation' http://graph.document.kremlin.ru/page.aspx?1547892

[105] Richard J. Herring and Jacopo Carmassi. "The structure of cross-sector financial supervision", *Financial Markets, Institutions & Instruments* 17, no. 1 (2008), 61.

[106] Eilis Ferran, "Institutional Design for Financial Market Supervision: The Choice for National Systems," *University of Cambridge Faculty of Law Research Paper* No. 28/2014 (2014), 10, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2425177 .

[107] http://www.cadoganfinancial.co.uk/

[108] Yuriy Kormosh, Anastasiya Burkova, "Shagi k Sozdaniyu Finansovogo Mega regulyatora v Rossii" (i.e., "Steps to Create a Financial Mega-Regulator in Russia") *Rynok tsennykh bumag (Securities market)* 15(318) (2006): 69–72.

[109] Presidential Decree of 25 July 2013 No. 645 'Abolition of the Federal Service for Financial Markets, Change and Repeal of Certain Acts of the President of the Russian Federation' http://text.document.kremlin.ru/document?id=70320938&byPara=1&sub=3

The Russian securities market regulatory structure is relatively developed in the sense of self-regulatory organizations activity. Currently, there are seven major self-regulatory organizations in the Russian securities market.[110] They actively participate in establishing rules and standards; protecting members' interests; improving law enforcement practice, and raising public awareness.

2.3.1.3.Origin and development of SM legal basis in Russia

The specifics of Russian securities market regulation are directly connected with the country's method of market economy transition and privatization reforms briefly discussed above. The *shock therapy* method of privatization and of creating a securities market overnight[111] did not leave space for the elaboration and adoption of appropriate legal bases for those relations. Consequently, the emerging securities market had had to survive unaided by the fundamental laws concerning the securities market, JSCs, and the stock exchange. Instead, "market participants were forced to use outdated, Soviet-time Civil and Penal Codes and other laws" and some by-law acts that regulated dynamic securities market relations.[112] According to the Chairman of the Russian Investor Protection Association, Dmitriy Vasiliev, the delay of the early legal reforms concerning the Russian securities market during 1991-1998 impacted on the character of the market and "allowed easy creation of so-called 'financial pyramids.'"[113] Gaps in legal regulation also caused the emergence of an oligarchs' class; an increase in corporate raiders practice; and other violations of shareholders' rights.

The law on the securities market was adopted in as late as 1996, after five years of intensive privatization reforms; after the almost complete distribution of state property

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[110] Namely, the Russian National Association of Securities Market Participants (NAUFOR) with 320 participants (website: www.naufor.org/default.eng.asp); the not-for-profit partnership 'National League of Management Companies' (NLMC) with 106 participants (website: www.nlu.ru); the National Securities Market Association (NSMA) with 230 participants (website: www.nfa.ru/?page=english); the Professional Associations of Registrars, Transfer Agents and Depositories (PARTAD) with 64 participants (website: http://partad.ru/); the Ural Region Non-Profit Professional Securities Market Participant Partnership (URPSMP) with participants (web-site: www.uralprofi.ru); the self-regulatory organization non-profit partnership 'National Associations of Non-State Pension Funds' (NAPF) with 72 participants (website: www.napf.ru); the non-profit partnership 'Assosiation of Professional Managers of Financial Market' with 7 participants (web-site: www.opufr.ru). Source: https://www.nsd.ru/common/img/uploaded/files/Documents/market_profile_2016.pdf

[111] Bernard S. Black, "The legal and institutional preconditions for strong securities markets", *UCLA L. Rev.* 48 (2000): 781.

[112] Dmitriy Vasiliev, "Capital market development in Russia", *World Bank Papers* (2001).

[113] Ibid.

among the Communist Party elite (nomenklatura) and officials to the "new Russians."[114] One could compare it to the situation in Kazakhstan and Uzbekistan where the adoption of the first special laws (not by-laws) was as early as in the early 90s.[115] Of course, one could reasonably argue that the adoption of laws alone when accompanied by weak institutions and poor enforcement practice does not change the situation much. Giving due attention to this viewpoint, it should be mentioned that the existence of exclusive legislation in the early stages of market relations suggests the presence of some concern about the fairness of relations, an attempt of ensuring investor protection, and of efforts on reducing systemic risk.

Despite the decent quality and level of and enforcement,[116] currently Russia possesses most special laws that are necessary for modern securities market relations including, among others: the Federal Law on the Securities Market;[117] the Federal Law on Joint Stock Companies;[118] the Federal Law on the Protection of Rights and Interests of Investors in the Securities Market;[119] the Federal Law on Banks and Banking Activity;[120] the Federal Law on the Central Depository;[121] the Federal Law on Investment Activities in the Russian Federation in the Form of Capital Investments;[122] the Federal Law on the Specifics of the Issue and Circulation of State and Municipal Securities;[123] the Federal Law on Clearing and Clearing Activities;[124] the Federal Law on Organized Trading;[125] the Federal Law on Investment Partnership;[126] and the Federal Law on Central Bank of Russian Federation (Bank of Russia).[127] In addition to these laws, regulation is also effected by bylaw acts on the part of the government, the President, and the central regulator – namely, the Central Bank of Russia.

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[114] Federal Law on the Securities Market, No. 39-FZ of April 22, 1996. http://www.ebrd.com/downloads/legal/securities/russiasm.pdf (NB., available in English).
[115] A detailed analysis of Kazakhstan and Uzbekistan securities market legislation is presented in the next subsections.
[116] A relatively recent assessment of Russian securities market regulation may be found in the IMF report on the Russian observance of IOSCO objectives and principles of securities regulation. Cf., IMF, Report on the Observance of Standards and Codes – IOSCO Objectives and Principles of Securities Regulation, Washington D.C., July 2016.
[117] No. 39-FZ of April 22, 1996, last amendment from June 18, 2017, http://www.garant.ru/hotlaw/federal/1117932/
[118] No. 208-FZ of December 26, 1995
[119] No. 46-FZ of February 18, 1999
[120] No. 395-1 of December 02, 1990
[121] No. 414-FZ of December 7, 2011
[122] No. 39-F3 of February 25, 1999
[123] No. 136-FZ of July 29, 1998
[124] No. 7-FZ of February 7, 2011
[125] No. 325-F3 of November 21, 2011
[126] No. 335-FZ of November 28, 2011.
[127] No.86-FZ of July 10, 2002.

Among the legislation mentioned above, the Law on the Securities Market plays an important role in securities market regulation due to its rich content and coverage of the whole range of securities market relations, including securities issuance, their circulation, regulation, and participant responsibility/liability matters. Russian securities law is relatively modest compared to that of Kazakhstan and Uzbekistan. For instance, in the relevant legislation, the main issues – such as the legal regime of the security, the conception of the securities market; the activity of the accounting system entities, etc. – have not been completely resolved. According to Gabov, judicial practice in cases arising from disputes in the securities market – for example, discussions of owners with registrars and issuers – suggests that a market with such regulation does not give participants a fundamental thing: namely, the certainty and inviolability of their rights.[128]

After the financial crisis of 2008 the government took seriously the need to improve its securities market legislation. Thus, with the aim of improving the regulation and development of the financial market for the medium- and long-term, the government approved the 'Strategy for the Development of the Financial Market of the Russian Federation for the Period to 2020' [129] and presented the 'Plan of Measures for Creating an International Financial Center in the Russian Federation'.[130]

2.3.2. Development of institutional and legal bases of Kazakhstan securities market

2.3.2.1. Overview of Kazakhstan securities market infrastructure

The Kazakhstan securities market belongs to the most developed financial markets in the Central Asian region and one of the leading markets in the CIS. Along with the general features of CIS countries' securities markets (discussed in previous sections), there are some notable specifics concerning the formation of the Kazakhstan securities market infrastructure. Firstly, unlike other CIS countries, Kazakhstan has been attempting to diversify the supply side of its securities market. For instance, in 2012 Kazakhstan was the

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[128] Габов, Андрей Владимирович, Проблемы гражданско-правового регулирования отношений на рынке ценных бумаг, диссертация на соискание ученой степени доктора юридических наук, Москва, 2010. (Andrey Vladimirovich Gabov, "Problems of civil-law regulation of relations in the securities market, dissertation for the degree of Doctor of Juridical Sciences", (Moscow, 2010)). Scientific Library of Dissertations and Abstracts disserCat http://www.dissercat.com/content/problemy-grazhdansko-pravovogo-regulirovaniya-otnoshenii-na-rynke-tsennykh-bumag#ixzz4lRko9ObK

[129] The Strategy of Development of the Financial Market of the Russian Federation until 2020. Approved by Resolution of the Government of the Russian Federation no. 2043- r dated December 29, 2008, http://www.fcsm.ru/ru/press/russia2020/ strategy2020/.

[130] Approved by Resolution of the Government of the Russian Federation no. 911- r dated July 11, 2009, http://www.economy.gov.ru/wps/wcm/connect/ economylib4/mer/resources/2fdaf580409d9e7a82e2eb2c73e16b99/911_p.doc

first in the post-Soviet region to launch Islamic bonds (*Sukuk Al-Murabaha*).[131] Sixty-two percent of this issue went to Malaysian investors and the remaining thirty-eight percent went to the securities market of Kazakhstan.

Moreover, Kazakhstan issued 10- and 30-year Eurobonds for USD 4 billion.[132] Even though the reason for issuing these bonds was to cover the deficit of the state budget,[133] it was a serious step towards the global securities market. Consequently, such financial instruments have become a serious alternative to traditional bank lending due to their level of credit risk, interest rates, and terms.

Secondly, the involvement of the banking industry in the securities market relations of Kazakhstan is more active than in Russia. The fact that Kazakhstan Stock Exchange, which is the leading platform for securities trading, was founded by National Bank and another twenty-three leading commercial banks of Kazakhstan is illustrative of the substantial role of the banking industry in the formation of the securities market infrastructure. Bank participation is far-reaching and covers all relations of the market, including issuing a wide range of securities, acting as an investor, and rendering market intermediary services.[134]

Thirdly, unlike Russia and other CIS countries, in Kazakhstan non-banking professional investment institutions are relatively developed. For instance, pension funds have an active role as investors, shareholders, and intermediaries in the securities market. [135]

Fourthly, unlike Uzbekistan, and like Russia, the Kazakhstan stock exchange acts as a universal financial market, there is systematically organized trading in fields including the foreign currency market, the government securities market, the equity market and corporate bonds, the repo operations market, and in the derivatives market.[136]

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[131] Bonds were issued to the amount of 240 million Malaysian *ringgit* (11.378 billion *tenge*) with an annual interest premium of 5.50%, and a five-year maturity (August 2017).

[132] Sabina Amangeldi, "Kazakhstan placed $2.5bn Eurobonds in two tranches of 10 and 30 years", *Halyk Finance,* October 7, 2014, http://www.halykfinance.kz/en/site/index/research/news:90984

[133] "Kazakhstan Places Two Eurobond Issues to the Amount of USD 2.5 BN", *Kazakhstan Stock Exchange*, October 15, 2014, http://www.kase.kz/en/news/show/1232335

[134] S. Dontsov, Kazakhstan's Securities market and Its Main Institutional Investors. *Rynok tsennykh bumag.* no.18, (2003).

[135] Alexander Libman and Evgeny Vinokurov, *Holding-Together Regionalism: Twenty Years of Post-Soviet Integration* (Springer, 2012), 132.

[136] See the website of Kazakhstan Stock Exchange for further details: http://www.kase.kz

And fifthly, in 2016 Kazakhstan[137] launched the International Financial Center (IFC) in Astana, which is based on English law principles and on the standards of the world's leading financial centers, and which is designed as a prototype of the Dubai IFC. The IFC[138] supplements the existing securities market infrastructure with a new institution, namely, a Special Court that is outside the ordinary judicial system of Kazakhstan. It was proposed to improve the dispute resolution system of the securities market, which is one of the critical points of investor confidence in the market, to increase the scale of investment, and to ensure the integration of the Kazakhstan securities market with international markets.

2.3.2.2. Securities market regulatory structure in Kazakhstan

The securities market organizational structure in Kazakhstan has also faced several reforms until the establishment of the current mega-regulator system under the regulation of the National Bank of Kazakhstan. In the first stage of changes (1991-1994) as has been the case with the other countries compared, the Ministry of Finance was responsible for the regulation of the emerging securities market.

The development of market relations, increasing the quantity and quality of financial instruments and market participants, as well as the necessity of implementing international standards on securities market regulation, severely reformed the regulatory structure of the industry. As a result of these reforms in 1995, the National Commission on Securities was established as an independent body, which was the authorized body for securities market regulation in Kazakhstan until 2000.

In terms of the specifics concerning the participants in the Kazakhstan securities market, banks are the most dominant both in relation to stock issuance and circulation, and in influencing the future development of the regulatory regime. Thus, for the next five years the securities market regulator sat within the structure of the National Bank as a separate department.

From 2004 to 2011 the regulatory and supervisory functions were performed by the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations (FSA) – an independent entity that reported directly to the President. During 2011–2013, the Committee for the Control and Supervision of the

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[137] Officially, the Astana IFC was launched in 2016, but started fully operating from 2018 after the conversion of the main pavilion of the EXPO.
[138] Decree of the President of Kazakhstan 'On the Establishment of the International Financial Center 'Astana'', May 19, 2015, No. 24.

Financial Market and Financial Organizations (FSC) – then a subdivision of the National Bank – performed the supervisory and regulatory functions in the securities market of Kazakhstan.

In January 2014, by Presidential decree, the FSC was abolished and its departments were subsequently absorbed by the National Bank, which is accountable to the President, who, among other things, appoints its Chair (with the consent of Parliament) and his/her deputies. The President also approves the National Bank's structure, overall size of its staff, and its salary system. The law does not specify the conditions under which the National Bank Chairman and his/her deputies may be removed from office.

2.3.2.3. Origin and development of SM legal basis in Kazakhstan

As mentioned above, Kazakhstan started to build a legal framework of its emerging securities market in parallel with its economic and institutional bases. Thus, the first Kazakhstan securities legislation appeared on 11 June 1991,[139] namely, the Law of the Kazakh SSR On Circulation of Securities and Stock Exchange – a critical law for securities market regulation that determined initial norms on the status of both financial instruments and regulators. This act mainly focused on facilitating trade in securities, and it did not institute any effective control or sanctioning mechanisms. Due to the lack of proper control over the securities market it is unsurprising that several major financial scandals soon emerged.[140] What is more, the Ministry of Finance had to issue a temporary instruction on licensing professional activities in the securities market following nine months from the adoption of this legislation. By this instruction, the Ministry of Finance authorized 1,460 individuals and 98 legal entities from 1992 to 1994.

In 1997 a new phase of property redistribution was launched that was characterized by the use of important schemes, such as legalized blurring of government shares, converting debts into securities, selling receivables, trust schemes, buying bills, and manipulating dividends on preferred shares. Also, the active participation of the state and escalating investor protection issues concerning the redistribution of the largest Kazakhstani companies resulted in strengthening the legal bases of investor protection. For instance, by the end of 1997, the Kazakh securities market had an expanded legislative

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[139] See: Maidan K. Suleimenov and Farkhad S. Karagoussov, "The Legal Basis for the Securities Market in the Republic of Kazakhstan", *Review of Central and East European Law,* 1998. Nos.5/6, 451-468, http://online.zakon.kz/Document/?doc_id=32240989&mode=p

[140] Rilka Dragneva (ed). *Investor Protection in the CIS: Legal Reform and Voluntary Harmonization*. Vol. 57. (Martinus Nijhoff Publishers, 2007), 159.

base based on the provisions of the Civil Code of the Republic of Kazakhstan, which provided a set of measures to protect the interests of investors. The legal basis of the securities market was the Law on the Securities Market of March 5, 1997, and some regulations issued under the above law by the Government of the Republic of Kazakhstan and the National Commission on Securities. For instance, the Law on Registration of Transactions with Securities in the Republic of Kazakhstan of 5 March 1997; the Law on Investment Funds in the Republic of Kazakhstan of March 6, 1997; and the Law on Pensions in the Republic of Kazakhstan of June 20, 1997.

Presently, the Law of the Republic of Kazakhstan on the Securities Market of July 2, 2003 determines the basics of securities market regulation.[141] It was adopted a month after the Law on Joint Stock Companies was approved on 13 May 2003, which represents the beginning of a more qualitative approach to regulation. The Securities Law regulates social relations arising in the process of issuing, placing, circulating and redeeming equity securities and other financial instruments. The specifics of the creation and activities of securities market entities, determine the procedure for regulation, control and supervision of the securities market in order to ensure the safe, open and effective functioning of the securities market, protection of the rights of investors and holders of securities, fair competition of participants in the securities market. The last reforms on the improvement of securities market regulation suggest a strong willingness on the part of government to boost the market and investment through financial instruments and the securities market. For instance, the state initiative to establish a Regional Financial Center in Almaty aimed at the development of the securities market, its integration with international capital markets, attracting investments into the economy of Kazakhstan through securities market and through the access of foreign issuers into the particular trading floor of the financial center, all encourage the improvement of the situation.[142] However, some scholars are skeptical as they consider the reality of attracting international portfolio investment through the Regional Financial Center of Almaty as discourage medium-sized domestic enterprises for involving access into the securities market. Instead, they propose that the most effective financing and the best government support for the market is the fostering of a competitive environment with equal conditions. Honest competition leads to more

[141] Adopted in July 2, 2003 No.461-II, with the amendments from February 27, 2017, http://online.zakon.kz/Document/?doc_id=1041258#pos=190;-223
[142] For further details on the Regional Financial Centre of Almaty (RFCA), see the official internet resource of the National Bank of Kazakhstan: http://www.nationalbank.kz/?docid=768&switch=english

efficient sector development.[143] Giving due attention to the government initiative, the present author also supports the approach of fostering a competitive environment in the financial market.[144]

2.3.3. Development of institutional and legal bases of the Uzbekistan securities market

2.3.3.1. Overview of Uzbekistan securities market infrastructure

Generally, the specifics of the securities market infrastructure of CIS countries reviewed are also present in Uzbekistan's securities market institutions. However, several features should be taken into account in proposing recommendations on the improvement of the current situation of the market. Firstly, financial instruments in Uzbekistan's equity and state securities markets are relatively developed rather than its corporate bonds and derivatives markets. The dominance of the equity market mainly derives from the privatization method adopted, based on which state enterprises were restructured as JSCs. Compared to the Kazakhstan and Russian securities market, there is almost no derivatives market in Uzbekistan. The reasons for the underdevelopment of the derivatives market in Uzbekistan is connected both with the systemic and structural drawbacks of the national securities market, and the features of the derivative itself.

Secondly, the leading platform for securities trading – namely, the Tashkent Stock exchange (TSE) – is not the multifunctional financial institution as is the case with those of Russia or Kazakhstan. The TSE organizes trading only with shares, state and corporate bonds, deposit certificates, and derivatives. Trading with commodities, and foreign currency held by Tashkent Commodity Exchange,[145] and Uzbekistan state Currency Exchange[146] respectively. For Uzbekistan, the consolidated exchange is characterized in the initial stage of development when in 1991 a stock department was formed within the Tashkent Exchange as the first securities market institution.[147] In the opinion of the present author, the high level of specialization of different exchanges is a sign of a

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143 Z. M. Omarkhanova, L. R. Esbergenova, Z. A. Makisheva, and G. K. Kishibekova. "Modernization of Securities Market in Kazakhstan", *International Electronic Journal of Mathematics Education* 11, no. 7 (2016), 2056.

144 A *competitive environment* in the present research means the acceleration of the securities market's activity and its resource allocation and distribution functions; and the building of a competitive atmosphere that will allow securities markets to compete with the banking industry for the provision of finance.

145 See details at: http://uzex.uz/en

146 See details at http://uzrvb.uz/en

147 Бутиков И. Отечественный рынок ценных бумаг: хроника событий, Октябрь, 2016. (I. Butikov, The Domestic Securities Market: A Chronicle of Events, (October, 2016) http://biznes-daily.uz/ru/gazeta-birja/42715-otchstvnniy-rinok-snnix-bumag-xronika-sobitiy

developed exchange system in the country. From this viewpoint, Uzbekistan's experience on establishment of separate trading platforms with different types of product (stocks, commodity, foreign currency, agricultural, etc.) could be a good example concerning the organization and regulation of exchange activity in the CIS region.

Thirdly, the state regulator for the securities market is not combined with the banking regulator, as is the case in Russia from 2013, [148] and Kazakhstan from 2014,[149] where the central bank is responsible for the regulation of the entire financial system, including the banking industry, capital markets, insurance, and the securities market. The state regulator's status was the object of separate research in which the present author had been involved, which included a comparative analysis of the state regulatory regimes of the securities markets of Russia, Uzbekistan, and Japan. The conclusions of that research indicated that it would be appropriate to implement in Uzbekistan a unified model of state securities market regulator under the authority of its Central Bank.[150]

And fourthly, Uzbekistan's securities market has a relatively modest index of trading stocks in foreign currency (FC trade/FTC), which shows the openness of the market to foreign investors and access of national companies to global financial markets. The underdevelopment of the FCT market, while not an excellent feature, was actually one of the main reasons that Uzbekistan's loss was minimized during the last major crisis – namely, the global financial crisis of 2008. However, in general, this is a critical factor for fostering foreign investment flows into the national securities market, and opening access for domestic companies in global financial markets.[151]

2.3.3.2. Securities market regulatory structure in Uzbekistan

The experience of Uzbekistan in establishing its state securities market regulator has been under way since 1991 when the country began gradual reforms towards building a market economy. These reforms could be divided into three stages. In the first stage, attention was mainly paid to creating the legal and institutional basis for securities market regulation through the adoption of legislation and the establishment of appropriate market

[148] For further details, see the official website of the Central Bank of the Russian Federation: https://www.cbr.ru/Eng

[149] For further details, see the official internet resource of the National Bank of Kazakhstan: http://www.nationalbank.kz/?docid=3000&switch=english

[150] For further details, see Otabek Sadievich Narziev, "Independence and Structure of State Securities Market Regulator in Uzbekistan", *Annual Report on Research and Education* 2014, Nagoya University, March 2015, pp. 45-87.

[151] For further details, see the Tashkent Stock Exchange website: https://uzse.uz/isu_infos/FCT

institutions. In 1991 the legal basis of exchanges activity was provided [152] by the Exchanges Council as a coordinating body for exchange activities. The Council was formed from the chairpersons of the exchanges operating in Uzbekistan.

In the second stage, the gradual reforms mostly focused on increasing the quality of the regulatory structure. For instance, the Presidential Decree on Additional Measures to Develop Securities Market, adopted on September 7, 1995, [153] introduced a series of fundamental standards directed at the state regulation of the securities market. According to that Decree, the State Securities and Exchange Commission (SSEC) was formed under the Ministry of Finance of Uzbekistan. Its purposes included the implementation of state policy on the development, deepening and broadening of the securities market, the removal of existing barriers to its further development, as well as the protection of investor and shareholder rights and interests.

The SSEC had to very closely cooperate with the State Committee of Uzbekistan for State Property Management (SPC) – i.e., the authorized body for the privatization process. The reason for this cooperation was securitization, which was the primary method of privatization. The Presidential Decree on the Formation of the Center for Coordination and Control over the Securities Market under the State Property Committee of Uzbekistan of March 26, 1996, [154] strengthened the legal framework for such cooperation. According to the Decree, the aim of establishing the Center for Coordination and Control of Securities Market under the SPC (CSM), instead of abolished SSEC under the Ministry of Finance, was to improve the functioning and state regulation of the securities market, to coordinate the activities of its members, and to ensure the protection of investor rights and interests. Moreover, this act determined the legal status of the CSM as the authorized state body regulating the securities market. The Resolution (Charter) of the CSM was approved by the Government's Resolution on Organization of the Center for Coordination and Control over the Securities Market under the State Property Committee of Uzbekistan of March 30,

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152 Указ о координации биржевой деятельности в республике Узбекистан, [Ukaz o Koordinatsii Birzhevoy Deyatel'nosti v Respublike Uzbekistan], 2 Vedomosti Verkhovnogo Soveta Respubliki Uzbekistan 88 (1992). (i.e., 'Decree on Coordination of Exchange Activities in Uzbekistan', *Bulletin of the Supreme Council of Uzbekistan*, vol. 2, 88 (1992))

153 Vedomosti Verkhovnogo Soveta Respubliki Uzbekistan, 1995 g., No. 10-11, st.225. Nastoyashchiy Ukaz utratil silu soglasno p.2 Ukaza Prezidenta Respubliki Uzbekistan ot 24.10.2008 g. za No. UP-4045, (i.e., The Vedomosti of the Supreme Council of Uzbekistan, 1995,Vol.10-11, Article 225. This Decree repealed according to clause 2 of the Decree of the President of the Republic of Uzbekistan dated October 24, 2008, No. UP-4045.)

154 Sobraniye postanovleniy Pravitel'stva Respubliki Uzbekistan, 1996 g., No. 3, st. 11, (i.e., *Assembly on Resolutions of the Government of Uzbekistan*, 1996, vol. 3, 11).

1996.[155] Based on this Resolution governmental bodies and securities market participants defined one of the main objectives of the CSM was to oversee the implementation of securities legislation.

In the third stage of reforms, which are ongoing, the structure of the securities market regulation was improved. These improvements included the further privatization of state assets and widening the range of private property as the basis of a market economy, the improvement of antimonopoly regulation and the fostering of a real competitive environment, the accelerated development of the securities market (especially the secondary one), and the improvement of corporate governance. A Presidential Decree of November 13, 2012, created the State Committee of Uzbekistan for Privatization De-monopolization and Development of Competition by the abrogated SPC and State Committee of Uzbekistan for De-monopolization and Development of Competition.[156]

However, these reforms toward a unified regulation of state property management, the securities market, and antimonopoly regulation gave rise to fundamental problems including conflicts of interest. Some of these have been solved, mainly through measures on the elimination of conflicts of interest between the SPC, which is the main authorized body on managing state shares in joint stock companies, and the CSM, which is under the jurisdiction of the SPC. Under a subsequent government Resolution, the new organizational structure of the SPC was approved, the Center for Management of State Assets under the SPC was created, and the name of the securities market regulator was changed to the 'Center on Coordination and Development of the Securities Market' (CSM).[157]

After these latest reforms, the securities regulatory body is still under the jurisdiction of the SPC. The difference from the previous structure is that managing state assets and regulating securities are currently the responsibility of two separate Centers in the formation of the SPC. This theoretically and partly solved the conflicts of interest mentioned above. However, due to both Centers being under the jurisdiction of the SPC, such problems may recur during their activities that could interfere in the independent operation of the securities market regulator.

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[155] Ibid.

[156] Decree on Creation of the New State Committee of the Republic of Uzbekistan, http://gki.uz/en/about-spc/day-to-day-activity-/8529-2012-11-14-11-34-46.

[157] Resolution of Cabinet Ministers dated December 14, 2012, No 322 'On arrangement of the activity of the State Committee of Uzbekistan for State Property Management and State Committee of Uzbekistan for the De-monopolization and Development of Competition' http://gki.uz/en/about-spc/comstructure

2.3.3.3.Origin and development of legal basis in Uzbekistan

The Law on Exchanges and Exchange Activity [158] was amongst the first pieces of legislation to determine, clarify, and guarantee the activity of the leading institutions of the securities market – i.e., the exchanges in Uzbekistan. As mentioned by one the prominent scholars of Uzbekistan specializing in securities market, Igor Butikov, at that time there was an urgent necessity for the adoption of this law. In the early 90s, in Uzbekistan, as was the case with other republics of the former USSR, the exchange movement had gained momentum. By the summer of 1992, there were already 36 different stock exchanges in the republic. The government was alarmed by the fact that the number of exchanges was growing at an explosive pace, and since exchanges are in the sphere of circulation, economic institutions such as exchanges were necessary to regulate such transactions.

Meanwhile, the country, particularly at that time, needed the production of consumer goods, food, etc. – that is it needed the development of its productive base. Since up to that point there had been no law on stock exchanges as such, any organization that registered itself as an exchange could receive significant revenues, producing nothing but the registration of various kinds of contracts. Therefore, in July 1992, the Supreme Council of the Republic of Uzbekistan adopted the Law on Exchanges and Exchange Activities, in which the status and basic norms for the activity of stock exchanges and stock departments of commodity exchanges were first determined. The main requirements for the exchanges were as follows: the statutory fund was to be at least 50 million rubles, the founders of exchanges could not be state bodies, and the stock exchanges themselves were prohibited from establishing and investing money in any business organizations whose activities were not connected to the maintenance of exchange trades. As a result, by 1993 there were only two exchanges left in the republic: namely, the 'Tashkent' Exchange and the 'Uzbekistan' Exchange i.e., the Republic's Agro-industrial Exchange. [159]

Another important act of that year was the adoption of the Law on Securities and Stock Exchanges,[160] which provided a definition of securities, its main types (shares,

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[158] *Zakon Respubliki Uzbekistan o birzhakh i birzhevoy deyatel'nosti, Vedomosti Verkhovnogo Soveta Respubliki Uzbekistan*, vol. 10, 1992, (Law of Uzbekistan on exchanges and exchange activity, Vedomosti of the Supreme Council of the Republic of Uzbekistan) http://lex.uz/pages/getpage.aspx?lact_id=24493.
[159] Igor Butikov, Domestic securities market: a chronicle of events, October 2016. For further details, see: http://biznes-daily.uz/ru/gazeta-birja/42715-otchstvnniy-rinok-snnix-bumag-xronika-sobitiy.
[160] *Zakon Respubliki Uzbekistan o tsennykh bumagakh i fondovoy birzhe, Vedomosti Verkhovnogo Soveta Respubliki Uzbekistan* vol. 11–12, 1994, (i.e., the Law of Uzbekistan on the Securities and Exchange,

bonds, treasury bonds, deposit certificates, exchange bills), provided for the regulation of their issuance and circulation, established the legal status of stock exchanges and market participants, and provided for the supervision of the securities market. This was the first law determining the legal basis for regulating the securities market and thus laying the foundations for its development in Uzbekistan. The Law on Securities and Stock Exchanges was enforced until 2008, when, further to far-reaching reforms of the securities legislation, the new Law on Securities Market[161] was adopted.

So, in the first stage of the development of the country's securities market (1990-1993), necessary legislation was adopted to determine the status of private property, including securities, market participants (issuers, investors, trade organizers, and intermediaries), and the framework of regulation of the securities market.

The strengthening of market infrastructure, increasing the number of participants, and strengthening state regulation were key features of the second stage of the development of regulation for the securities market of Uzbekistan. Thus, in 1994 the first, and, currently, the sole, stock exchange – namely, the Tashkent Stock Exchange (of the Republic) – was created as an organized market for the circulation of securities. In that year 13 broker firms were accredited, and exchange trade circulation was 30 million USSs. Unsurprisingly, without an authorized regulatory body of the securities market, it was difficult to regulate and coordinate the whole securities market, hence why establishing the Center for Coordination and Control of Securities Market[162] under the State Property Management Committee of the Republic of Uzbekistan on March 26, 1996, represents the beginning of a new stage in the development of securities regulation in Uzbekistan.

During the second stage of privatization, several new JSCs appeared almost daily. On April 25, 1996, the Law on Joint Stock Companies and the Protection of Shareholder Rights[163] was adopted.[164] This law was the first to create the legal framework for corporate governance in Uzbekistan. The same day a further piece of key legislation concerning

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Vedomosti of the Supreme Council of the Republic of Uzbekistan) http://lex.uz/pages/getpage.aspx?lact_id=112172.

[161] *Zakon Respubliki Uzbekistan o rynke tsennykh bumag, Sobraniye zakonodatel'stva Respubliki Uzbekistan*, vol. 39, 2009, (i.e., the Law of Uzbekistan on the Securities Market, Collection of Laws of the Republic of Uzbekistan) http://lex.uz/pages/getpage.aspx?lact_id=1374867.

[162] See the official website of the Center for Coordination and Development of the Securities Market: http://csm.gov.uz/en

[163] *Zakon Respubliki Uzbekistan ob aktsionernykh obshchestvakh i zashchite prav aktsionerov, Vedomosti Oliy Mazhlisa Respubliki Uzbekistan*, vol. 5–6, 1996, (i.e., Law of Uzbekistan on Joint-stock Companies and the Protection of Shareholders' Rights, Vedomosti of Oliy Majlis of Uzbekistan) http://lex.uz/pages/getpage.aspx?lact_id=14667.

[164] During the preparation of the current paper, this legislation was adopted in new edition and entered into force on May 7, 2014. For further details, see: http://lex.uz/pages/getpage.aspx?lact_id=2382409

securities regulation was adopted – namely, the Law on the Mechanism of Operation of Securities Markets.[165] This legislation was relevant because it covered all aspects of securities market relations and their regulation. Notably, the law provided: for the clarification of the concept of the securities market and investment institutions, the operation and regulation of the securities market, the disclosure of information rules, and for the clarification of the responsibilities of securities market participants. At that time one of the foremost institutions of the securities market – namely, the depository system – was complicated, and the depositories have insufficient links to each other. The Law on Depository Activities at Securities Markets of August 29, 1998,[166] reorganized the depository system into a two-tier order: the State Central Securities Depository and second-level depositories.

After laying down the necessary legislation and the securities market infrastructure, subsequent reforms in securities regulation aimed at strengthening international relations and the protection of investors' rights in the securities market. Based on this reform on January 12, 1998, Uzbekistan's authorized regulatory body for the securities market joined the International Organization of Securities Commissions (IOSCO).[167] Taking into account the active participation of foreign investors in the securities market, on August 30, 2001, the Law on the Protection of Investors' Rights at Securities Markets was adopted.[168] That year exchange turnover stood at 8.0 billion UZSs, including less than USD 1 million in the foreign currency platform.[169] In September 2001 the Tashkent Exchange joined the International Association of Exchanges of CIS countries.[170] As a result of these reforms, the EBRD's Securities Markets Legislation Assessment in 2004 indicated that Uzbekistan's legislation was in 'medium compliance' with IOSCO principles.[171]

Such relatively high international appraisal and other existing issues provided the impetus for further reforms aimed at improving the securities legislation and regulation.

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[165] *Zakon Respubliki Uzbekistan o mekhanizme funktsionirovaniya rynka tsennykh bumag, Vedomosti Oliy Mazhlisa Respubliki Uzbekistan*, vol. 1, 2003, (i.e., Law of Uzbekistan on the Mechanism of the Operation of the Securities Markets, Vedomosti of Oliy Majlis of Uzbekistan) http://lex.uz/pages/getpage.aspx?lact_id=14626.

[166] *Zakon Respubliki Uzbekistan o deyatel'nosti depozitariyev na rynke tsennykh bumag, Vedomosti Oliy Mazhlisa Respubliki Uzbekistan*, vol. 1, 2003, (Law of Uzbekistan on depository activities at securities market, Vedomosti of Oliy Majlis of Uzbekistan) http://lex.uz/pages/getpage.aspx?lact_id=12207.

[167] http://lex.uz/pages/getpage.aspx?lact_id=647839&query=IOSCO

[168] *Zakon Respubliki Uzbekistan o zashchite prav investorov na rynke tsennykh bumag, Vedomosti Oliy Mazhlisa Respubliki Uzbekistan*, vol. 9–10, 2001, (i.e., Law of Uzbekistan on Investor Protection in the Securities Market, Vedomosti of Oliy Majlis of Uzbekistan) http://lex.uz/pages/getpage.aspx?lact_id=6270.

[169] http://www.uzse.uz/new/about/about_us.asp

[170] Ibid.

[171] *Commercial Laws of Uzbekistan: An Assessment by the EBRD*, 2002, 4–5

Various special teams in the Cabinet of Ministers, Ministry of Finance, Central Bank, and the Centre for Coordination and Control of Securities Market were created to study the reasons and to explore solutions for existing problems in the field. Based on the intensive work and joint efforts of academics, practitioners, and experts, a draft Securities Market Development Program for 2006-2007 was prepared which very soon was approved by way of Presidential Resolution on Measures on Further Securities Market Development dated 27 September 2006, No. PP-475.[172] The preparation and adoption of this program marked a new stage in the event of securities market legislation and regulation.

The second part of the Securities Market Development Program focused on accelerating the development and expansion of the secondary securities market, and had the most significant tasks among the other elements of the Program.[173] The first of these tasks was the elaboration of a law on the securities market by the fourth quarter of 2006. The draft of the bill was prepared and was passed by the Legislative Chamber (i.e., the lower house of parliament) on February 13, 2008.[174] The Law on the Securities Market[175] came into force on July 23, 2008, following approval by the Senate (i.e., the upper house of parliament) on June 27, 2008, and signature by the President on July 22, 2008.

In general, the adoption of the Law on the Securities Market has brought the country closer to the implementation of the recommendations of the Group of Thirty (G30) concerning both the dematerialization of securities and the concentration of accounting for securities in a single center. In this way, another significant step was taken to integrate the domestic securities market into global capital markets. According to this legislation, shares should be issued in a non-cash form – namely, in the form of entries in deposit accounts. The legislation further established the rule that the depositary accounting for stocks and corporate bonds is carried out only by depositaries. Depositary accounting of securities by the Central Depository is considered as the maintenance of the owners' list.

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[172] Postanovleniye o merakh po dal'neyshemu razvitiyu rynka tsennykh bumag, Sobraniye zakonodatel'stva Respubliki Uzbekistan, 2006, (i.e., Decree on Measures for the Further Development of the Securities Market, Collection of Laws of the Republic of Uzbekistan) http://lex.uz/pages/getpage.aspx?lact_id=1061597.

[173] The other parts of the program include: the further development of the primary securities market due to the complete divestiture of businesses and the creation of new joint-stock companies; the improvement of corporate governance in joint stock companies; the formation of the modern securities market infrastructure and strengthening its material-technical base; and the improvement of the organization of training and skills development for the securities market.

[174] The intensiveness of this complicated task could be understood when considering the fact that the Program was approved on September 27, 2006.

[175] *Zakon Respubliki Uzbekistan o rynke tsennykh bumag, Sobraniye zakonodatel'stva Respubliki Uzbekistan*, vol. 29–30, 2008, (i.e., Law of Uzbekistan on the Securities Market, Collection of Laws of the Republic of Uzbekistan) http://lex.uz/pages/getpage.aspx?lact_id=1374867.

With the adoption of the Law on the Securities Market four existing laws were unified, namely: the Law on Exchanges and Exchange Activity; the Law on Securities and Stock Exchanges; the Law on the Mechanism of Operation of Securities Markets; and the Law on Depository Activities at Securities Markets. It was not just a simple merger of the four acts. It consisted of double-checking all norms of actual acts to prevent duplication and normative conflicts; it provided improvements for regulators and convenience for participants through a single primary source, and sought to address existing problems and to the norms in rapidly growing relations consistent.

Substantively, the new law introduced some innovations, which promoted better regulation of the securities market. For instance, the restrictions on combining different forms of professional activity in the securities market were abolished. The disclosure information system for small business entities was liberalized. All kinds of shares were changed into electronic form. The securities register system was improved, a centralized digital database was created, and the Central Depository of Securities was nominated as a Central Register. A new type of professional activity in the securities market – transfer-agency – was introduced, and the system of central regulators was improved to better implement consistent state regulatory policy in the securities market. Principally, the legislation determined that the authorized state body for the provision of the securities market should regulate all security issuance, distribution, and circulation independently, except state securities, the regulation of which would be conducted together with the Central Bank and the Ministry of Finance.

In May 2014 the Law on Joint Stock Companies and Protection of Shareholder Rights was adopted in a new edition. The aim of this revised legislation was to increase the legal protection of shareholders, especially minority shareholders, to enhance the role and importance of management and control bodies of joint stock companies, to further develop the corporate governance system, and to ensure information transparency of JSC activities for shareholders and potential investors. A year later, in 2015, the Law on the Securities Market was adopted in a revised/amended form to simplify the procedures related to the issuance of securities, including new financial instruments. This legislation also introduced the conclusion of transactions with securities through the widespread introduction of modern electronic technologies, as well as the revision of the requirements for professional activities in the securities market, including clarification of liability for violation of market legislation.[176] The law enhanced the range of securities market objects and subjects. For instance, Article 3 of the revised legislation is supplemented by such concepts as 'depositary receipts', 'infrastructure bonds', 'clearing', 'market maker', and 'netting'.

The securities law from 2015 presented several regulatory initiatives, for instance, according to the law, securities-trading organizers should establish a guarantee fund for the compensation of possible losses to investors (cf., Article 23). The depositary activity is abolished as a separate professional activity (cf., Article 24), and its functions transferred to the investment intermediary (cf., Article 26). Furthermore, under this legislation, Uzbekistan National Bank is given the exclusive right to make cash payments on the transactions made in the organized markets (cf., Article 33), and the Central Depositary is empowered to assign securities with international codes (e.g., ISIN / CFI) (cf., Article 39).

What is more, this legislation also represented a shift towards taxation of incomes from securities transactions. According to Article 16, it is the seller (except issuers) who must pay to the state a fee of 0.01% of the transaction value. However, the income/profit of the seller, including non-residents of Uzbekistan, under the transaction, is not subject to corporate income tax or personal income tax. The new law establishes that the market maker[177] is exempted from payment of fees and other debts to the Stock Exchange, Central Depository, and to the Uzbekistan National Bank where transactions are made in the stock exchange to maintain the level of prices, supply, and demand of securities (cf., Article 39).

Significant changes in the types of professional activities in the securities market, (namely, under Article 24 of the Law on the Securities Market), such activities are carried out as: an investment intermediary; the investment adviser; investment fund; trust manager of investment assets; transfer agent; and/or organizer of over-the-counter securities trading. The depositary and the clearing institution as independent types of activities are abolished, while according to Article 26 of the revised legislation, the investment intermediary is required to keep a record of the securities and monetary funds of each customer, and to carry out transactions with securities by the contract concluded with the client.

[176] President of the Republic of Uzbekistan on June 3, 2015, No.ZRUU-387 signed the Law of the Republic of Uzbekistan.

[177] Market maker is one of the professional participants of the securities market, whose task is to continuously ensure supply and demand on the trading floor for shares, for which company specifically assigns them.

2.4. Development level and problems of SM in CIS countries

2.4.1. Development level of CIS countries' SM

Currently, the securities markets of CIS members are facing a range of institutional and legal problems that hinder their further development and integration with regional and global markets. According to the review of the transition experience of Russia, Kazakhstan, and Uzbekistan in previous sections of the present thesis, reform failure in CIS countries had much to do with institutional and legal factors. Also, despite almost three decades of changes, these factors remain the key issues for the implementation of market economy principles in CIS countries.

Today's general problem for all CIS countries' securities markets is the absence of a mechanism to ensure the complete realization of the potential of securities markets at the level of the national, regional, and global economy. Particularly, currently, the securities markets of CIS countries cannot be considered as providing a real competitive alternative source of business financing, an alternative system of mobilizing savings and allocations, an effective method of ensuring corporate governance and transparency of companies, and a potential way to attract foreign investors.

Statistics and the overview of securities market activity in the countries under review helps one to better understand the current situation. In the specific literature[178] market capitalization over GDP, [179] trade volumes, and some listed companies are used as leading indicators of securities market development.

Securities market capitalization is usually described as a percentile value /portion of GDP and shows the securities market size relative to the size of the entire economy. However, high securities market capitalization rates do not necessarily mean that the securities market is dynamic, especially in oligopolistic markets such as those of CIS countries. Securities market capitalization in Russia, Kazakhstan, and Uzbekistan are quite moderate compared to developed markets figures. [180] For instance, in 2015 market

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[178] See for example: Stefka Slavova, *Law and Finance in Transition Economies*, London School of Economics, Financial Markets Group, 1999.

[179] Market capitalization (also known as market value) is the share price times the number of shares that are outstanding (including their several classes) for listed domestic companies. Investment funds, unit trusts, and companies whose only business goal is to hold shares of other listed companies are excluded. The data relate to end of year values.

[180] For instance, in 2015 in Japan market capitalization was 112% (with around 4.895 trillion USD);[180] in USA 139% (25.068 trillion USD); in Germany 51.01% (1.716 trillion USD); in UK[180] 65% (1.868 trillion USD). See details at: http://data.worldbank.org/indicator/CM.MKT.LCAP.CD?locations=GB-US-DE;

capitalization of listed domestic companies in Russia stood at 29 % (c. 622 billion USD) of its GDP, and in Kazakhstan it stood at 19% (c. 40 billion USD).[181] In Uzbekistan World Bank analysis shows 4.1% in 2006 (c. 715 million USD).[182] According to the latest figures found in the ADB research paper from 2013 that relates to Uzbekistan securities market capitalization information for 2007-2011, the average rate of market capitalization in Uzbekistan stood at about 10 % of its GDP (cf., Table 2).

Table 2. Securities market capitalization in % of GDP

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Russia	n/a	116	24	70	66	42	43	37	22	29
Kazakhstan	54	39	23	50	41	23	12	11	11	19
Uzbekistan	4	8.8	10.4	7.30	9.4	9.7	n/a	n/a	n/a	n/a

Source: The figures for Russia and Kazakhstan are based on World Bank Database (Market Capitalization of Listed Companies, % of GDP 2006—2015).
The figures for Uzbekistan for 2006 are based on World Bank Database; for 2007 - 2011 is based on the ADB Country Assessment of Uzbekistan, 2013.[183]

Another leading indicator for assessing securities market activity is the trade volume versus GDP (Table 3). It shows the value of shares traded is the total number of shares traded, multiplied by their respective matching prices. In 2015 securities market trade volume in Russia was 8.5 % of its GDP; in Kazakhstan 1.4%, and in Uzbekistan according to the latest available data from 2011 the trade volume of stocks comprised just 0.1% (about USD 118.7 million (c. SUM 213.1 billion)) of its GDP.[184]

To conclude, there is still some space in the economy of CIS countries for trading with securities. In the largest economy of the region, securities trading does not reach even 10%, in others, this index represents around 1% of GDP, which suggests significant underdevelopment of the securities industry as a business activity. At the same time, it provides a focal point for further development reforms and for fostering investment activity through this area of the market economy.

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http://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS?locations=GB-US-DE
[181] http://data.worldbank.org/indicator/CM.MKT.LCAP.CD?locations=RU-KZ; http://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS?locations=RU-KZ
[182] http://data.worldbank.org/indicator/CM.MKT.LCAP.CD?locations=UZ; http://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS?locations=UZ
[183] https://www.adb.org/sites/default/files/project-document/173358/43359-012-tacr-05.pdf (cf., pages 61, 63, and 7.)
[184] Regional: Financial Sector Development in Central and West Asia, Country Assessment Uzbekistan, ADB, 2013. https://www.adb.org/sites/default/files/project-document/173358/43359-012-tacr-05.pdf (at 7).

Table 3. Securities market trade volume in % of GDP

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Russia	46	31	68	65	29	18	13	14	8.5
Kazakhstan	8,5	2,9	3,7	1,3	0,6	0,7	0,3	0,5	1.4
Uzbekistan	0.4	0.3	0.02	0.09	0.1	0.08	0.04	0.04	0.05

Source: The figures for Russia and Kazakhstan are based on the World Bank Database (Stocks traded, total value (% of GDP) 2007-2015);

The figures for Uzbekistan in 2007-2011 are based on the World Bank Database. NB., for 2012-2015 the figures are based on this author's calculations in turn based on data found at: uzse.uz; stat.uz; and cbu.uz.

The next important indicator as to the potential of the supply side of the securities market is the number of listed companies (Table 4.),[185] including foreign companies, which are exclusively listed, and which have shares listed on an exchange. A higher number means that more companies use equity financing in their business. This indicator does not include market professionals, such as investment funds, unit trusts, and companies whose only business goal is to hold shares of other listed companies, such as holding companies and investment companies, regardless of their legal status.

According to the available data, among the countries examined in the present thesis, the highest index is that of the Russian market with an average of 250 listed companies. Despite the lowest level of securities market turnover and rate of market capitalization, there are almost 200 listed companies in Uzbekistan's securities market. A considerable amount of JSC stocks are not listed in the stock exchange, and these are traded in over-the-counter (OTC) markets. For instance, in 2008 there were only 19 listed companies out of 1800 JSCs; 20 companies out of 1781 JSCs in 2009; in 2011 100 listed companies out of 1309 JSCs; in 2014 only 138 companies were listed out of 1090 JSCs. Lastly, concerning Kazakhstan, market analysis suggests a modest ranking concerning listed companies, with around 85 companies, despite the relatively active market turnover, which suggests a relatively high level of ownership concentration.

Table 5. Listed companies

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Russia	328	314	279	345	327	276	276	266	251	242
Kazakhstan	90	74	69	60	63	74	80	77	78	85
Uzbekistan	114	19	20	152	100	130	138	138	261	191

Source: The figures for Russia and Kazakhstan are based on the World Bank Database (Listed domestic companies, total 2007-2016).

[185] NB., a company with several classes of shares is counted once. Only companies admitted to listing on the exchange are included.

The figures for Uzbekistan are derived from various sources: namely, for 2007 and 2008 the figures are based on the World Bank Database; for 2010-2012 they are from Almanac Uzbekistan, 2013; [186] and the figures for the rest are taken from uzse.uz.

The listed companies' indicator highlights the oligopolistic character of the securities markets and the ownership concentration level of the economy for the countries under review. Furthermore, it also reveals the unrealized potential of securities markets that once realized through legal and institutional reforms could serve for the increase of investments into the economy and for the development of the country. However, at present, the securities markets of the CIS countries under review is in a state of underdevelopment, as the figures presented in the foregoing so abundantly suggest; they have yet to attract, and become the locomotive of, significant investments into the economy. The next task of the present thesis is to consider the significant underperformance of the securities markets of the CIS countries under review, to try to establish its causes, and to explore appropriate solutions.

2.4.2. SMD Problems in CIS countries

In previous sections, there were brief analyses of the origins and development of the securities markets in the three CIS countries under review, and there were attempts to outline the current level of their performance. According to the statistics mentioned in the foregoing, CIS securities markets exhibit modest levels of development. There are several factors that directly and indirectly influence the development of securities markets at the national, regional, and global level. These include economic, political, social, cultural, institutional, and legal factors. This research primarily focuses on the institutional and regulatory problems due to their nature and influence on the further development of securities markets in CIS countries. As shown in the earlier analysis and the discussion on the different transition 'puzzles' of CIS countries, the institutional and legal context is essential for building an efficient securities market. Respectively, to better understand the problems of securities market development (SMD) in CIS countries, these were categorized into two groups: namely, *structural* and *regulatory*.

Structural pertain to systemic and institutional issues that could be taken into account during the design of reforms. Particularly in this research, the following institutional problems are tackled: the oligopolistic nature of the market, the lack of

[186] http://www.unece.org/fileadmin/DAM/hlm/prgm/cph/experts/uzbekistan/01_general_info/Almanach_Uzbekistana_2013_RUS.pdf. (at 198)

competition in the financial services sector, and the significant role of the state both in regulation and business.

The oligopolistic nature of the market refers to the structure of the economy as a whole, and to the company ownership structure, in particular. In the structure of economics, it means dependence of the economy on few sectors, and the absence of, or insufficient, diversification of market economy sectors. This feature could be seen in every studied country, for instance, in Russia, securities markets are mainly dependent on oil and energy sector companies,[187] in Kazakhstan oil companies and banks,[188] and in Uzbekistan banks and natural resource-related companies.[189] Oligopoly at the company level means a high concentration of shares within a limited number of shareholders. High concentration of shares and a limited number of shareholders cause the appearance of scarcity in the securities, which negatively affects the demand and supply balance of the market. Also, this kind of ownership structure of the company undermines the protection of minority shareholders' rights, and hinders access of new investors to the market.

Another structural feature of the securities markets of the CIS countries under review, which is indirectly connected with the oligopolistic nature of the market, is the lack of real competition in the financial services industry. In this regard, three types of competition are discussed below, namely: competition between the banking industry and securities market, primarily in accumulating funds and business financing, competition within the securities market, and competition between conventional forms financing (bank and securities market) and quasi-legal form of funding of (shadow lending and borrowing mechanisms).

The competition between the bank and the securities market is the most significant for the present research, hence why this issue is analyzed in more detail in chapter four. The present section is limited to relying on some basic statistics to hint at the scale of the problem. In CIS countries a substantial part of the accumulated and distributed financial resources is accounted for the banking industry, in comparison with the securities market. For instance, in Uzbekistan, as of April 1, 2017, total volume of bank loans directed to the

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[187] See detailed analytics at the official webpage of Moscow Exchange http://2016.report-moex.com/en/review/markets/equity-and-bond-market
[188] See detailed analytics at the Official website of the Kazakhstan Stock Exchange http://www.kase.kz/files/publications/2017/31_01_2017_Kursiv.pdf
[189] For instance, in 2016 banks share was 50.6 percent (151.8 billion Uzbek *sums*) of exchange turnover. For further details, see the official website of the Tashkent Stock Exchange. https://uzse.uz/boards/183

real sector of the economy was in excess of 57.3 trillion UZS,[190] while in 2016 the amount of Tashkent stock exchange transactions had only been 299.8 billion UZS.[191] In Russia, the volume of bank credits in 2016 was 17 trillion rubles, in contrast, the securities market turnover was 9.2 trillion rubles.[192] In Kazakhstan the volume of bank credits to the economy KZT 12.9 trillion in 2016,[193] while transaction volume with shares in the same year was KZT around 3.9 trillion.[194] There are several factors behind high divergence in the roles of the banking and the securities markets in business financing, including the financial structure, legal system, and the regulatory framework. However, the regulatory framework factor seems to be the most influential in terms of cause and potential for solutions.

Today in CIS countries real competition is necessary not only between the banking sector and the securities market but also within securities market institutions as competition is scarce. For instance, in Uzbekistan, despite the existence of three organized trading platforms, around 98 percent of the whole trading volume belongs to the Tashkent Stock Exchange. The other trading systems, namely, the Inter-Bank trading system (MTS) and the Electronic OTC trading system ('Elsis-Savdo') are limited to minor shares.[195] The Tashkent Stock Exchange is the leading securities trading platform and the only corporate securities exchange.[196] Also in Russia, there is a similar situation as the Moscow Stock Exchange became a leading platform for trading with securities after the merging of two major Russian exchange groups – namely, the MICEX Group (founded in 1992) and the RTS Group (founded in 1995) – in 2011.[197] The Kazakhstan Stock Exchange is the leading

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[190] From the official report of Central Bank of Uzbekistan: http://cbu.uz/ru/press-tsentr/statisticheskie-dannye/88320/ (NB., in Russian).

[191] See website of internet newspaper *Uzbekistan Today* at: http://www.ut.uz/en/business/the-republican-stock-exchange-turnover-reached-the-all-time-high/

[192] For further details, see: NAUFOR (Russian National Association of Securities Market Participants), "Russian Securities market: 2016 Events and Facts." (2016), 6, 14. https://www.naufor.ru/download/pdf/factbook/en/RFR2016_eng.doc

[193] Report of the National Bank of the Republic of Kazakhstan for 2016, 5. http://www.nationalbank.kz/cont/Annual%20report_16.pdf.

[194] For further details, see: KASE, "Volume of trades on KASE increased by 60.3 % to KZT151.5 tn ($467.7 bn) in 2017", http://kase.kz/en/news/show/1359935/.

[195] The competition within the securities market institutions was the object of past research in which the current author had been involved. In the previous research devoted on the legal regulation of stock exchanges activity in Uzbekistan we found that one of the main problems hindering stock exchanges activity in Uzbekistan was the lack of competition among stock exchanges. For further details, see: Otabek Narziev, "Legal Regulation Problems of Stock Exchanges Activity in Uzbekistan" (PhD diss., Tashkent State Law University 2009) (NB., in Uzbek).

[196] See details in Uzbekistan Country Commercial Guide: https://www.export.gov/article?id=Uzbekistan-6-Financial-Sector

[197]Official website of Moscow Exchange Group: http://www.moex.com/en/

trading platform in Kazakhstan.[198] Weak competition among stock exchanges in CIS countries is one of the main factors of the underdevelopment of the securities market in these jurisdictions.[199]

And lastly, the third issue connected with competition in fund accumulation and business financing is the so-called 'street funding'. In transition countries such as those of the CIS, there is a significant share of the shadow economy that is directly reflected in the financial services market. Particularly, alongside with bank credits and the securities market, there is another casual source, the so-called 'borrowing from the street' practice. It means borrowing from individuals, usually in a foreign currency and under higher interest rates than the securities market and even banks. From the outside, it looks like normal private lend-borrowing relations, but its nature and scale of this phenomenon is beyond the content of an ordinary consumer loan and it already covers a significant part of entrepreneurs. Among the countries under review, this phenomenon is most developed in Uzbekistan. Unfortunately, there are no official data or statistics on this issue,[200] but merely observing business activity in Uzbekistan and the existence of a double and triple accounting system[201] in major part of business entities prove the role of such 'quasi-legal' loans in the financial services industry of the country. One of the reasons that such 'quasi-legal' loan practices are thriving is connected to problems concerning foreign currency exchange; until recently,[202] entrepreneurs, especially small- and medium-sized businesses (SMBs), had difficulty in taking credit from banks in foreign currency; and there was a significant difference[203] between official, real, and exchange rates of foreign currency exchange. For business entities that usually import goods, it was easier and cheaper to

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[198] For further details, see the website of the Kazakhstan Stock Exchange: http://www.kase.kz/en/

[199] For further details, see: "Capital Markets in Eurasia: Two Decades of Reform", OECD report, June 2012, https://www.oecd.org/daf/ca/CapitalMarketsinEurasia.pdf

[200] In the scale of recent liberalization reforms in Uzbekistan, for last two years there has been an increase in official reports that enlighten some issues of shadow business. For instance, according to the video translated by the *Uzbekistan 24* TV channel, the representatives of the State Security Committee intercepted foreign currency smugglers, who had attempted to bring USD 5.3 million out of Kazakhstan. (September 3, 2018) https://www.facebook.com/groups/649483048588031/permalink/962526937283639/.

[201] The double and triple accounting system in Uzbekistan was connected with three different foreign currency exchange rates: the official, which is established by central bank; the real, which is the 'black market' rate; and the rate that was determined by currency exchange. Enterprises that buy foreign currency from black market had to 'legalize\ these transactions through currency exchange in a higher market price.

[202] See: Decree of the President of Uzbekistan "On Priority Measures on Liberalization of Currency Policy" No. UP-5177, September 2, 2017. http://lex.uz/pages/getpage.aspx?guid=87&lact_id=3326423&query=%D0%B2%D0%B0%D0%BB%D1%8E%D1%82%D0%B0

[203] For instance, as of September 2017, the official rate of USD was around 4000 UZS, its black market rate was in excess of 8000 UZS. There was also foreign currency exchange rate, which was more expensive than official and black market rates.

borrow money from the 'street'. The fact of the existence of a shadow lending and borrowing system in CIS countries confirms that both the banking system and the securities market cannot meet the financial necessities of business, which, consequently, forces entrepreneurs to seek funds beyond the banking and securities market industry. This hugely impacts the regulatory framework both in terms of the causes and possible solutions to this problem. If SMD reforms directed to legalize this kind of 'quasi-legal' practice and convert this to banking and securities market activity, it can be useful both to the state, and to business. State benefits from such reform at least by increasing investor confidence in the financial system, the inflow of investments, and additional taxes. The legalization of shadow mechanisms of business financing gives legal guarantees to businesses, relatively affordable funds, and a chance for growth.

Also, the last structural feature of the securities markets of the CIS countries under review, to be covered in this research, is the significant role of the state as regulator and as a key participant. [204] The level of state participation in securities market relations provides fertile ground for the assessment of the quality of implementation of market principles in the country. Today in CIS countries the state actively participates in securities market relations through its SOEs and banks that issue, own and manage various securities, and render intermediary services. Most importantly, the state sets the rules, regulates market relations through the authorized body, and is responsible for the fairness of dispute resolution. All CIS countries exhibit strict state regulation of the market through state regulators rather than through self-regulatory organizations. [205] A high degree of direct and indirect state participation in securities market relations in CIS countries is a sign of administrative principles prevailing over market principles despite the almost three decades of market transition reforms. In Russia, Kazakhstan, and Uzbekistan, the state actively participates in the market through SOEs and banks. For instance, in Uzbekistan, around 70 percent of securities market turnover belongs to banks and their financial instruments, while approximately 60 percent[206] of the banking industry belongs to the state. [207] 20 percent (regarding the remaining 30 percent) of securities market turnover

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[204] Cf., chapter five of this research for a more detailed analysis of this issue.
[205] See details in: EBRD, "Securities Markets Assessment and Legal Indicator Survey", 2007.
[206] In January 2017, the banking sector's capitalization was about USD 3.2 billion and the value of total bank assets in the whole country was equivalent to USD 27.1 billion. Included in this amount are the assets of the two largest state-owned banks, which together hold about USD 17 billion. See details in Uzbekistan Country Commercial Guide, https://www.export.gov/article?id=Uzbekistan-6-Financial-Sector
[207] There are 27 commercial banks, including 3 state-owned banks; 11 partly state-owned joint-stock banks; 5 banks with foreign capital; and 8 private banks. See the Uzbekistan Country Commercial Guide, https://www.export.gov/article?id=Uzbekistan-6-Financial-Sector.

belongs to SOEs or companies with state assets. Initial Public Offerings (IPOs) and securities issues are usually performed on administrative decisions, [208] instead of on market demand and supply principles. The stock exchange mainly hosts equity and secondary market transactions with shares of SOEs. In most cases, government agencies decide who can buy and sell shares and at what prices, and it is often impossible to locate accurate financial reports for traded companies.[209] The situation in Russia [210] and Kazakhstan is very similar.[211]

Concerning structural problems, a lack of competition (between the banking industry and the securities market; as well as within securities market institutions) and the role of state (both in private and public relations) are key issues on which this research focuses, and the theoretical basis of these two issues will be analyzed in the next two chapters. The oligopolistic feature of CIS countries securities market will be taken into account during the exploration of solutions as a framework, due to its systemic character. The primary aim of this research is the exploration of appropriate solutions to the structural problems through legal and regulatory reforms. For achieving this task, below follows a brief exposition of the regulatory issues of securities market development in CIS countries in the example of Russia, Kazakhstan, and Uzbekistan.

The regulatory problems of securities market development in CIS countries are mostly connected with the drafting, adoption, and implementation of mandatory rules that are directed to the regulation of relations in this area. The content, form, and methods of enforcement of the law are the main issues of this cluster of problems. Unfortunately, it is outside the scope of this research to cover all the regulatory aspects of securities market development in CIS countries. Hence why the review is limited to the range of subjects who can issue securities, market access issues, and the range of securities that could be released by subjects.

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[208] It could be justified in case of JSCs, where the state holds the controlling share. But usually such decisions will be at the level of Cabinet Minister or Presidential Decree that is compulsory for all market participants. For instance, in October 10, 2017 based on the Resolution of the Cabinet of Ministers No. 268, one of the JSC with 75% states share (namely, the 'Quartz' JSC) announced an IPO. For further details, see at the official website of Uzbekistan SEC: https://csm.gov.uz/ru/o-tsentre/novosti/59-news-obyavleniya/news-novosti-fondovogo-rynka/484-ao-kvarts-provodit-ipo

[209] For further details, see the Uzbekistan Country Commercial Guide: https://www.export.gov/article?id=Uzbekistan-6-Financial-Sector

[210] See: Russian Federation Financial System Stability Assessment, IMF Country Report No.16/231, July 2016, 11, https://www.imf.org/external/pubs/ft/scr/2016/cr16231.pdf

[211] For further details, see: Financial system stability assessment of Kazakhstan, IMF country Report 14/258, July 2014, https://www.imf.org/external/pubs/ft/scr/2014/cr14258.pdf

As for the securities issuer subjects, among the compared countries only in Uzbekistan, its scope is limited to JSCs and state bodies. In Russia and in Kazakhstan, the range of entities that has the right to issue securities is much broader and includes JSCs, LLC, partnerships, pension funds, and other objects. Today in Uzbekistan 80 percent of existing companies were established in the form of LLC. The number of JSCs is decreasing annually,[212] and most of them are state-owned or with significant state shares, and less than one-third of existing JSCs are listed in the Tashkent Stock Exchange. To further develop the potential of securities markets in business financing, company law reform should be carried out to expand the range of companies that has the right to issue securities and involve funds from the securities market. There are several LLCs that are much bigger than JSCs. Even state participated companies are founded in the form of LLC. Complicated disclosure information mechanisms and various inspection system of JSCs makes this form of company unpopular/unfavorable to business representatives. Restrictions on the issuance of securities only by JSCs make the market passive and limits access to its financial resources.

The next issue on increasing the share of the securities market in business financing is connected with the access to the market by investors. Currently, Russia and Kazakhstan completed several reforms on opening their securities market to investors and have created opportunities for purchasing their securities on global markets. Unfortunately, in the case of Uzbekistan there is still a lack of reforms in both the national and global market context. For the domestic market until September 2017 because of the foreign currency exchange problems, the share of foreign investors was less than 10 percent of total trade volume.[213] As for entering global markets, until now Uzbekistan has never seriously considered this issue.

Another issue connected to boosting the business financing potential of the securities market is improving the legal basis for diversifying the types of securities circulated in the market. In this regard, the Kazakhstan experience in launching Islamic bonds – *Sukuk* – could be one way of introducing a new product for the market. It would be better to create the legal bases for the particular financial instrument, which could be issued by small and medium-sized enterprises with simplified procedures on issuance, circulation, and reporting.

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[212] For instance, according to the report of Uzbekistan SEC as of April 1, 2017, the number of JSCs in the Republic was 630, which is 29 fewer than at the end of 2016, https://csm.gov.uz/ru/o-tsentre/novosti/73-rezultaty-deyatelnosti-tsentra/433-itogi-i-kvartala-2017-goda

[213] For further details, see the website of Tashkent Stock Exchange: https://uzse.uz/analytics

Summary

In the foregoing it has been attempted to outline the genesis, evolution, and development of the securities market in the CIS region, and to draw up key regional and some country-based specifics of the CIS embryonic securities market infrastructure and of its legal and regulatory framework. It was concluded that there were particular political, economic, and social bases for the emergence of the securities market and its infrastructure in these post-Soviet jurisdictions. Notably, the collapse of USSR, the formation of CIS, the choice of the market economy as the primary means of development, privatization, and the appearance of shares and JSCs all provided fertile ground for the genesis of basic securities market institutions in post-Soviet territories. Despite the almost three decades of existence, these markets have yet to rid themselves of certain anomalies including their oligopolistic character, state and bank dominance, scarcity of professional institutions, opacity and modest corporate governance, and lack of investor confidence. This, and other consequent issues will be the subject of the next part of this research.

CHAPTER 3. THEORETICAL BACKGROUND OF SECURITIES MARKET REGULATION

The analysis in the previous chapter has revealed several problems and factors that hinder the proper development of securities markets in CIS countries, especially in Uzbekistan. At the local and regional level, such problems may appear unprecedented, but at a broader level most of them had already occurred in some form. There are certain theoretical and practical aspects of approaching such challenges. This chapter attempts to outline the theoretical basis of securities market regulation, to describe some actual problems, and to propose some improvements.

This chapter serves as the core of our study that stands containing the ideas and conclusions of the research. It provides conceptual and ideological remedies for application at the local level through analyzing existing theories on securities market regulation at a global scale, and through considering chronic issues that plague the modern securities market. The structure of chapter three is as follows: first, there is discussion on the necessity and importance of securities market regulation theory with the aim of determining the actual need for legal regulation. Then an overview follows on the basic theories that directly relate to securities market regulation. And, lastly, there is a review of the main problems of modern securities markets accompanied by proposals aimed at addressing those problems.

3.1. Importance of theory in securities market regulation

In the previous chapter, some light was shed on the necessity of securities market regulation in the case of CIS countries. In this section, there is an attempt to focus on the importance and role of SMR theory in the organization and development of active securities markets. According to a relatively extensive study on regulation and growth, which analyzed business regulation across 135 countries, "government regulation of business is an important determinant of growth", "the impact of improving regulations is large", and "countries should put priority on reforming their business regulations when designing growth policies".[214]

The consensus is that regulation is crucial to achieving and maintaining an efficient and fair securities market nationally, regionally, and globally. The securities market needs

[214] Simeon Djankov, Caralee McLiesh, and Rita Maria Ramalho, "Regulation and growth", *Economics Letters* 92, no. 3 (2006), 4-5.

comprehensive regulation because of its institutional (market), contextual (functional features, unique relations and so on), and formal features. The need for regulation in the securities market is more pressing than commodity and real estate markets, because of several specific characters of the securities market. These features mostly relate to financial instruments.[215] Every stage of financial instruments starting from their origin (issuance and registration), existence (circulation), and their annulment, requires the direct involvement of legal institutions, rules, and procedures. In the case of other market products, such as commodities, economic factors prevail over legal factors. In general, commodities can be produced and put into circulation without the direct involvement of legal institutions, rules, and procedures.[216] However, in the case of financial instruments this is less so due to the unique economic and legal nature of financial instruments and the high systemic risk that can be generated through these instruments. Hence why the design and implementation of effective regulation of such markets with unusual objects, subjects, and relations should be based on a sound theoretical framework, which will provide an ideological basis for regulation and reforms. For proving this statement, it is enough to look back and consider the consequences of the 'deregulation stream' just in the last two decades, with a particular focus on the latest financial/economic crisis and the contributions of SMR theory on making sense of it. There are many studies and opinions following the crisis. Nobel prize scholar Joseph Stiglitz wrote perhaps the most generally accepted view on this matter:

> "…many of most popular micro- and macro-economic theories aided and abetted regulators, investors, bankers, and policy makers – they provided the 'rationale' for their policies and actions. They made the bankers believe that, in pursuing individual self-interest, they were advancing the well-being of society; they made the regulators think that in pursuing policies of benign neglect, they were allowing the private sector to flourish, from which all would benefit."[217]

Lessons are drawn from the recent financial crisis, and the aim of avoiding such catastrophes in the future places considerable challenges before scholars and professionals on securities market regulation to reconsider the ideological agenda that underpins it, and to provide suitable perspectives based on the realities of current conditions. To such end, a

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[215] The phrase of financial instruments here refers to all kind of stocks (including equities, bonds, options, and futures) that might be the object of transactions in the securities market.
[216] Except for certification and standardization, ecological and other necessary procedures, which are common, practice for some products and services.
[217] Joseph E. Stiglitz, "The Anatomy of a Murder: Who Killed the American Economy?", in *What Caused the Financial Crisis*, ed. Jeffrey Friedman (Pennsylvania: University of Pennsylvania, 2011), 144.

brief overview of theories that directly affect SMR follows where the main problems are highlighted, and a series of proposals are presented for the improvement of SMR.

3.2. Overview of basic approaches

Securities market relations and issues concerning their regulation, by their nature and essence, are interdisciplinary matters that are primarily studied in the fields of economics and the law. The development of the securities market, the enhancement of financial instruments, the emergence of various market intermediaries and participants, and the rising necessity on effectiveness and fairness in securities market relations, require law and regulation to be brought closer with economics and the market. In this sense, Cooter and other scholars mention that "law needs economics to understand its behavioral consequences, and economics needs law to understand the underpinnings of markets".[218]

The scope of theories that treat law and economics issues is quite broad, and a few theories concern securities market relations. This brief overview of such theories concerns those directly related to securities market regulation – namely, the *efficient market hypothesis* (EMH), *behavioral economics*, the *economic dynamics of law*, and the *social business initiative*.

3.2.1. Microeconomic approach: Efficient Market Hypothesis (EMH)

The Efficient Market Hypothesis (EMH)[219] is the basic concept of economic analysis of law, [220]which aims to explain and predict the behavior of market participants to ensure efficiency (positive theory),[221]and to use incentives and political instruments for changing their behavior for ensuring justice (normative theory).[222]

[218] Robert Cooter and Thomas Ulen, *Law, and Economics*, (Berkeley: Berkeley Law Books, 6th edition, 2016), 24. http://scholarship.law.berkeley.edu/books/2

[219] In some literature this notion is cited as *efficient capital market hypothesis* (ECMH). See Burton G. Malkiel and Eugene F. Fama, "Efficient Capital Markets: A Review of Theory and Empirical Work", *The Journal of Finance* 25, no. 2 (1970): 383-417.

[220] The history of economic interpretation of law goes back to the 18th century CE when Adam Smith wrote about the economic effect of legislation on merchants and commerce. However, the beginning of the modern school of law and economics is often placed in the 1960s. For details, see: Robert Cooter and Thomas Ulen, *Law, and Economics*, (Berkeley: Berkeley Law Books, 6th edition, 2016), 24, http://scholarship.law.berkeley.edu/books/2

[221] The positive approach to the economic analysis of law seeks to understand how the behavior of people is affected by incentives created by the law. This approach uses the analogy of the law as a type of pricing machine. The law 'prices' various forms of human behavior through the use of fines, penalties, and other measures. For details, see: Richard A. Posner, *Economic analysis of law* (Wolters Kluwer Law & Business, 2014).

[222] The normative approach to the economic analysis of law proposes an efficiency criterion for shaping the legal system based on wealth maximization. In the legal context, this approach asks how much each would be

Nobel Prize economist Eugene Fama who argued that stocks always trade at their fair value, making it impossible for investors to purchase undervalued stocks either or sell shares for inflated prices, put the EMH forth in the early 1960s.[223] Some scholars state that the origin of the EMH can also be traced back to the work of Paul A. Samuelson. They point out that Fama and Samuelson independently developed the same basic notion of market efficiency from two slightly different research agendas.[224]

The EMH states that asset prices fully reflect all available information and therefore there are no undervalued or overvalued stocks because the amount in the stock exchange is the fair value of that particular stock. According to the EMH, it is impossible for investors to either purchase undervalued stocks or sell shares for inflated prices.

Initially asserting the efficiency of US capital markets,[225]The EMH has occupied a significant place in the economics and finance literature since the 1960s[226] also, has a strong presence in the contemporary culture of securities regulation.[227] Belief in the EMH has led Chicago School of Law and Economics scholars, especially those studying financial markets, to conclude that markets are self-correcting and therefore in little need of regulation.[228] However, severe criticisms of the belief in efficient and rational markets also exist.[229] According to Lo, even after several decades of research and numerous published studies, economists have yet to reach consensus on whether markets – particularly financial markets – are, in fact, efficient.[230] Opponents of the EMH also question the pure practical rationality of market participants pointing out an existence and

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willing to pay to either get rid of or keep specific laws or rules. For details, see: Richard A. Posner, “Utilitarianism, Economics, and Legal Theory”, *The Journal of Legal Studies* 8, no. 1 (1979): 103-140.

[223] Later Chicago School of Law and Economics scholars developed this hypothesis. See Richard A. Posner, *Economic Analysis of Law* (Boston: Little, Brown, University of Chicago Law School, 1972), 415.

[224] See Andrew W. Lo, “Efficient Markets Hypothesis”, in *The New Palgrave: A Dictionary of Economics*, eds. L. Blume, S. Durlauf, (2nd Edition, Palgrave Macmillan Ltd., 2007), https://ssrn.com/abstract=991509

[225] See Christopher Paul Saari, “The Efficient Capital Market Hypothesis, Economic Theory and the Regulation of the Securities Industry”, *Stanford Law Review* (1977): 1031-1076.

[226]. In the early 1960s economists Ronald Coase and Guido Calabresi working independently from one another, published two articles, “The Problem of Social Cost” and “Some Thoughts on Risk Distribution and the Law of Torts” respectively, that revolutionized legal theory and laid the foundation for many of the ideas that were developed in the following years. The movement gained further ground with the publication of Chicago University professor Richard A. Posner's “Economic Analysis of Law”. This work led to an era of economic principles being applied to all aspects of the law, referred to as the “Chicago School of thought”.

[227] See Donald C. Langevoort, “Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited”, *University of Pennsylvania Law Review* 140, no. 3 (1992): 851-920.

[228] For further details, see: Lynn A. Stout, “Are Stock Markets Costly Casinos? Disagreement, Market Failure, and Securities Regulation”, *Virginia Law Review* (1995): 611-712.

[229] For instance, a detailed analysis could be found in professor Langevoort’s papers. For details, see: Donald C. Langevoort, “Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited”, *University of Pennsylvania Law Review* 140, no. 3 (1992), 851-920; and Donald C. Langevoort, “Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation”, *Nw. UL Rev.* 97 (2002): 135.

[230] See Andrew W. Lo, “Efficient Markets Hypothesis”, in *The New Palgrave: A Dictionary of Economics*, eds. L. Blume, S. Durlauf, (2nd Edition, Palgrave Macmillan Ltd., 2007): https://ssrn.com/abstract=991509

sometimes prevailing irrational component in their behavior. As evidence, they cite the securities market crash in late 1987 when stock prices seriously deviated from their fair values.[231]

Another scholar – Chang also questions the credibility of this EMH by stating that: "individually rational actions can lead to the collective irrational outcome",[232]and supports his statement with concrete cases and theoretical arguments. Notably, he mentions a compelling story of two Nobel Prize economists – Robert Merton and Myron Scholes –[233] whose free market concept and practice failed twice, hurting investors and industry.[234] At the end of his critic analysis Chang poses the following reasonable question:

> "When the Nobel Prize winners in financial economics, top bankers, high flying fund managers, prestigious colleges and the smartest celebrities have shown that they don't understand what they are doing, how can we accept economic theories that work only because they assume that people are fully rational? The upshot is that we are not smart enough to leave the market alone. We need regulation exactly because we are not smart enough."[235]

The diversity of opposing arguments on EMH makes it burdensome to compile a list of all existing criticisms on EMH. Moreover, this would be outside the scope of this research. The reason for analyzing some key criticisms of EMH is to show that there is room for improvement concerning EMH theory – it should be reconsidered not only from microeconomic but also macroeconomic angles. Next there will be a brief overview of one of the leading macro approaches that seriously questions the EMH.

3.2.2. Macroeconomic approach: economic dynamics of law

The economic dynamics of law is a relatively new theory that offers a new vision of law as fundamentally a macro-level enterprise establishing normative commitments and a framework for numerous private transactions, rather than as an analogous to a market transaction. Professor David Driesen proposes the main ideas of this approach in a 2012

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[231] See details in Burton G. Malkiel, "Is the Stock Market Efficient?." *Science* 243, no. 4896 (1989): 1313-1318.
[232] See details in Ha-Joon Chang, *23 Things They Don't Tell You about Capitalism*, (Bloomsbury Publishing USA, 2012), 170.
[233] In 1997 these two scholars were awarded the Nobel Prize in economics for their "new method to determine the value of derivatives". In 1998 a considerable hedge fund, the Long-Term Capital Management (LTCM), went bankrupt following the Russian financial crisis. It was founded in 1994 and the two Nobel Prize scholars were on its board of directors. Another failure case is connected to the Platinum Grove Asset Management (PGAM) hedge fund, which was founded in 1999 again by these two scholars. In late 2008 this hedge fund also went bust, temporarily freezing investor withdrawal. For further details, see: Ha-Joon Chang, *23 Things They Don't Tell You about Capitalism*, (Bloomsbury Publishing USA, 2012), 170-173.
[234] Ibid.
[235] Ibid, 170.

book [236] and in a 2014 paper.[237] According to Driesen, the law is not a transaction as claimed by Chicago School scholars. Instead, it is a framework of rules by which deals occur. Because law aims to influence future behavior, rather than the past, its architects must often address surprise, change, and uncertainty. In other words, we must deal with the dynamics of an unknowable future. For Driesen most law is neither efficient nor inefficient. It merely provides the framework under which market actors seek to achieve practical outcomes. Hence, it is often not possible to determine whether a law is efficient. Because the statute provides a framework, it should be thought of as more closely analogous to macroeconomic policy than to the transactions that microeconomics typically focuses on.[238]

As Driesen argues, the microeconomic model of government regulation misconceives the essence of law. Government regulation produces not an immediate transaction, but a set of rules intended to influence future conduct, often for many years. Accordingly, regulation provides a framework for private resource allocation, rather than allocating the resources itself. This framework performs a macroeconomic role by reducing systemic risks that might permanently impair important economic, social, and natural systems. As such, government regulation resembles monetary policy, which likewise affects, but does not control, resource allocation.[239]

According to Driesen the law and economics, which is a microeconomic approach by its content, assume that government regulators should aim to make their decisions efficient by seeking to associate costs and benefits at the margin.[240] The Economic Dynamic approach focuses on the shape of change over time to avoid systemic risk. According to Driesen, "we cannot expect the government to make perfectly efficient decisions or ensure our future happiness, but we should, at a bare minimum, expect the government to ward off catastrophes, leaving much of the fine-tuning to private

[236] For further details, see: David M. Driesen, *The Economic Dynamics of Law* (Cambridge, UK: Cambridge University Press, 2012), 250.
[237] For further details, see: David M. Driesen, "Legal Theory Lessons from the Financial Crisis", *J. Corp. L.* 40 (2014): 55.
[238] Ibid.
[239] For further details, see: David M. Driesen *The Economic Dynamics of Law* (Cambridge, UK: Cambridge University Press, 2012), 250.
[240] Speech of Driesen at the Prague Conference on Political Economy (PCPE) in 2012, https://www.youtube.com/watch?v=rQe9xNpnCco

markets".[241] This approach explains how neoclassical law and economics sparked decades of deregulation culminating in the 2008 financial collapse.[242]

The dynamic economic analysis also proposes a form of institutional, economic analysis as a way to aid regulators in analyzing threats and responding efficiently. This approach requires regulators to study how relevant actors react to financial incentives, taking into account the level of bounded rationality anticipated in each group of regulated actors. Such analysis requires, in particular, consideration of countervailing incentives that may defeat legal spurs.[243]

According to Driesen, efficiency leads to an attempt to quantify, and then convert to dollar values, all of an action's consequences, to formulate 'optimal' policies. "Unfortunately, cost-benefit analysis (CBA) in a strictly quantitative sense becomes impossible or incomplete and unreliable when we face important future consequences. Instead, law and economics scholars often use neoclassical economic assumptions as a proxy for CBA, because they recognize that reasonably reliable CBA of many legal decisions addressing complex dynamic problems proves impossible".[244]

The economic dynamics approach also provides a systematic method of analyzing the law's effects. It focuses on avoiding significant systemic risks (like financial crises in case of SMR) and implemented through a systematic analysis of law's economic incentives and how people respond to them. Accordingly, this approach could be a broadly applicable framework to adequately address neoclassical law and economics failures, such as the 2008 financial crisis.

Another instance of criticism of EMH relates to the relatively new field of study – namely, behavioral finance – that focuses on the relations between irrationality and human emotions such as fear, panic, hope, envy, confidence, greed, etc., in financial investment decision-making.

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[241] For further details, see: *The Economic Dynamics of Law* (Cambridge, UK: Cambridge University Press, 2012), 250.
[242] For further details, see: David M. Driesen, "Legal Theory Lessons from the Financial Crisis", *J. Corp. L.* 40 (2014): 56-57.
[243] For further details, see: David M. Driesen *The Economic Dynamics of Law* (Cambridge, UK: Cambridge University Press, 2012), 250.
[244] For further details, see: David M. Driesen, "Legal Theory Lessons from the Financial Crisis", *J. Corp. L.* 40 (2014): 59.

3.2.3. Behavioral finance: *"not only and not always rational…"*

Behavioral finance is the branch of behavioral economics that studies the effects of psychological, cognitive, emotional, cultural and social factors on the economic decisions of market participants. This is a relatively young and promising field of modern finance theory with remarkable progress in the last decades.[245] Behavioral finance is based on the alternative notion that investors are subject to behavioral biases and therefore their financial decisions can be less than entirely rational.[246]

There are two main issues that behavioral finance mainly focus on: first, the reason that market participants make such irrational systematic errors that affect prices and returns, creating market inefficiencies contrary to the assumption of EMH; and, second, how do other participants take advantage of such mistakes and market inefficiencies.

The most continuing critiques of the EMH turn around the preferences and behavior of market participants. Lo brings relatively detailed analysis of behavioral critics of the EMH, [247]and argues that investors are often – if not always – irrational, exhibiting predictable and financially harmful behavior.[248]

It would be better to consider behavioral finance as an alternative solution to the challenges of the EMH in explaining certain financial phenomena, rather than to treat it as a replacement of classical economic theory.[249] In the case of extreme complexity and unpredictability of contemporary securities markets, relying on only EMH and rationalism will not reflect market realities. Just the 2008 financial crisis, when "the supposedly smartest people did not truly understand what they were doing"[250] would be enough to demonstrate the role of behavioral factors in securities market relations.

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[245] See Felicia Ramona Birău, "The Impact of Behavioral Finance on Securities markets", *Annals of the "Constantin Brâncuşi" University of Târgu Jiu, Economy Series* 3 (2012): 45-50.
[246] See Alistair Byrne and Mike Brooks, "Behavioral Finance: Theories and Evidence" (2008): 1-26.
[247] For instance, overconfidence (Fischoff and Slovic (1980); Barber and Odean (2001); Gervais and Odean (2001)), overreaction (DeBondt and Thaler (1985)), loss aversion (Kahneman and Tversky (1979); Shefrin and Statman (1985); Odean, (1998), herding (Huberman and Regev (2001)), psychological accounting (Tversky and Kahneman (1981)), miscalibration of probabilities (Lichtenstein, Fischoff and Phillips (1982)), hyperbolic discounting (Laibson (1997)), and regret (Bell (1982)). For details, see: Andrew W. Lo, "Efficient Markets Hypothesis", in *The New Palgrave: A Dictionary of Economics*, eds. L. Blume, S. Durlauf, (2nd Edition, Palgrave Macmillan Ltd., 2007): https://ssrn.com/abstract=991509, 9-10.
[248] See Andrew W. Lo, "Efficient Markets Hypothesis", in *The New Palgrave: A Dictionary of Economics*, eds. L. Blume, S. Durlauf, (2nd Edition, Palgrave Macmillan Ltd., 2007): https://ssrn.com/abstract=991509
[249] See Felicia Ramona Birău, "Behavioral Finance Paradigm And Its Implications On Investment Decisions", in *Proceedings of the International Scientific Conference, ECO-TREND*. 2011.
[250] See Ha-Joon Chang, *23 Things They Don't Tell You about Capitalism*, (Bloomsbury Publishing USA, 2012),170-173.

Critical studies on economics revealed another important theory that not only provides an alternative vision to the issues under review here, but also severely criticizes EMH, wealth maximization theory, and other microeconomic approaches, and proposes substantial solutions tested in real life over the last four decades, namely, the *social business approach* briefly outlined in the next subsection.

3.2.4. Social business: *"not only and not always wealth maximization aim…."*

Social business is an entirely new, dynamic, and bright notion within the field of economics that was defined and developed by Nobel Prize economics scholar Muhammad Yunus.[251] The concept of social business is based on the following four pillars:[252]

Firstly, it is the business that created and designed to address a social problem, rather than to earn money, maximize profit or wealth, in contrast to the tenets of conventional economic theories. According to professor Yunus traditional economic theory is not relevant to the realities of humans; it is misinterpreting human nature focusing only on egoism. However, the human being is not a 'money-making machine', it is multi-faceted, and one of its facts may include its selflessness, which based on the principle of "the best way of being happy is to make others happy".[253]

Secondly, it is based on the principle of non-loss and non-dividend business, which means that investors from the beginning decide not to take any profit of their investment, but only get back their invested amount. Instead, investors look forward to the impact of their investment through a real solution of some social problems. The opportunity of one hundred percent withdrawing investment by investors makes social businesses different to traditional non-profit organizations or other NGO's, which usually have a limited profit-making right.

Thirdly, unlike a non-profit, a social business is not dependent on donations or other grants to survive and to operate, because, like any other business, it is self-sustainable. Profits realized by the company are reinvested in the industry itself (or used to

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[251] Professor Muhammad Yunus is the recipient of 55 honorary degrees from universities across 20 countries. He has received 112 awards from 26 countries including state honors from 10 countries. He is one of only seven individuals to have been awarded the Nobel Peace Prize, the United States Presidential Medal of Freedom and the United States Congressional Gold Medal. For further information on professor Muhammad Yunus, see: http://muhammadyunus.org/index.php/professor-yunus/curriculum-vitae-in-brief

[252] For further details, see: Muhammad Yunus, *Building Social Business: The New Kind of Capitalism that Serves Humanity's Most Pressing Needs*, (Public Affairs, 2010); Muhammad Yunus, *Creating a World Without Poverty: Social Business and the Future of Capitalism* (Public Affairs, 2009).

[253]" See Muhammad Yunus, "Nobel Prize Winner Muhammad Yunus: The Key to Super Happiness" (2013).

start other social companies), with the aim of increasing their social impact.[254] This feature makes social businesses a new form of a commercial venture that lies somewhere between for-profit and philanthropy.[255] According to Muhammad Yunus in philanthropy or charity one dollar has only one life and one chance; in the case of social businesses one dollar can be used over and over to solve social problems.[256] For Muhammad Yunus, the profit made through social business operations is less important than the beneficial effects it has on society. This is again connected with the purpose of business activity that should be other than merely making a profit as an end in itself. So social businesses could provide an alternative model for utilizing capitalism to address social concerns at the local, national, regional, and global levels.[257]

And, lastly, the social business concept is not a hypothesis any longer. Instead, it is effectively implemented and a developing business model for more than three decades in many countries across the globe. In 2006 the Nobel Prize was awarded to Professor Muhammad Yunus and Grameen Bank which are implementing social business projects since 1976.[258] Today the Grameen Group is a network of nearly 30 sister organizations in around 60 countries, involving 9 million borrowers in Bangladesh and 300 million around the world, with a 3 billion USD loan turnover with 98.4 percent return rate.[259]

Some of the future challenges deriving from the development of the social business are listed up in the recent research by Agafonow and others,[260] where authors raise a reasonable question: is the development of a capital market that targets social businesses possible? This research attempts to partly contribute to this issue by considering the implementation of the social business model in the securities market relations of CIS countries.

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254 For instance, expanding the company's reach, improving the products or services or in different ways subsidizing its social mission.

255 See Alejandro Agafonow and Cam Donaldson, "The Economic Rationale Behind the Social Business Model: A Research Agenda", *Social Business* 5, no. 1 (2015): 5-16.

256 See Muhammad Yunus, *Building Social Business: The New Kind of Capitalism that Serves Humanity's Most Pressing Needs*, (Public Affairs, 2010); Muhammad Yunus, *Creating a World Without Poverty: Social Business and the Future of Capitalism* (Public Affairs, 2009).

257 See Muhammad Yunus, Bertrand Moingeon, and Laurence Lehmann-Ortega, "Building Social Business Models: Lessons from the Grameen experience", *Long Range Planning* 43, no. 2-3 (2010): 308-325.

258 See Nancy Wimmer, *Green Energy for a Billion Poor: How Grameen Shakti Created a Winning Model for Social Business*, MCRE-Verlag, 2012, 226; Muhammad Yunus, Bertrand Moingeon, and Laurence Lehmann-Ortega, "Building Social Business Models: Lessons from the Grameen experience", *Long Range Planning* 43, no. 2-3 (2010): 308-325.

259 See Muhammad Yunus's keynote speech at the Conference 'The Future of Finance' at Imperial College Business School in London on April 19, 2018, https://www.youtube.com/watch?v=ccX0pisosB4 (video).

260 For further details, see: Alejandro Agafonow and Cam Donaldson, "The Economic Rationale Behind the Social Business Model: A Research Agenda", *Social Business* 5, no. 1 (2015): 5-16.

3.3. Contemporary problems of securities market regulation

One of the tasks of the current chapter is to analyze the main theoretical problems currently at play in securities markets, to consider their primary reasons, and to examine their implications for CIS and other countries with transition securities markets.

Here only those problems that are directly or indirectly pertinent to the above basic theories shall be discussed. One of the main problems is connected with the failure of the EMH, and the necessity of adjusting it with the realities of today's securities market.

3.3.1. The excessive efficiency of securities markets

The first problem is connected to the notion that securities markets are 'too efficient'.[261] Even though this problem is characteristic of developed financial markets, it can be easily have implications for emerging or transition countries in the current information technology and globalization conditions. At the very least, developing countries cannot entirely avoid the harmful consequences of the overly efficient securities markets in developed countries, as has been the case with the financial crisis in 2008.

Chang refers to this problem as having to do with the short-term generation of profits by the financial sector through financial 'innovations' in the form of various complicated financial instruments. According to Chang "these new assets have made the overall economy, as well as the financial system itself, much more unstable".[262] Consequently, there have formed a massive gap between the financial sector with a short-term focus and the real sector of the economy, which has long-term goals. For instance, if in 1980 the total value of all financial assets was approximately five times the value of US GDP, by 2007 this ratio had doubled. In the US, the securities industry increased from 107 percent of GDP in 1980 to 323 percent of GDP in 2007.[263] In the UK, the financial assets ratio to GDP was around 700 percent of GDP in 2007.[264] In equities, much growth came

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[261]" This problem is widely discussed in various papers, especially after the financial crisis of 2008. See for instance: Ha-Joon Chang, *23 Things They Don't Tell You about Capitalism*, (Bloomsbury Publishing USA, 2012), 231-241. See also: Raymond Goldsmith, *Financial Structure and Development*, (New Haven: Yale University Press, 1969); Robert G. King and Ross Levine, "Finance and Growth: Schumpeter Might be Right", *The Quarterly Journal of Economics* 108, no. 3 (1993): 717-737; Raghuram G. Rajan and Luigi Zingales, *Financial Dependence and Growth*. No. w5758. National Bureau of Economic Research, 1996.

[262] See Ha-Joon Chang, *23 Things They Don't Tell You about Capitalism*, (Bloomsbury Publishing USA, 2012), 231-232.

[263] See details in Kevin R. Brine and Mary Poovey, *Finance in America: An Unfinished Story*, (Chicago: University of Chicago Press, 2017), 361.

[264] See Ha-Joon Chang, *23 Things They Don't Tell You about Capitalism*, (Bloomsbury Publishing USA, 2012), 237.

from an increase in assessment ratios rather than their substantial increase.[265] Due to the creation of more and more financial claims for each underlying asset and economic activity financial derivatives, which did Warren Buffet call as "financial weapons of mass destruction" before the crisis of 2008, grew about eight times faster than world output.[266] In 2016 total debt levels globally came in at a record USD 164 trillion, amounting to 225 percent of the world economy's gross domestic product.[267]

So, the root of the problem of excessive efficiency of the modern securities markets goes to the deviation from the basic securities theory, which is the equivalence of issued securities to the amount of existing real assets or economic activity. If under a real asset worth USD 1 a USD 10 derivative is generated, there is 100% possibility that the owners of USD 9 derivatives will be in loss. During the high speed of securities market relations, this possibility of failure may seem low, but it is only an illusion.

The best, credible, and initially assumed way of organizing securities market efficiency did not rely on the 'artificial increase' of financial assets, as was the case with the 'invention' of derivatives, collateralized debt obligations, or credit default swaps, but on ensuring the real sector of economy involved financial flows through the accumulation and redistribution functions of the securities market. Ideal securities market efficiency cannot be achieved based on the lopsided development, i.e., fostering of financial instruments without the growth of the real economy; or in the case with the securities market, which should reflect the real economy will pose it to high risk of destruction.

The financial crisis is not a natural disaster, i.e., all measures and their consequences did not happen accidentally and by chance. Some scholars have further supplied some theoretical background through the notions of 'self-interest' and 'wealth maximization' theories. There were professionals who 'invented' complicated and complex financial instruments and cared mostly about achieving their self-interest and wealth-maximizing aim. There were credit rating agencies whose biased assessment of

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[265] See details in Robin Greenwood and David Scharfstein, "The Growth of Finance", *Journal of Economic Perspectives* 27, no. 2 (2013), 9.

[266] The increase was in just ten years from USD 92 to USD 683 trillion or from 2.4 to 11 times the size of global output. See details in José Gabriel Palma, "The Revenge of the Market on the Rentiers: Why Neo-liberal Reports of the End of History Turned Out To Be Bremature." *Cambridge Journal of Economics* 33, no. 4 (2009), 837

[267] See: Cheang Ming, "Global Debt Is at Historic Highs And Governments Should Start Cutting Levels Now,the IMF Says", *CNBC,* April 19, 2018: https://www.cnbc.com/2018/04/18/global-debt-is-at-historic-high-and-governments-should-cut-levels-imf.html

financial instruments speeded the circulation. Also, there were 'illiterate'[268]and bargain-seeking consumers; and some regulators could not recognize the actual value of these 'financial innovations' and foresee their harmful consequences.

The next problem of the modern securities market to be discussed tries to find an answer to the question as to why this had happened, and what were the main factors and driving force. In the opinion of this author, there are two key answers: the misbalance in theoretical supply and the human factor.

3.3.2. Misbalance in theoretical supply

The foregoing included a brief discussion as to the importance of theory in securities market regulation, and it was concluded that theory is essential for the design and implementation of effective regulation. In this subsection, an attempt is made to shed light on the deficiency of economic theory that was dominant in the last centuries. There are two main issues in economic theory directly relevant to the securities market and its regulation: first is the theory focusing on, and by all means to stimulate, self-interest approach of market participants, and the second is the hypothesis that encourages wealth maximization. There is sufficient literature and debates are on the advantages and disadvantages of these theories. This research does not aim to review those debates but, rather, to direct the focus on the other side of the issue – the moral side, which did not enlightened decades, and lagged behind the self-interest and wealth maximization streams.

3.3.2.1. Self-interest focused approach is misbalance in interpreting human merits

Some ideas and experiences about selfless interest are concisely discussed above within the scope of social business and behavioral finance theory and practices. Briefly, altruistic interest means that human beings, who are the main subjects and taks a central position in the market relations, are not only self-interest driven, but may also behave in selfless ways, i.e., acting not only for their own ego or their own interest.

The economic theories of last century mainly focused only one feature of a human being – its self-directness, ignoring and depreciating its moral and social characteristics. As a result more and more people in society are brought up as self-interested. Existing theories

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[268] 'Illiterate' here means that ordinary people without special knowledge of finance economics could not and cannot understand the whole scheme and terms of those risky financial instruments. This was briefly raised earlier in the foregoing, referring to Chang's book, where he showed that even Nobel Prize scholars in economics, top managers, and bankers could not fully understand the realities of such financial instruments. See details in Ha-Joon Chang, *23 Things They Don't Tell You about Capitalism*, (Bloomsbury Publishing USA, 2012), 170-173.

neither provide firm conclusions about the limits of such self-interest behaviors nor could consider its harmful consequences in the personal and public spheres. Moreover, the original natural remedy for the deviation of self-interest conduct – namely, the selfless instincts – was not accounted for by those theories. Therefore selflessness became unsustainable and could not fulfill its original function – to be an antidote for the plague of self-centeredness both in the personal and in public spheres. As a result, there have been overwhelming financial crises, global fraud and manipulation, and loss of trust, which are the core values of both market and social relations.

In conclusion, however, it must be stated that this self-interest misbalance does not necessarily depreciate the essence of self-interest theory and its practice. The present author is merely drawing attention to balancing it through considering the limits of self-interest; and by bringing up possible antidotes, such as selfless directed behavior in practice. In case of securities market this will contribute in solving such key problems of the modern securities market such as greediness, fraud, demand and price manipulation, insider dealing, Ponzi schemes, abuse of investor trust, etc – in short: both market and regulatory failures.

3.3.2.2. Wealth maximization approach is misbalance in interpreting business aim

The second misbalance in theoretical supply is connected with the misinterpretation of wealth maximization as the purpose of the activity of market participants. As one of the main concepts of market efficiency theory, wealth maximization provided the ideological background for fostering market relations. It seems that there is nothing wrong with it because endeavoring wealth maximization is the consequence of natural self-interest instinct. However, the problem is in the interpretation of wealth maximization as the principal purpose of business. This does not fit with the notion of wealth, which originally tends to be as a means for achieving some greater goals rather than being an end in itself. In this author's opinion, wealth in and of itself does not have significant value. The relation and demand of subjects on the proper item determine its value. For instance, in the case of securities, their value is no more than the value of ordinary paper. However, state guarantees, the company's activity, transparency, and development prospects, along with investor demand turns such paper to valuable commodities.

The misinterpretation of wealth by existing economic theories is also not in line with the ideal business goal, which is not only about making money, but also solving problems, and avoiding loss. According to the 2015 Deloitte Millennial Survey[269] 75 percent of millennials overwhelmingly believe that businesses are focused on their profit-making agenda rather than helping to improve society.[270] According to millennials in the 21st-century business needs to reset its purpose, and it should focus on people and mission, not just products and profits.[271] This kind of necessity is becoming even sharper in case of the modern securities market.

Today in the securities market there is massive divergence between two common aims of doing business with securities. Speculative aim is prevailing over investment aim in the securities market. However, investment focused aim was the original purpose of the securities market formation through the accumulation of resources and their redistribution within the sectors of the economy. In this long-term goal shareholders' primary aim is to gain from the development of the business and industry. In contrast, participants with speculative purposes care little about the long-term growth of the company or industry. Instead, their goal is to maximize their profit by all means in short-term price fluctuations caused by objective and subjective factors.

The ideal conduct for market participants is to act towards solving some problems – for instance, in the case of the securities market, to invest their funds to sectors of the economy where there is scarcity in financial resources. In this process, investors seek appropriate profit and bear the relevant risk of loss for their investment. Of course, a market participant investing in the securities market can choose a short-term investment, mainly focusing on daily price changes of stocks. It is entirely justifiable in normal conditions when a participant has to sell or buy shares on a short-term basis. However, when speculation becomes a routine business, and this business becomes dominant in the securities market, there is increased risk of a market crash. Consequently, risk and scale of harm will be higher and higher.[272] This is because the circulation of financial instruments is much faster than the financial assets or real sector business. For instance, professor Chang makes an interesting comparison: "building factory takes at least months, if not years; technological know-how may take decades; but financial assets can be issued and

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[269] See more about the 2015 Deloitte Millennial Survey: https://www2.deloitte.com/bm/en/pages/about-deloitte/articles/2015-millennial-survey-press-release.html
[270] Ibid.
[271] See Deloitte Touche Tohmatsu Limited's (Deloitte Global) fourth annual Millennial Survey, https://www2.deloitte.com/bm/en/pages/about-deloitte/articles/2015-millennial-survey-press-release.html
[272] History contains enough evidence on this issue. Cf., for instance the securities market crashes in 1930, 1980, and 2008.

circulated in minutes, if not seconds". According to Chang, "if the financial sector moves too fast, it can derail the real economy".[273]

There is appropriate link between overgrowths of speculative practice in modern securities markets and wealth maximization, the efficient market hypothesis, and self-interest approaches. The imbalance in securities market business goals is causing several substantial problems that go beyond the financial sphere and a single jurisdiction. It is necessary to reconsider wealth maximization theory in order to adequately interpret the aim of business, to resolve the mentioned divergence between business aims in the securities market, and to return the modern securities market to its initial aim, which is to facilitate investment.

The fostering of moral values already integrated into individuals could be an effective way of achieving these tasks. Primarily, in case of scarcity of moral values in modern securities markets, this measure will assist in achieving a balance between moral and material merits of market participants, which could consequently lead to fair and transparent market relations in the securities business.

3.3.3. Moral value deficit syndrome

The last problem of the modern securities market discussed in the foregoing has been referred to as the moral value deficit syndrome.[274] *Moral value* here means all merits intrinsic to a human being that can be put opposite its material values. This research considers both the moral values and the material interests as being integral parts of human beings. However, due to several factors, these are not always equally developed, and a fair balance between them is not always achieved. For instance, there is a considerable gap between material and moral values in modern securities market relations, because of lopsided explanation by above-mentioned economic theories and their practice in the last half-century.

It is hotly debated in the relevant literature whether the market and morality are consistent with each other,[275] whether there is a place for morality in the market,[276] or,

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[273] See Ha-Joon Chang, *23 Things They Don't Tell You about Capitalism*, (Bloomsbury Publishing USA, 2012), 239-241.
[274] A metaphor coined from the 'acquired immune deficiency syndrome' disease.
[275] See for instance: Jeffery D. Smith, "Moral Markets and Moral Managers Revisited", *Journal of Business Ethics* 61, no. 2 (2005): 129-141; See also: Ian Maitland, "Virtuous Markets: The Market as a School of the Virtues", *Business Ethics Quarterly* 7, no. 1 (1997): 17-31.
[276] See for instance: Thomas Clay Arnold, "Rethinking Moral Economy" *American Political Science Review* 95, no. 1 (2001): 85-95.

alternatively, what may be the moral limits of the market[277] etc. Unfortunately, reviewing these discussions is outside the scope of the present research. The goal of this subsection is to show the role of moral values in modern securities market relations and to use their potential in potentially solving the problems discussed earlier.

Moral values are connected with the market through the participation of human beings, who, in this author's opinion, should be at the center of market relations.[278] In other words, because moral values are an integral part of human beings, they, by extension, also become an essential part of market relations. Moral values are the main feature that distinguishes human nature from vending machines. By this statement, the present author does not suggest that market participants should be saintlike. Rather, what should be pointed out is the need to use the natural integral 'watchdog' of human beings – their moral values in market relations as a remedy – that is to say, their moral values can restrain market participants from such wrongdoings, such as fraud, abuse of trust, insider dealing, manipulation and so on. Unfortunately, neither in current securities market theory nor in practice are moral values duly regarded. In contrast, because of the above-mentioned dominant economic theories, moral values have not been taken into account in market relations, which has consequently contributed to the various failures both in market and regulation procedure.[279]

The recent survey shows a clear, negative shift in millennials' views on business motivations and ethics. Today, only a minority of millennials (albeit a substantial one), believe that businesses behave ethically (namely, 48 percent vs. 65 percent in 2017), and that business leaders are committed to helping improve society (47 percent vs. 62 percent in 2017).[280] In this regard, millennials believe that corporations should set out to achieve a full balance in social objectives, such as making a positive impact on society and the environment; creating innovative ideas, products and services; and seek to achieve job creation, career development, and to improve people's lives. In their collective view,

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[277] See for instance: Philip Booth, "The Moral Limits to the Market Economy, and the Financial Crash." *IEA Discussion Paper* No. 30, September 2010, https://iea.org.uk/wp-content/uploads/2016/07/upldbook521pdf.pdf

[278] In the literature, there are various approaches to this issue. For instance, some scholars place institutions in the front line; others corporations and their behavior; and the third group of scholars prioritize regulation, etc. In the present author's opinion, the human is the crucial factor in all of the mentioned aspects; respectively in market relations, its position is central. As there is no institution, corporation, and regulation without human, it is humans who really may develop or debase relations, including market relations.

[279] See Stan Viorica, "The Actual Collapse and the Importance of Moral Values (Ethics); Some Reflections Regarding the Roots of the Current Crisis," *Procedia - Social and Behavioral Sciences* 58 (2012): 1057-1063.

[280] The Deloitte Millennial Survey 2018, "Millennials' Confidences in Business, Loyalty to Employers Deteriorate" https://www2.deloitte.com/bm/en/pages/about-deloitte/articles/millennialsurvey.html.

businesses are out of step with these priorities.[281] In the opinion of the present author concerning the origin of this situation, the dominant theories of the last century have made a substantial contribution to the present situation.

Self-interest and wealth maximization approaches will be the leading cause of the problem in securities markets if they are not equipped with moral values. The recent financial crisis is a clear example of this.[282] The person who owns 10 dollars has more intention to earn more than the person who possesses less money. On the one hand, there is nothing wrong with self-interest and wealth maximization – on the contrary, it encourages action in all business relations. On the other hand, in the majority of cases the practice of profit or wealth maximization shows a deviation from moral values.[283] In contrast, the existence of strong moral values help to use the wealth and money according to their initial purpose – as a mean to solve problems, not as an ultimate goal in and of itself. For instance, philosopher Jacob Needleman states that people with strong ethical and religious lives have often stayed quite stable after being rich. According to Needleman "they have a sense that there's something more important than wealth. That is why, even when they get wealthy, it does not deflect them"[284]

The longest research on happiness, which took about 80 years, also revealed that it is not wealth that is the source of happiness, but things such as communication, love and close relationships that provide real happiness.[285] Professor Robert Waldinger, who is the fourth director of this research project, stated that: "what I learned from this 75-year study is that good human relations are a secret of happiness".[286] It is impossible to reach good human relations without strong moral values, whether this is is in social or market relations.

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[281] Ibid.
[282] The core causes of majority financial crisis were fraud, abusing trust, insider dealing, manipulation or other forms of ethical and moral failures. See, for instance, Joseph E. Stiglitz, "The Anatomy of a Murder: Who Killed the American Economy?" in *What Caused the Financial Crisis*, ed. Jeffrey Friedman, (Pennsylvania: University of Pennsylvania, 2011) 140-141. See also: Viral V.Acharya and Matthew Richardson, "How Securitization Concentrated Risk in the Financial Sector", in *What Caused the Financial Crisis*, ed.Jeffrey Friedman, (Pennsylvania: University of Pennsylvania, 2011).184-185; Daron Acemoglu, The Crisis of 2008: Lessons For and From Economics, in *What Caused the Financial Crisis*, ed. Jeffrey Friedman, (Pennsylvania: University of Pennsylvania, 2011), 255.
[283] Professor Jacob Needleman wrote in this regard the following: "[w]hen money can make you feel humble, then I think it's beneficial. However, if it fattens your ego, which it often does, then look out". See: Jacob Needleman, "Money and the Meaning of Life",(1991).
[284] See in details: Needleman, Jacob. "Money and the Meaning of Life." (1991).
[285] Robert Waldinger, "What makes a Good Life? Lessons from the Longest Study on Happiness" TEDx Beacon Street, November 2015, https://www.ted.com/talks/robert_waldinger_what_makes_a_good_life_lessons_from_the_longest_study_on_happiness?referrer=playlist-the_most_popular_talks_of_all#t-754153
[286] Ibid.

Recent research that used data from 73 jurisdictions from 2009 to 2011 examined the existence of social capital thresholds in the securities market development and macroeconomic performance nexus. The empirical results demonstrate that securities market liquidity is significant and positive in influencing GDP and *total factor productivity* (TFP) growth respectively only after the achievement of a certain threshold level of firms' ethical behavior. Until then, the effects of the securities market on both GDP growth and TFP growth are found to be negligible. They mention that even though ethics and trust are as old as humanity, "we are only at the starting point in the journey to better understand the role of ethics and trust, or in a broader sense, social capital, in financial markets".[287] Therefore, modern securities market relations need a proper ideological supply for the activation and development of market participants' moral values, at least up to the level that will provide balance with their dominant material values. This issue would be a promising field of further research and future studies.

Summary

In this chapter, it was attempted to provide an outline of the basic theories of securities market regulation and some challenges they are facing in contemporary conditions. It was found that theories have a significant impact on securities market regulation and current theoretical notions focus mostly on self-interest, wealth maximization, and microeconomic issues, and do not adequately reflect the market and human features. There should be substantive research and consideration towards encouraging business (including securities business) to consider alternative aims, market participants to espouse alternative values, and the securities market regulation to shift towards a more balanced approach.

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[287] See details in Adam Ng, Mansor H. Ibrahim, and Abbas Mirakhor, "Ethical Behavior and Trustworthiness in the Securities market-Growth Nexus", *Research in International Business and Finance* 33 (2015): 44-58.

CHAPTER 4. SECURITIES MARKET AS AN ALTERNATIVE SOURCE OF BUSINESS FINANCING IN CIS COUNTRIES

Chapter two[288] highlighted the presence of a vast difference in business financing through banks and securities markets in CIS countries, especially in Uzbekistan where more than ninety percent of business financing comes from banks, and less than ten percent from the securities market. The main aim of this chapter is to analyze the reasons behind the high discrepancy in bank and securities market financing of business, and to work out solutions on balancing the sources of business financing in transition countries, including those of the CIS. To achieve this goal this chapter: provides an analysis of the main features of the bank-based and market financial systems, attempts to examine the notions of debt and equity financing, and explores the main regulatory differences of banking and securities market financing.

4.1. Bank-based and market based financial systems: does financial structure matter?

There are several causes of the high divergence between the role of banking and securities market in business financing. Financial structures, financial instruments, and the regulatory framework are the most influential among them. This subchapter seeks to clarify the reasons behind bank dominance in business financing from a financial structure viewpoint.

Overall, financial systems may be divided into bank-based and market-based, according to the role of banks or securities markets in accumulating and directing funds to sectors of the economy; and the degree to which the state is involved in the allocation of credit.[289] In general, in bank-based systems, the majority of financial assets and liabilities mainly consist of bank deposits, loans, and credits. Contrary in market-based systems, securities are the dominant form of financial asset. Bank-based systems mostly rely on relationships and collateral, while market-based systems are mainly driven by effective investor protection laws, clear disclosure standards, good faith, and investor trust. Market-based countries generally have better-developed markets for equity finance,[290] whereas bank-based systems are characterized by a powerful and dominant banking system.

[288] See especially 2.4.2 subsection of the current thesis.
[289] This chapter mostly covers the first criterion – the issue connected to state involvement will be discussed in the next section.
[290] See details in Michiel J. Bijlsma and Gijsbert T. J. Zwart, *The Changing Landscape of Financial Markets in Europe, the United States and Japan*. No. 2013/02. Bruegel Working Paper, 2013. https://www.cpb.nl/sites/default/files/publicaties/download/dp238-changing-landscape-financial-markets-europe-us-and-japan.pdf

A significant part of the literature on bank-based and market-based financing of business discusses the link between financial structure and economic growth.[291] The findings and results of these studies are diverse. The majority of studies took a balanced approach mentioning the importance of both bank-based and market-based systems to economic growth,[292] while some studies conclude that financial structure per se does not matter, it is the overall provision of financial services (banks and financial markets taken together) that is important for growth.[293]Other research emphasizes a country's level of economic and financial development, mentioning that the relationship between financial structure and economic growth is more complicated.[294] The latest studies on financial structure and growth favor market-based systems.[295] Their findings are mostly connected to the results of post-crisis research,[296] where banks overstretch and misdirect credit in economic expansions and share credit in financial recessions more than markets. Other, more recent, research concludes that financial structure matters from the systemic risk viewpoint. Notably, authors argue that bank-based financing generates systemic risk, while market-based financing reduces it.[297] They conclude that countries could increase their resilience to systemic risk by reducing the share of bank financing and respectively increasing market-based funding.[298]

As a conclusion, it must be mentioned that in general what is essential is not whether a financial system is bank-based or securities market-based, but, rather, how developed and efficient the financial system is, and whether companies have access to

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[291] See, for instance, Leonardo Gambacorta, Jing Yang, and Kostas Tsatsaronis, "Financial Structure and Growth," (2014); Asli Demirgüç-Kunt, Erik Feyen, and Ross Levine, *The Evolving Importance of Banks and Securities Markets,* World Bank, 2011; Ross Levine and Sara Zervos, *Stock Markets, Banks, and Economic Growth*, World Bank, 1999, 537–58.

[292] See, for instance, John H. Boyd and Bruce D. Smith, "The evolution of debt and equity markets in economic development", *Economic Theory* 12, no. 3 (1998): 519-560; Ross Levine and Sara Zervos, *Stock Markets, Banks, and Economic Growth*, World Bank, 1999, 537–58; Thorsten Beck and Ross Levine, "Stock Markets, Banks, and Growth: Panel Evidence", *Journal of Banking & Finance* 28, no. 3 (2004): 423-442; Leonardo Gambacorta, Jing Yang, and Kostas Tsatsaronis, "Financial Structure and Growth," (2014).

[293] See for instance: Ross Levine, *Bank-based or Market-based Financial Systems: Which is Better?*, No. w9138. National Bureau of Economic Research, 2002; Asli Demirgüç-Kunt and Ross Levine, "Stock Markets, Corporate Finance, and Economic Growth: an Overview", *The World Bank Economic Review* 10, no. 2 (1996): 223-239.

[294] See details in Asli Demirgüç-Kunt, Erik Feyen, and Ross Levine, *The Evolving Importance of Banks and Securities Markets,* World Bank, 2011.

[295] See for instance: Sam Langfield and Marco Pagano, "Bank Bias in Europe: Effects on Systemic Risk and Growth", *Economic Policy* 31, no. 85 (2016): 51-106.

[296] See Marco Pagano, Sam Langfield, Viral V. Acharya, Arnoud Boot, Markus K. Brunnermeier, Claudia Buch, Martin F. Hellwig, and Ieke van den Burg, *Is Europe Overbanked?*, No. 4. European Systemic Risk Board, 2014.

[297] See Joost Bats and Aerdt Houben, "Bank-based versus Market-based Financing: Implications for Systemic Risk", (2017).

[298] Ibid.

actual alternative sources for financing their business. Imbalance in business financing, in the case of CIS countries bank dominance, causes serious micro- and macro-level concerns. At the micro level, the predominance of either form in business financing limits company chances to attract finance from alternative sources. At the macro level, as the analysis indicates, bank-based financing generates systemic risk. The dependence of a country's economy on either form of financial structure does not refrain working on the achievement of the balance between bank-based and securities market-based financing.

4.2. The notion of debt and equity financing

The debt and equity financing issue is the logical supplement to the bank-based and market-based financial structure issue that was briefly analyzed above. In general, bank-based countries have a dominant debt financing economy, and market-based countries have a dominant equity financing. Also, the aim of this subchapter is not to try to change this phenomenon, but to better understand the notion and specifics of debt and equity financing to identify the implications useful for regulatory remedies in the case of CIS countries.

Overall, any business in any stage of its activity needs to fulfill its short-term or long-term financial needs. There are two ways for a company to attract outside funds: namely, via debt-based (loan) financing and via equity-based financing. Each method has its advantages and disadvantages, and each is a better fit for some situations than others. Factors that distinguish these two types of business financing include: fundraising terms, process, size, time frame, aim and methods of usage.

In general, so-called debt and equity financing are two different systems of business financing based on different principles. The central tenet of debt financing is based on borrowing funds from a lender with the obligation of returning these by the prearranged date at a fixed interest rate stipulated from the outset. Primary forms of debt financing are lending and sale of bonds. The structure itself does not change the principle of the transaction: the lender retains a right to the money lent and may demand it back under conditions specified in the borrowing arrangement.

The important point here to mention is that debt financing is not limited only to the banking industry. Debt (bonds) is also an active financial instrument in the securities market. So, the main difference in debt and equity financing is not based on institutional factors, but in the terms and principles of funding. One more critical issue here is the active participation of banks in securities markets. For instance, in Uzbekistan the average share of banks in the securities market is more than 70 percent.[299]

The notion of pure equity financing is based on investing goal rather than lending for the interest, as in the case of debt financing. Equity financing provides ownership and managerial rights to investors. Companies involving this investment without any collateral are required to share their profit and disclose appropriate information. Profit or return in relation to equity financing is highly risky than in the case of debt financing, where interest rate and time of recovery is preliminarily established before lending. In the case of equity finance, an investor might not get any revenue if the company did not make any profit. However, on the other hand, the level of an investor's gain is not limited, as in the case with debt financing where the interest rate is predetermined and fixed. If the company is successful, there will be more dividends, and consequently more investment flow. Increasing investment is a decisive factor for the company rather than growing its debt balance. In other words, investors tend to look with caution at a company that has more debts, and seek to finance the company that has a high flow of investment. The following table describes the fundamental differences of debt and equity financing.

Table 5. Comparison of debt and equity financing

	Criteria of comparison	**Debt financing**	**Equity financing**
1.	Ownership status	No	Yes
2.	Profit	Guaranteed and fixed	Not guaranteed and not fixed
3.	Level of profit	Low	High
4.	Management possibility	No	Yes
5.	Return form	Interest	Dividend
6.	Collateral	Generally essential	Not required
7.	Risk of lost	Relatively low	Relatively high
8.	Duration	Limited	Unlimited

In the end, some researchers found that firms tend to turn to banks for financing mainly due to the fact that banks are good at helping them through times of financial distress.[300] Another reason is connected with the desire of a company – whether it wants to share ownership, profit, management, and information. The research has concluded that, "the riskier firms prefer bank loans, the safer ones tap the bond markets, and the ones in between prefer to issue both equity and bonds."[301] And the last point is that loan or debt-

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[299] Very similar situations may be witnessed in other CIS countries too.

[300] Patrick Bolton and Xavier Freixas, "Equity, Bonds, and Bank Debt: Capital Structure and Financial Market Equilibrium under Asymmetric Information." *Journal of Political Economy* 108, no. 2 (2000): 324-351.

[301] Ibid.

based fundraising is the most common form and relatively easier method of business financing in developing countries[302] and among SMEs.[303] This is due to the fact that in developing countries banks' infrastructure, regulatory support, and corporate conduct are relatively advanced than the securities market. And not only SMEs, but also larger companies not eager to use equity financing due to factors, including the complicated procedure of securities issuance, strong corporate governance and disclosure information standards, and relatively less state encouragement.

4.3. Regulation as a tool for striking a balance

Regulatory policy and state support of bank and equity financing have a significant impact on the development of the real economy. Research on bank competition in access to finance suggests that the institutional and regulatory framework is essential in improving the competitive and regulatory environment of business financing.[304] Notably, the authors underline the importance of regulations, institutions, and ownership structure for policymakers who are interested in easing financing obstacles.[305] Later, other studies examined this issue deeper and found that the functioning of factors such as decent property rights protection, strong shareholder rights, high quality of corporate information, and less government interference in the form of corruption and political interference have a high impact on access to finance.[306] Usually, in developing countries, including those of the CIS, the factors mentioned above that assist financial access are underdeveloped or partially developed.[307]

One of the examples of regulation impact on the development of the banking sector would be large-scale state support of the banking industry, which has created an unfair situation in business financing in CIS countries. For instance, in Uzbekistan, direct

[302] See details in Meghana Ayyagari, Asli Demirgüç-Kunt, and Vojislav Maksimovic. *Financing of Firms in Developing Countries: Lessons from Research*. The World Bank, 2012, https://ssrn.com/abstract=2039204
[303] See, for instance, Meghana Ayyagari, Asli Demirgüç-Kunt, and Vojislav Maksimovic. *Financing of Firms in Developing Countries: Lessons from Research*. The World Bank, 2012; Thorsten Beck, Asli Demirgüç-Kunt, and Vojislav Maksimovic, "Bank Competition and Access to Finance: International Evidence", *Journal of Money, Credit and Banking* (2004): 627-648; Thorsten Beck and Asli Demirgüç-Kunt, "Small and Medium-size Enterprises: Access to Finance as a Growth Constraint", *Journal of Banking & Finance* 30, no. 11 (2006): 2931-2943; Neil Lee, Hiba Sameen, and Marc Cowling, "Access to Finance for Innovative SMEs since the Financial Crisis", *Research policy* 44, no. 2 (2015): 370-380; Babajide Fowowe, "Access to Finance and Firm Performance: Evidence from African Countries", *Review of Development Finance* 7, no. 1 (2017): 6-17.
[304] Thorsten Beck, Asli Demirgüç-Kunt, and Vojislav Maksimovic, "Bank Competition and Access to Finance: International Evidence", *Journal of Money, Credit and Banking* (2004): 627-648.
[305] Ibid.
[306] Meghana Ayyagari, Asli Demirgüç-Kunt, and Vojislav Maksimovic. *Financing of Firms in Developing Countries: Lessons from Research*. The World Bank, 2012.
[307] 'Partial development' here means dominance of banking or securities market financing.

government intervention through specialized institutions, subsidized financing programs, and tax incentives have tended to preserve the role of the banking sector as a channel for planned financing.[308] On the contrary, the nascent securities market that was deprived of such care on the part of government was almost abandoned. By this, this author is far from stating that government should always support all forms of market institutions. This author does not favor excessive administrative regulation of market relations. Rather, what is argued is for there to be a balance concerning the attention and care that banking and the securities market, regarding business financing, receive from the state. Balancing here is necessary for ensuring regulatory neutrality, and it does not mean reducing bank privileges, but providing at least the same level of state support to the securities market, and for its development. As bank participation (as issuer, shareholder, and intermediary) in the securities market is more than seventy percent, the banking industry is likely to lose very little if anything from this reform. Instead, it is likely to indirectly enjoy any privileges given to the securities market.

Uneven levels of protection of consumers' interests of financial services and investors characterize CIS countries. For instance, one of the institutional measures of investor rights protection – guarantee (compensation) funds – in all CIS countries mainly focuses on payment of insurance compensation in the case of financial insolvency of a bank. However, none of the countries have established guarantee (compensation) funds to cover the losses of investors in case of illegal actions or bankruptcy of participants of the securities market. The securities legislation of all of the three countries compared in the present thesis provides rule of guarantee or insurance fund based on which securities market intermediaries (traders and brokers) should create their own insurance deposit fund for covering their liability. In Russian and Kazakhstan law, the rules on the foundation of such funds seem milder,[309] as opposed to Uzbekistan law, where market intermediaries should form a guarantee fund to compensate the investor for losses.[310] This is a useful mechanism that provides some guarantees of investor rights. However, this is an individual and limited system, and cannot be compared to the nationwide measures such as those concerning a guarantee fund for bank deposits, or some other centralized institution.

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308 See ADB, "Country Partnership Strategy: Uzbekistan 2012–2016", Sector Assessment (Summary): Finance, 2, https://www.adb.org/sites/default/files/linked-documents/cps-uzb-2012-2016-ssa-05.pdf.

309 See: Law on Securities Market of Russian Federation (amended as of April 23, 2018), Article 51.9, http://docs.cntd.ru/document/9018809; and Law on Securities Market of Kazakhstan (amended as of February 27, 2017), article 90-1.2.

310 See Law on Securities Market of Uzbekistan, June 3, 2015. Article 23, http://lex.uz/docs/2662541.

In Russia and Kazakhstan, there are established institutions of the financial ombudsman that are authorized to protect the rights of investors, and of consumers of financial services. However, their effect did not cover all aspects of the financial market and is limited mainly to banking. Uzbekistan also founded several country-level institutions for the protection of investor rights, [311] however, as is the case with its neighbors, these foundations mainly focused on the banking industry and its clients.

One more issue that requires a balance between banking and the securities market is connected to the mechanism of creditor/investor rights protection. In general, all CIS countries legislation introduced creditor/investor protection rules both for banking and securities market relations. However, there is high divergence between the status and legal interpretation of credit and investment, and, respectively, between creditor and investor, in comparatively in the legislation of the countries under review. The tendency is towards the view that law better protects bank credits and creditor rights than shares and shareholder rights. Different regulatory approaches and special preferential packages to bank credits and creditors raise concerns regarding the competitiveness of debt and equity financing in CIS countries.

The present author is far from stating that government is intentionally discriminating between debt and equity financing – the existence of competition between the banking industry and the securities market is beneficial both for state and companies. The existence of separate state initiatives on fostering the securities market (albeit, not equal with bank-supporting measures) is undisputable evidence on this point. The reason for the difference in the level of support and outcomes is mainly based on bank concentration and state ownership issues. Concerning the countries reviewed here, bank concentration is relatively high. For instance, in Russia and Kazakhstan, the five largest banks own more than 50 percent of assets. [312] In the case of Uzbekistan, this figure is more than 70 percent. [313] According to Beck and others, in low-income countries bank concentration increases financing obstacles, with a stronger effect for small and medium

[311] For instance, in August of 2017 the State Fund for Support of Business Development was established to provide resources to commercial banks, including through attracted foreign credit lines, for subsequent lending to small businesses. In October 2017 the Guarantee Fund for SME development was established the majority of shareholders of which are twenty banks.

[312] For further details, see: Финансовые рынки Евразии: устройство, динамика, будущее / под ред. проф. Я. М. Миркина. — М. : Магистр, 2017. — 384 с. (Financial Markets of Eurasia: Structure, Dynamics, Future, ed. Prof. Ya. M. Mirkina. - M.: Master, 2017, 384).

[313] For further details, see: Central Bank of Uzbekistan, Report on the Activity of Commercial Banks, June 1, 2018, http://cbu.uz/uzc/statistics/bankstats/2018/06/127781/.

compared to large firms.[314] In countries with high government interference in the banking system and a higher share of government-owned banks, the effect of bank concentration has deteriorated.[315] The overall results of the research suggest the importance of institutional and regulatory policies for the relation between banking market structure and firms' access to finance at any level of economic development.[316]

State ownership is also one of the key reasons for differentiated policy in banking and securities market financing. This is based on the statement that the state supports banks and bank financing, as the majority share in the banking industry belongs to the state. Recent research also suggests that in most developing countries firms with state participation had better access to bank financing due to implicit or explicit guarantees from the governments and due to other government interventions.[317] In all of the countries under review in this thesis, state banks possess over half of the assets, capital, and loan portfolio of the banking sector. In the case of Uzbekistan this figure exceeds 80 percent.[318] At this point, it is not argued that state ownership may necessarily influence the different regulatory policies between banking and securities market financing. Because in the countries examined here the state holds almost the same level of share in SOEs too,[319] however banks enjoy considerable state support, subsidies, guarantees, and privileges rather than other SOEs. This weakens any argument that government supports banks because of the ownership issue. Equally, however, by this the author does not deny the nature and various effects of state ownership concentration in this matter. This matter requires a more detailed analysis of the character of state ownership, which we would like to fulfill in the next chapter.

Summary

In this chapter, it was attempted to offer an analysis of the reasons behind the disparity of share of business financing regarding banks and the securities market in CIS

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[314] See Thorsten Beck, Asli Demirgüç-Kunt, and Vojislav Maksimovic, "Bank Competition and Access to Finance: International Evidence", *Journal of Money, Credit and Banking* (2004): 627-648.

[315] Ibid.

[316] Ibid.

[317] See: Yao Wang, "What are the Biggest Obstacles to Growth of SMEs in Developing Countries?–An Empirical Evidence from an Enterprise Survey", *Borsa Istanbul Review* 16, no. 3 (2016): 167-176.

[318] By June 1, 2018, the total state share in Uzbekistan banks stood at 82 percent. See official statistics of the Central Bank of Uzbekistan: http://cbu.uz/uzc/statistics/bankstats/2018/06/127781/.

[319] For instance, there were 659 JSCs registered in Uzbekistan by January 1, 2017, of which 73.4 % with state shares. See: "The Concept of Development Secondary Securities market in 2017-2018 in Uzbekistan" developed by the Center for Research on Privatization, Development Problems Corporate Governance, and the Securities Market under the State Committee of the Republic of Uzbekistan to promote privatization and competition. https://research-center.uz/info/concept/

countries. For this purpose, central financial structure systems, which is bank based and market-based were reviewed as a means of identifying solutions through the analysis of the notion of debt and equity financing, and, lastly, the regulatory framework both as a reason and solution of the problem was considered.

The findings indicate that financial structure matters in the origin and development of either industry (bank or securities market), but dependence on one economic structure does not restrict the development of the other. Therefore, no matter which type of financial system dominates in a country's financial system, the regulatory framework should provide sufficient room and create the climate for real and fair competition among banks and securities markets. In the case of CIS countries, bank financing is relatively developed, so there should be a supportive regulatory framework for fostering equity financing to achieve fair competition between these two financial institutions. Concerning the financial instruments, we found that there are principal differences of debt and equity financing, and they should be taken into account while balancing the share of bank and securities market financing. And, lastly, this chapter aimed to provide an overview of the regulatory framework that, on the one hand, is a contributing reason behind the problem discussed, and on the other, could be the appropriate solution to it.

CHAPTER 5. STATE ROLE AND SECURITIES MARKET DEVELOPMENT IN CIS COUNTRIES

The analysis in the previous chapters indicates that in the CIS countries' securities market, the state has a significant role as regulator and as the principal shareholder. In CIS countries the state actively participates in securities market relations through its SOEs and banks that issue, own and manage various securities, and render intermediary services in the securities market. The state sets rules to regulate market relations through authorized bodies that are also responsible for the fairness of dispute resolution. Consequently, a high level of direct and indirect state participation in securities market relations suggests the prevalence of general administrative principles over market principles. In such conditions, one of the main tasks of implementing market principles in the securities market, and respectively improve equity financing, would be to consider the reduction of state share and administrative methods. For this, it is necessary to hold extensive and comprehensive reforms that are underpinned by sound theory to get proper understanding and direction. In this regard, this chapter provides an outline of the theoretical bases of state participation in the economy, an overview of the state's role and the extent of state ownership, an analysis of the main SOE problems, and provides perspectives of future SOE reforms in selected CIS countries.

5.1. Outline of theories on state participation in the economy

In general, the modern market economy cannot exist without the state's economic activity. Especially during the last two decades, the state's presence in business relations as a unique subject has only increased. For instance, according to Bremmer, "[g]overnments, not private shareholders, already own the world's largest oil companies, and control three-quarters of the world's energy reserves."[320] In the late 70s of the last century SOEs' share in developed countries accounted for about 7% of GDP; in non-socialist developing countries almost 12%, and in planned economies around 90%.[321] Despite the privatization movements in the last three decades, SOEs still have a significant impact in key industries

[320] See Ian Bremmer, "State Capitalism Comes of Age-The End of the Free Market", *Foreign Aff.* 88 (2009): 40.

[321] See, for instance, Aldo Musacchio and Sergio G. Lazzarini, "Reinventing State Capitalism: Leviathan in Business, Brazil and Beyond", Harvard University Press (2013); Max Büge, Matias Egeland, Przemyslaw Kowalski, and Monika Sztajerowska. "State-owned Enterprises in the Global Economy: Reason for Concern?" *Vox: CEPR's Policy Portal* (2013); L. Bernier, ed. 2014. *Public Enterprises Today: Missions, Performance, and Governance. Learning from Fifteen Cases*. Brussels: P.I.E. Peter Lang S.A.

of the economy, market capitalization, investment, and employment, especially in the post-Soviet countries. In such conditions, state presence in the economy is a crucial issue that generates fruitful discussion and much controversy.

The recent history of the main discussion on the state's involvement in market relations goes to the classics of economic theory (A. Smith, D. Ricardo et al.) according to which the market economy should develop by self-regulation, that is, without the involvement of any external forces, including the state.[322] The classical model assumes minimal intervention in the economy and is based on the notion of Adam Smith whereby the state is the 'night watchman' of a market economy. Following this concept, business produces and consumes, and the state is engaged in the protection of property rights, ensures the observance of market principles, and strongly reacts to the deviation of rules, up to the use of force (law, court, army, police and so on). However, the crisis of the capitalist economy and securities market crash in 1929-1933 marked the end of the free enterprise 'era', and reflected the inability of the market system to develop itself without state involvement.

The Keynesian model was presented as a remedy for the economic crisis. It assumes active and, as far as possible, maximum government intervention in the economy to minimize cyclical fluctuations, unemployment, inflation and loss of resources and products of all market participants. In his 'The General Theory of Employment, Interest, and Money', Keynes questioned the assumption that self-regulation is automatic in a market economy, and justified the need for government intervention in economic processes.[323] This theory received a practical application in the US economy (in the 50s) and brought specific, definite results in economic activity. Later, Keynes's theory of state regulation formed the basis of the economic policy of almost all developed capitalist countries.

In the 1970s-80s, when excessive state intervention in the economy was considered responsible for slowing down the development of social production, neoclassical economic ideas have again become relevant and remain so to this day. According to this doctrine freeing up markets and the reduction in direct state intervention make economies more flexible and creative. They inspired liberalization and privatization in many developed and

[322] Adam Smith, *Essays on philosophical subjects*, (London: T. Cadell Jun. and W. Davies, 1795).
[323] See details in John Maynard Keynes, *The General Theory of Employment, Interest, and Money*, (Springer, 2018).

developing countries, and even political revolution in many socialist countries.[324] According to Chang, "despite the continuous widening of their scope, neoliberal reform programs have failed to produce expected results". Neoliberalism failed in generating faster growth, instead of increased income inequality and economic instability.[325] By the end of the 20-century neoclassical theory was no longer dominant. Recent research suggests that globalization has increased government sectors around the world.[326] The latest tendency in the attitude of the world's largest economies to a maximum usage of state leverages in economic relations may change the further direction of theories on the state's role in the marketplace.[327]

5.2. Overview of the state's role in CIS countries

Almost three decades earlier, the state in all CIS countries had an absolute role, both in terms of market regulation and economic activity. Around 80 years CIS countries experienced a centrally planned economy and administrative command ruling in their economic, social, and political life. During the command and regulatory system, the state was the principal buyer of products, the central monopolist, and the exclusive distributor of resources, financial means, equipment, and human resources. Enterprises sought different ways of access to these resources, and very often the situation developed in such a way that some received enough resources, sometimes in excess, and others were deprived of them. In the absence of competition, enterprises with resources were not interested in their rational use, and enterprises deprived of the necessary means could not intensively develop their production.

It seemed that the market economy could change that situation, but despite the almost three decades of reforms, most CIS countries consider liberalization and privatization reforms very cautiously. As a result, today most CIS countries have dominant (i.e., more than fifty percent of) state shares in their economy, and a tight market regulation system. For instance, in Russia by the end of 2015, the share of SOEs in the country's

[324] See Ha-Joon Chang, *Globalization, Economic Development and the Role of the State*, (Zed Books, 2003), 37.
[325] Ibid, 2.
[326] For further details, see: Stephanie Meinhard and Niklas Potrafke, "Globalization–Welfare State Nexus Reconsidered", *Review of International Economics* 20, no. 2 (2012): 271-287.
[327] For instance, recent US initiatives on *de-facto* restricting access to its economy, triggering a US-China trade war, and preferring a protectionist over a globalist approach may also lead to a change of state theory.

GDP was almost seventy percent,[328] in Kazakhstan sixty percent,[329] and in Uzbekistan, according to official statistics,[330] around twenty percent.[331] Also, in all countries examined here banks dominate in the financial sector, and the state share in bank ownership is around eighty percent. This has great significance for the further development of the securities market in these countries, where banks play a considerable role in market relations as securities issuers, shareholders, and intermediaries.

As for the reasons of high state involvement in the economy, several factors could be listed, including historical, geographical, legal/juridical, political, and economic. Historical elements relate to the heritage of the centrally planned economy that was in operation for more than a century. The geographical aspect is explained through natural resource abundance in the countries examined. Usually at the initial stage of development the management and extraction of natural resources is the responsibility of public entities rather than private ones. Another main factor by which the dominance of state regulation and state presence in the economy in CIS countries is explained is through legal origin theories. For instance, several scholars in their numerous studies found that civil law countries were associated with a greater state ownership and regulation than common law countries.[332] Political and economic factors mainly relate to the weak regulatory framework and the transitional stage of the economy that is usual for countries with identical or similar characteristics. In other words, in the transition period, there will be more demand for the state's paternalistic, welfare, and social roles. However, the limits of the transition period and the content of state participation on it may differ based on a country's features. To get a picture of such features, an attempt to outline the level of state ownership in the case of Uzbekistan, Russia, and Kazakhstan is offered below.

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[328] See details in: Государственное участие в российской экономике: госкомпании, закупки, приватизация, Бюллетень о развитии конкуренции, март 2016, с.4. (State Participation in the Russian Economy: State Companies, Purchases, Privatization, *Competition Development Bulletin*, March 2016, 4). http://ac.gov.ru/files/publication/a/8449.pdf.

[329] Вячеслав Щекунских, Госкомпании безнадежно неэффективны для государства, June 23, 2017, (Vyacheslav Shchekunsky, State-owned Companies are Hopelessly Ineffective for the State), https://www.kursiv.kz/news/vlast1/goskompanii-beznadezno-neeffektivny-dla-gosudarstva/ .

[330] Detailed analysis of GDP structure by sectors and state share of them raises some doubts on the reality of these official statistics. Below we briefly present those analyses.

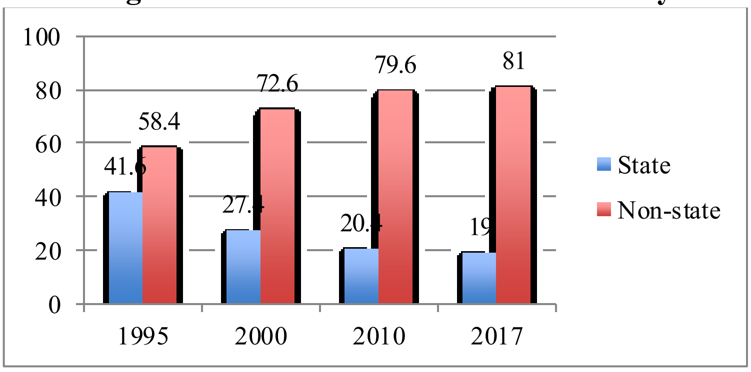
[331] See Official Report of the Statistics Committee of Uzbekistan about Macroeconomic Indicators for 2017, 5, https://stat.uz/uploads/docs/vvp-uzb.pdf.

[332] See for instance recent research on this issue: Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, "Law and Finance after a Decade of Research", in *Handbook of the Economics of Finance*, vol. 2, 425-491 (Elsevier, 2013).

5.2.1. State ownership level in Uzbekistan

The state ownership level issue is one of the puzzles that occur in studying the issue of SOEs in Uzbekistan. This puzzle is mainly caused by inconsistent data and statistics, including from official sources, on the level of state ownership. The analyses show that socially-oriented market economy and gradual privatization reforms have had a significant influence on SOE reform in Uzbekistan. According to official statistics the share of state ownership in the GDP structure of the country decreased from 41 percent in 1995 to 19 percent in 2017 (Figure 2).

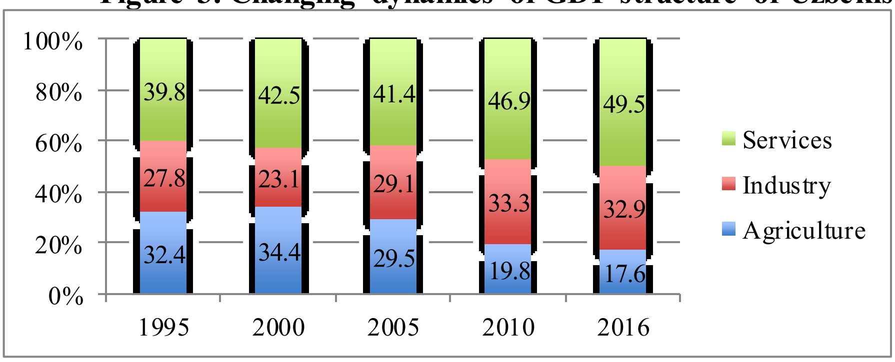
Figure 2. Structure of Uzbekistan GDP by ownership form



Source: State Statistic Committee of Uzbekistan.[333]

The above figures are based on the Report of the Uzbekistan Statistics Committee, but attempts to scrutinize the figures by checking other sources, including official sources, give rise to serious doubts on the reality and reliability of these figures. An attempts follows in the below to interrogate the statistic data in order to understand the real share of state ownership in the GDP of Uzbekistan. First, an examination of the GDP structure (figure 3) suggests that in 2016 almost half of the GDP relates to the services sector, nearly one-third to industry, and about 18 percent to agriculture.

Figure 3. Changing dynamics of GDP structure of Uzbekistan

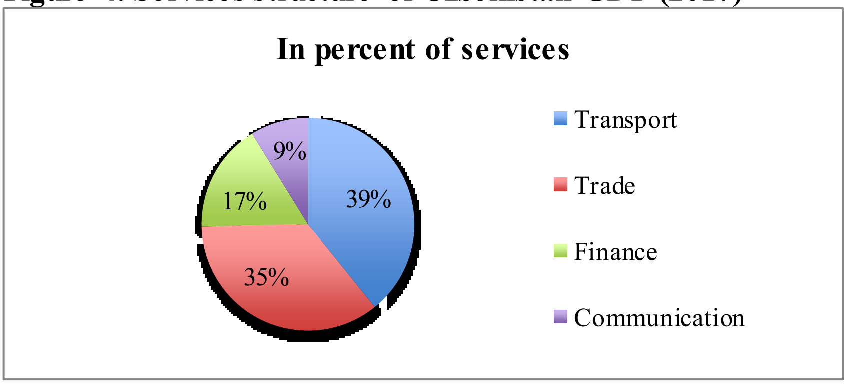


[333] For details see: https://stat.uz/uz/statinfo/milliy-hisoblar/tahlillar-milliy-hisoblar/432-analiticheskie-materialy-uz/2023-makroiqtisodiy-ko-rsatkichlari-tahlili; https://stat.uz/uploads/docs/vvp-uzb.pdf.

Source: State Statistic Committee of Uzbekistan.[334]

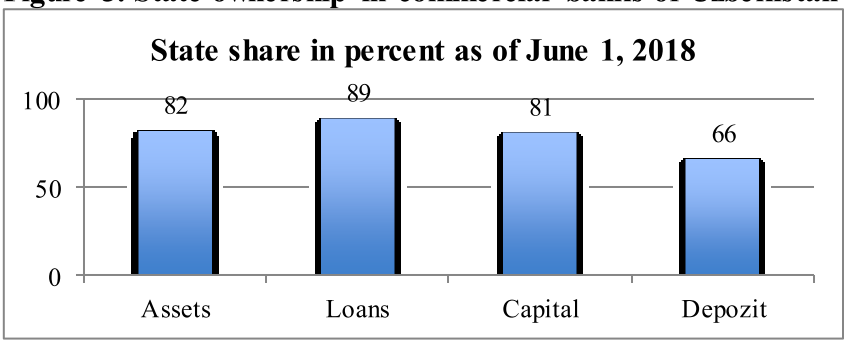
The next step of investigation is to look inside the services sector and analyze its structure. The following chart (figure 4) demonstrates the main industries within the services sector of Uzbekistan, where transport services lead with around 40 percent of the share, trade covers more than one-third of the services sector, almost one fifth goes to finance, and about 10 percent belongs to the communication services. Moreover, were one to dig deeper into specific service sectors, it would appear that the state has a significant share in each of them. For instance, in the transport sector, airways and railways facilities are entirely owned and managed by SOEs, in the banking sector, almost 80 percent of services and assets belong to the state (figure 5), and in the trade sector, more than 65 percent of export accounts for SOEs or government-related entities (figure 6).

Figure 4. Services structure of Uzbekistan GDP (2017)



Source: State Statistic Committee of Uzbekistan.[335]

Figure 5. State ownership in commercial banks of Uzbekistan



Source: Central Bank of Uzbekistan, Information on the leading indicators of commercial banks activity as of June 1, 2018.[336]

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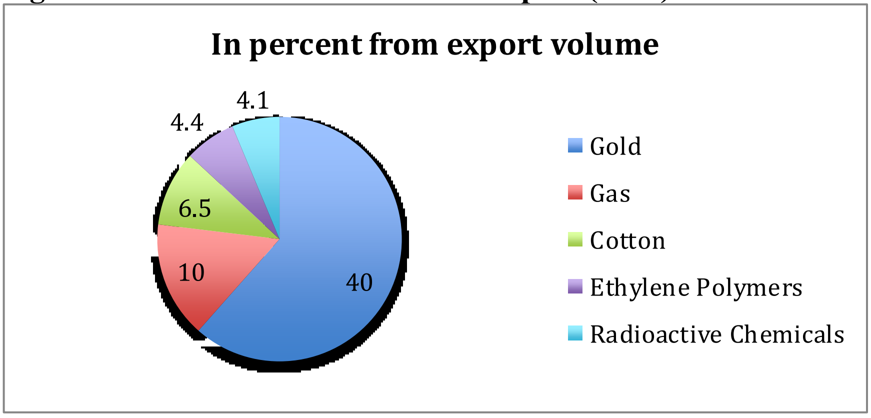
334 See: https://stat.uz/uz/statinfo/milliy-hisoblar/tahlillar-milliy-hisoblar/432-analiticheskie-materialy-uz/2023-makroiqtisodiy-ko-rsatkichlari-tahlili; https://stat.uz/uploads/docs/vvp-uzb.pdf.
335 See: https://stat.uz/uploads/docs/Xizmatlar-uz-12-2017.pdf
336 See: http://cbu.uz/uzc/statistics/bankstats/2018/06/127781/

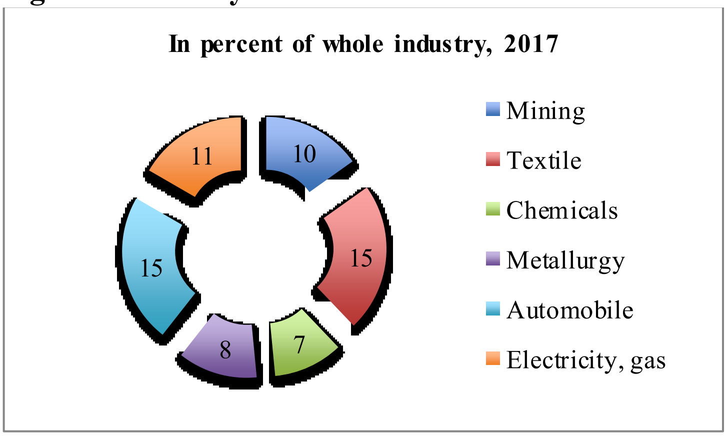
Figure 6. State share in Uzbekistan export (2016)



Note: Export volume in 2016 was USD 7.11 billion.
Source: https://atlas.media.mit.edu/en/profile/country/uzb/

Going further on with seeking to verify the figures on the state share in Uzbekistan's GDP, it is necessary to analyze the structure of the industry sector. The following chart shows that Uzbekistan's industry sector is quite diversified (Figure 7), however, in all sectors of industry SOEs have a significant share. For instance, in the mining sector one of the largest companies is *Navoiy Mining and Metallurgical Combinat*,[337] which is the primary producer and exporter of uranium and precious metals, including gold. There are other giant companies in the mining sector including *Bekobod Metallurgical Combinat* and *Angren Metallurgical Combinat* in which the state owns a significant share. In the ownership structure of textile, chemicals, automobile, electricity, and gas sectors, a similar situation is witnessed.

Figure 7. Industry structure of Uzbekistan GDP



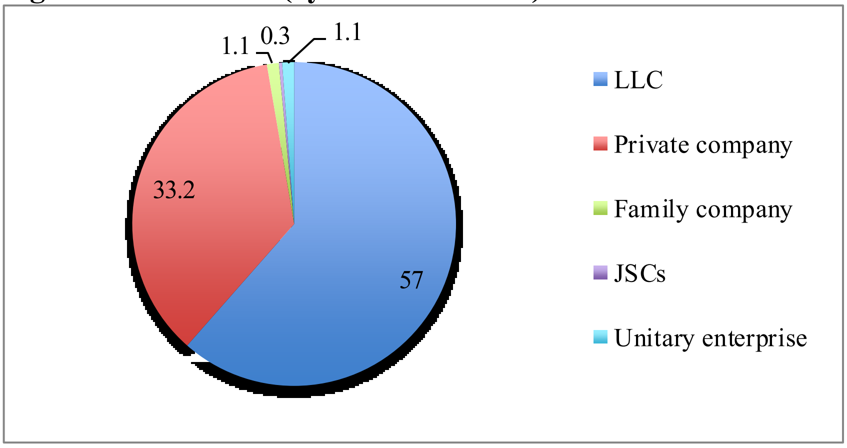
Source: State Statistic Committee of Uzbekistan.[338]

Next, an attempt to identify state ownership in the number of companies could also shed further light on the question of state involvement. By January 1, 2017, there are

[337] See the official website: https://www.ngmk.uz/en/about/about..
[338] See: https://stat.uz/uploads/docs/vvp-uzb.pdf

213,089 acting companies (excluding farmers) in Uzbekistan, 1.1% of which are unitary enterprises totally owned by the state (i.e., the state holds 100% of their shares). The main organizational-legal form of operating companies is that of Limited Liability Company (LLC) – namely, 57% of companies (Figure 8). There are only 2,302 large companies, which cover around 1.1 percent of the total quantity of acting businesses.[339]

Figure 8. Classification of companies in Uzbekistan by their legal-organizational form (by Jan.1st of 2017)



Source: State Statistics Committee of Uzbekistan[340]

The following table presents the summarizing picture of ownership structure in the companies, which are mainly JSCs, acting in the industry sector (table 6). From the table it is clear that the state share in these JSCs, including SOEs shares, exceeds 80 percent.

Table 6. State share in JSCs of Uzbekistan, by January 1, 2017

Structure of stock by nominal price	**USD billion**	**Number of JSCs**	**Share in %**
State share in JSCs	2.78	158	73.01
SOEs share in JSCs	0.43	326	11.34
Total	**3.21**	**484**	**84.35**
Private sector share	0.6	175	15.65

Source: 'Concept of Development Secondary Securities market in Uzbekistan in 2017-2018'[341]

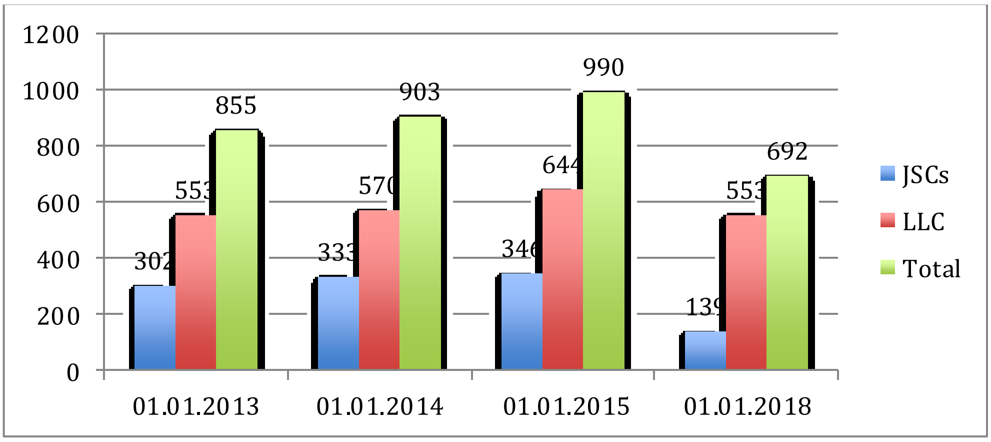
By quantity, JSCs comprise only 0.3 percent of all existing companies (figure 8), but by financial status – they are much larger than LLCs. According to legislation the

[339] Unfortunately, it was not possible to find any reliable information about the quality, i.e., turnover of companies, which could be useful for clarifying state share.
[340] See: https://stat.uz/uz/432-analiticheskie-materialy-uz/2032-korxonalar-va-tashkilotlarning-demografiyasi
[341] The text of the Concept was developed by the Center for Research on Privatization, Development Problems, Corporate Governance and the Securities Market under the State Committee of the Republic of Uzbekistan to promote privatization and competition. See: https://research-center.uz/info/concept/

minimal amount of charter capital of JSCs should be no less than USD 400,000,[342] while in the case of LLC this amount is 40 times of minimum wage,[343] which will be around USD 920.[344]

The following chart demonstrates a change of the quantity of SOEs in the last five years (figure 9), where there has been an increase both in the quantity of JSCs and LLCs until 2015, and a significant decrease in the previous two years.

Figure 9. Change of SOEs' quantity of Uzbekistan in the last five years



Source: State Committee of Uzbekistan for Assistance Privatized Enterprises and Development of Competition.[345]

Also, lastly, the agriculture sector, which, according to official statistics, covers around one-fifth of the country's GDP (figure 3). Despite several reforms and attempts to diversify ownership in the sector, the state remains the principal owner. According to the Constitution of Uzbekistan, the land amounts to national wealth, and, consequently, it is outside the scope of privatization.[346] The Law on Privatization and Denationalization (1991) also prohibits the privatization of land and related resources.[347] Farmers produce

[342] Article 17 of the Law on Joint Stock Companies and the Protection of Shareholders Rights, May 7, 2014, http://lex.uz/docs/2382411#2383643

[343] Article 14 of the Law on Companies with Limited and Additional Liability, December 6, 2001, http://lex.uz/docs/18793#19022

[344] Currently, the minimum wage is UZS 184,300 and the exchange rate is about UZS 8,000 to USD 1.

[345] For 2013 data, see: https://gkk.uz/ru/deyatelnost/rezultaty-deyatelnosti/press-relizy-o-rezultatakh-deyatelnosti-komiteta/93-itogi-2012-goda; for 2014: https://gkk.uz/ru/deyatelnost/rezultaty-deyatelnosti/press-relizy-o-rezultatakh-deyatelnosti-komiteta/96-itogi-2013-goda; for 2015: https://gkk.uz/ru/deyatelnost/rezultaty-deyatelnosti/press-relizy-o-rezultatakh-deyatelnosti-komiteta/1331-press-reliz-o-rezultatakh-deyatelnosti-goskomkonkurentsii-respubliki-uzbekistan-za-2014-god; and for 2018: https://gkk.uz/ru/deyatelnost/rezultaty-deyatelnosti/press-relizy-o-rezultatakh-deyatelnosti-komiteta/3190-rezultaty-deyatelnosti-goskomkonkurentsii-respubliki-uzbekistan-za-2017-god..

[346] "The land, its minerals, fauna, and flora, as well as other natural resources shall constitute the national wealth, and shall be rationally used and protected by the state" (cf., Article 55), (English text available at http://www.wipo.int/edocs/lexdocs/laws/en/uz/uz007en.pdf).

[347] See Article 4 of this legislation, http://lex.uz/docs/127000 (in Russian).

agricultural products in the leased land, which at any time and for any reason may be taken over by local and central authorities.[348] In most cases, farmers do not have actual choice in terms of crop, marketing, pricing, and selling of their crops. Usually, local authorities administratively order what kind of product/crop should be sown, and at what price it should be sold. In most cases, authorities do not take responsibility for selling the product that was grown by administrative pressure, without any marketing analysis. Consequently, farmers waste time and funds – that in most cases were borrowed from state-owned commercial banks –, and lose confidence.[349] In sum, in the agricultural sector, there is absolute state ownership over the land, which is the primary means for the organization of business in that sector, and there is actual state control over farmers' activities.

The scrutiny and interrogation of the figures mentioned above concerning state ownership in the GDP of Uzbekistan suggests the presence of inconsistencies between official data and other sets of data and statistics. For instance, the recent Resolution of the President of Uzbekistan 'on Measures to Improve the System of State Assets Management, states that: "[s]tate-owned enterprises and other legal entities with the predominant share of state in the capital fund play [a] significant role in the national economy, occupying key positions in priority sectors, primarily in the fuel and energy, agro-industrial, mining, engineering, transport, chemical industry, [and in] telecommunications."[350]

There are some enlightening conclusions in the EBRD, US Government reports, and in the ADB concept paper. According to the latest EBRD country assessment, "the state continues to play a dominant role in the economy. Progress under the recently renewed privatization programme has been minimal".[351] The US Government Report of 2018 also mentioned SOE dominance in a range of sectors including in "energy (power generation and transmission, and oil and gas refining, transportation and distribution), metallurgy, mining (non-ferrous metals and uranium), telecommunications (fixed telephony and data transmission), agriculture (cotton processing), machinery (the automotive industry, locomotive and aircraft production and repair), and transportation

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[348] For instance, see a recent documentary film about depriving a farmer of their land in the Bukhara region of Uzbekistan, https://www.facebook.com/kunuznews/videos/328601307697880/.

[349] A recent documentary film explores these issues that farmers face: https://www.facebook.com/UzbekTVofficial/videos/282061672401929/. See also a documentary film about farmers who had grown pepper based on administrative decisions and were subsequently facing issues with its sale: https://www.facebook.com/kunuznews/videos/312268516043486/.

[350] See the Resolution of the President of the Republic of Uzbekistan on Measures to Improve the System of State Assets Management of May 12, 2018, No.PP-3720, http://lex.uz/docs/3734161

[351] EBRD, Country Assessments Uzbekistan, http://2013.tr-ebrd.com/en/country-assessments/3/uzbekistan#corporate

(airlines, railways, municipal public transportation)"[352] A recent ADB concept paper also mentioned that "SOEs dominate all the important segments of the economy, and thus leave little space for the private sector."[353] However, as mentioned above, the recent reforms suggest that the current situation in Uzbekistan will no longer remain as it is. The extent, intensity, and content of the intended reforms may help mitigate SOE problems not only within Uzbekistan, but could also lead to the reconsideration of the issue of SOEs by the other countries within the CIS region.

5.2.2.The share of SOEs in Russia

The public sector also plays a significant role in the Russian economy. The share of SOEs' revenue in terms of the total revenue of the largest companies has grown steadily in recent years. According to the recent report of the Russian Federal Antimonopoly Service (FAS), the state's presence in the Russian economy is proliferating. Thus, the contribution of SOEs to GDP grew to 70% in 2015 from 35% in 2005, and the number of state and municipal unitary enterprises has tripled in the last three years.[354] According to the data for 2011, the largest share of the state's presence was observed in the transport sector (73%), banking (49%), oil and gas sector (45%), housing and public utilities (35%), mechanical engineering (15%), and in the telecommunications sector (14%).[355] The dynamics of the sectorial structure of SOEs ranked by Expert RA (i.e., Russia's oldest credit rating agency) according to the annual accounts for 1998, 2005, 2009, and 2014 shows an increase in the state's share in the engineering, oil, and gas, and banking sectors. The presence of the state has noticeably decreased however in the chemical and petrochemical industry. The state is practically not represented only in the trade, non-ferrous, and ferrous metallurgy sectors.[356]

At the same time, the state demonstrates inflexibility, and is very reluctant now to part with its property. The FAS report, for example, notes that in 2012 the list of the largest

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[352] U.S. Department of State, Bureau of Economic and Business Affairs, Uzbekistan: 2017 Investment Climate Statements Report, June 29, 2017, https://www.state.gov/e/eb/rls/othr/ics/2017/sca/270035.htm,.
[353] ADB Concept Paper, "Proposed Programmatic Approach and Policy Based Loan for Subprogram 1 Republic of Uzbekistan: Economic Management Improvement Program" Project Number: 51350-001, January 2018, 6, https://www.adb.org/sites/default/files/project-documents/51350/51350-001-cp-en.pdf
[354] For details, see: Государственное участие в российской экономике: госкомпании, закупки, приватизация, Бюллетень о развитии конкуренции, март 2016, с4. (State Participation in the Russian Economy: State Companies, Purchases, Privatization, Competition Development Bulletin, March 2016, 4), http://ac.gov.ru/files/publication/a/8449.pdf
[355] Ю. Цепляева, Ю. Ельцов, Половину экономики России уже составляет госсектор, 22 октября 2012 год. (Y. Tseplyaeva, Y. Eltsov, Half of the Russian Economy is Already in the Public Sector. October 22, 2012), https://www.vedomosti.ru/politics/articles/2012/11/06/esche_odin_byudzhet
[356] Bulletin on Competition Development, "State Participation in Russian Economy: State-owned Companies, Procurement, and Privatization", Analytic Center under the Government of Russian Federation, March 2016, 20, http://ac.gov.ru/files/publication/a/8449.pdf

companies subject to privatization was expanded. The state was going to significantly reduce its share in them, or even wholly withdraw. However, plans have changed, and now the state is not going to part with corporate control.[357] According to Russian Prime Minister Dmitriy Medvedov "[s]ince 2013, we have doubled the number of unitary enterprises, while different orders provide for their further reduction."[358] As FAS emphasizes, such enterprises are still being created in markets with relatively developed competition, where the use of administrative resources and budget financing negates the efforts of more active players. It should be mentioned that FAS is more active in reducing anticompetitive actions and the dominant position of state companies in Russia compared with the same authorities in Uzbekistan. For instance, recently FAS proposed several bills on reducing the state share of, and promoting competition in, the market. A separate bill of the FAS proposes to prohibit the creation of unitary enterprises in competitive markets, and from February 1, 2018, to eliminate such an organizational and legal form, which is considered a relic of the planned economy system. The enormous growth of state and municipal enterprises is the most dangerous trend in terms of the general strengthening of state monopoly in the economy, which, according to FAS, over the past three years their number has doubled. A unitary enterprise, by entering a competitive market, monopolizes it after a certain period, and private business is consequently discriminated.

Furthermore, the FAS prepared a draft presidential decree approving the national plan for the development of competition in 2017–2019, which it submitted to the government for adoption.[359] The main threat to competition, according to the FAS, comes from the state itself, and a presidential decree needs to reduce state participation in the economy. The FAS proposes to do this in several ways, and the first is to reduce the market share of state and municipal companies. The government should ban SOEs and public enterprises from acquiring new assets, both directly and through subsidiaries. Also, the state should divest itself of all existing SOEs, and not only of the less important ones. According to the draft decree, SOEs ought to be obliged to develop programs for the alienation of core assets. The reality is that these bills may not actually change the situation

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[357] Ibid.
[358] "Why is the Share of the State Growing in the Russian Economy?", *Factograph,* October 11, 2017. https://www.factograph.info/a/28786989.html
[359] Екатерина Мереминская, Маргарита Папченкова ,ФАС предлагает Путину указом снизить присутствие государства в экономике. Ведомости, 8 февраля, 2017.(Yekaterina Mereminskaya, Margarita Papchenkova "FAS predlagayet Putinu ukazom snizit' prisutstviye gosudarstva v ekonomike") ("FAS Offers Putin Decree to Reduce the Presence of the State in the Economy") *Vedomosti,* February 8, 2017. https://www.vedomosti.ru/economics/articles/2017/02/08/676610-prisutstvie-gosudarstva-ekonomike

much given that the FAS's authority is limited against large SOEs that are fully exploiting their lobbying capacity to influence state policy in this matter.

Furthermore, there has been a significant increase in state presence in the financial services of Russia. For instance, while in 2004 the state share in the banking sector had been only 30%, by 2018 it had risen to 70% from 61% at the beginning of 2015.[360] Currently, among the top five Russian banks, there is no private bank, and in the top ten, only three, including a branch of a foreign bank. The share of four state-owned banks represented in the top 100 largest companies in 2014, accounted for 86% of the revenues of all companies in the industry.[361] Since August 2017, the three largest private banks have come under state control, as the Bank of Russia began to seize them through the newly created Fund for the Banking Sector. The nationalization of the banking sector carries severe risks for investors, including the inefficiency of bank management caused by financing industries on political grounds – an action that is not necessarily always economically justified.

State presence in the economy directly reflects the share of the state in the securities market of the country. According to a recent report, the country's largest SOEs are in the top ten most capitalized stock issuer companies. The total share of the ten most capitalized issuers practically stopped shrinking from 2011, and in 2017 this figure was about 61.5% of total market capitalization (table 7). For instance, the share of *Gazprom*, *Rosneft*, and *Sberbank* together covered over 30% of the total capitalization of the market in 2017. In the period 2007-2014 *Gazprom* had been the leader concerning capitalization, in 2016 it was *Rosneft*, and in 2017, it was Sberbank.[362]

Table 7. The list of most capitalized Russian issuers (2017)

	Company issuer	Capitalization in billion USD	% in total capitalization
1	*Sberbank*	87.61	14.06
2	*Gazprom*	53.35	8.56
3	*Rosneft*	53.30	8.55
4	*Lukoil*	48.99	7.86
5	*Novatek*	35.54	5.70
6	*Noril Nickel*	29.51	4.74

360 Analytical Credit Rating Agency "ACRA: State Share in Banking Sector reaches 70%", February 14, 2018. https://acra-ratings.ru/about/articles/301

361 Bulletin on competition development, "State Participation in Russian Economy: State-owned Companies, Procurement, and Privatization", Analytic Center under the Government of Russian Federation, March 2016, p.20. http://ac.gov.ru/files/publication/a/8449.pdf

362 NAUFOR Report, Russian Securities market: 2017, Events and Facts, 2018. http://naufor.ru/download/pdf/factbook/ru/RFR2017.pdf

7	*Surgutneftgaz*	20.94	3.36
8	*Gazprom neft*	20.17	3.24
9	*Tatneft*	18.90	3.03
10	*NLMK*	15.35	2.46
	Total	**623.2**	**61.6**

Source: NAUFOR Report, Russian Stock Market: 2017, Events and Facts, 2018,13

Overall, Russian business attempts to survive in whatever economic space is not yet occupied by the state. According to a survey conducted by the Russian Union of Industrialists and Entrepreneurs, 48% of Russian companies believe that government considers business as a 'wallet'.[363] It is officials who entrepreneurs consider to be the main enemies of competition. The actions of the authorities are the main reason for the reduction of the number of competitors in the critical sectors of the economy that directly reflects the securities market indicators of the country.

5.2.3. SOEs presence in Kazakhstan's economy

Kazakhstan's economy is also characterized by the dominance of large SOEs, industrial and financial conglomerates, especially in the gas, transport, electricity, postal, and mobile telecommunication services sectors. There are about 7,000 registered SOEs, of which over a thousand are considered significant, as they employ more than 250 people. As of October 2017, about 10.3% of all operating companies in Kazakhstan are either state-owned or involve state participation. In recent years, the share of the state in large companies has significantly increased rather than decrease. Notably, in October 2017, about 46.9% of all large operating enterprises in Kazakhstan are either wholly state-owned or with partial state participation. This is the highest indicator of the public sector's share in large businesses over the past ten years, while the lowest record was in 2007 when the state share was 41.7%.[364] The percentage of SOEs in medium-sized enterprises is significantly higher (56.5%) than in relation to large companies. Despite this fact, the state share in relation to medium-sized enterprises is decreasing.

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[363]" Андрей Полунин, Россия заигралась в монополию: Доля госкомпаний в ВВП страны выросла до 70 процентов, 29 сентября 2016 (Andrei Polunin, "Russia Played a Monopoly: The Share of State-Owned Companies in the Country's GDP Grew to 70 percent", *Free Press*, September 29, 2016), http://svpressa.ru/economy/article/157621/.

[364] "In Kazakhstan, the state's share in Big Business Reached a Peak in 10 years", *Informburo*, October 12, 2017, https://informburo.kz/novosti/v-kazahstane-dolya-gosudarstva-v-krupnom-biznese-dostigla-maksimuma-za-poslednie-10-let.html

Kazakhstan has set a goal to reduce the state's share in the economy to 15% by 2020, which is the most ambitious privatization program since independence. There is considerable support for the idea that privatization can lead to a significant increase in profitability, company performance, and efficiency. The present privatization program seems extremely ambitious as it is proposes to privatize about 800 companies, including the 'top 65' and some large enterprises.[365]

As for state presence in the banking sector, SOEs and various state funds are still the main creditors of the banking system of Kazakhstan. Together, they account for about a third of the liabilities of banks, for which there are objective reasons, such as a high proportion of the state in the economy, especially in the oil and gas sector. At the same time, the state also takes indirect financial participation in the rehabilitation of loan portfolios through the framework of business support programs, construction, and agriculture. In a relatively small and poorly diversified economy, it is difficult for banks to get significant and stable financial resources. The state had been actively involved, through massive government bailouts, in the banking sector in the crisis years of 2009-2010. At present, the state, represented by the government of Kazakhstan and the National Welfare Fund, *Samruk-Kazyna*, has significantly reduced its share of the banking sector. So while at the beginning of 2014, the state controlled 19% of the total assets of Kazakhstan banks, in 2016 the share of state assets was less than 4%.[366]

On the other hand, state presence in Kazakhstan's securities market is relatively significant. For instance, as of January 2017 assets of second-tier banks invested in securities amounted to 3,217,295 million *tenges* (c., USD 8.5 billion). More than 76% of this was spent on government securities of Kazakhstan.[367] However, there are recent reforms promising further liberalization of the securities market, the reduction of state participation in the economy, and the creation of a competitive market. Some of such concrete measures are determined in the Joint Action Plan on the Development of the Securities market for 2018–2021, which was adopted by the Government and the National

[365] OECD, Comprehensive Country overview of Kazakhstan, Part II, Depth analysis and recommendations, 2017. https://www.oecd.org/dev/MDCR_Kazakhstan_Vol_2_web.pdf
[366] "The state is leaving the banking sector of Kazakhstan; the market is moving into a competitive environment. After a series of privatizations of state assets, the banking sector shows stronger financial indicators". See: http://ranking.kz/a/infopovody/osudarstvo_pokidaet_bankovskij_sektor_rk_rynok_perehodit_v_konkurentnuju_sredu_posle_serii_privatizacij_gosaktivov_bankovskij_sektor_demonstriruet_bolee_silnye_finansovye_pokazateli?mcode=banks (January 12, 2016) (in Russian).
[367] National Bank of Kazakhstan, "The Current State of the Securities Market of Kazakhstan" as of January 1, 2017. http://www.nationalbank.kz

Bank of Kazakhstan. According to a report of the National Bank, part of the measures mentioned above has already been implemented. Particularly, actions on the simplification of procedures for issuers to enter the securities market, access to trading for retail investors, substantial liberalization of brokers, and the expansion of investment opportunities of bank-holding companies have all led to a revival of dealing in securities on the Kazakhstan Stock Exchange.[368] Despite these reforms there still are significant problems that require immediate and comprehensive solutions. Below follows an attempt to address to address the issue of SOEs in CIS countries by reference to the case of Uzbekistan.

5.3. Main SOE problems in case of Uzbekistan

In this part the term 'SOE problems' is used in relation to the following two meanings: first, in the meaning of the problems that SOEs face; and, second, the problems that third parties[369] face because of the improper organization of SOEs activity. These two meanings of SOEs problems are interrelated and require a comprehensive approach, which, unfortunately, is lacking in the current SOE policy reform both in Uzbekistan and its regional peers.

In the present author's opinion, the current tendency of SOE reforms in Uzbekistan considers the SOE problems mostly in relation to the first meaning, i.e., the reform is limited to: addressing some SOE issues with little or no attention to the impact of their activity, ensuring healthy competition, and to implementing market economy principles as a whole. For instance, the recent Resolution of the President of Uzbekistan highlights several problems related to SOEs activity in Uzbekistan such as conflict of interest in corporate governance, the lack of effective investment management system, fragile transparency in corporate governance, and the ineffectiveness of management training system of SOEs.[370] In general, the spirit of current SOE reforms focuses on the improvement of corporate governance, investment management, and the effectiveness of SOEs. While there is little doubt that these reforms may indirectly affect the development

[368] National Bank of the Republic of Kazakhstan, Report for 2017. http://www.nationalbank.kz/cont/%D0%93%D0%9E-2017_%D1%80.pdf
[369] The term 'third parties' here means private enterprises as competitors, taxpayers and investors as stakeholders, and the economy as a whole business platform.
[370] Resolution of the President of the Republic of Uzbekistan on Measures to Improve the State Assets Management System, No.PP-3720. May 12, 2018. (Постановление Президента Республики Узбекистан, "О мерах по совершенствованию системы управления государственными активами", ПП-3720, 12 мая 2018 года), http://lex.uz/docs/3734161.

of competition and the implementation of market principles in the country, from a strategic and macroeconomic perspective, these reforms mostly serve to strengthen SOEs and increase their role in the economy, instead of to reduce their share, and to promote healthy competition and market principles.[371] Eventually, these reforms are likely to result in strong and dominant SOEs that will remain disciplined under administrative rules, rather than market principles such as sound transparency, healthy competition, and effective corporate governance.

5.3.1. Transparency

Transparency and limited access to information remain the core issues of SOEs in the post-Soviet republics, including Uzbekistan. The brief analysis in the previous section hints at some aspects of the transparency issue such as the lack of information, the inconsistency of data, and the unreliable statistics at the macro and micro level. Reports of several international financial institutions also certify this fact. For instance, the recent EBRD reports mention that in Uzbekistan "availability and access to business data is still poor, with reporting methods often outdated."[372] According to the ADB concept paper "the data dissemination system is fragile in Uzbekistan, and will require significant strengthening[…]."[373]

Transparency of SOEs activity is necessary for providing clear, reliable, and on-time information on the content and form of state assets, the process of their usage, and the main results of state business activity. A well-established and effective disclosure system of SOEs action will serve to strengthen and maintain public and investor confidence both in SOEs and the whole industry.

Transparency is mainly maintained through a sound disclosure system that allows the public to reach necessary, relevant, and on time information about state assets, their management, and efficiency. Usually, there are two kinds of subjects responsible for disclosure information: the government, and SOEs themselves. Disclosure by these two subjects differs from each other depending on the content, form of information, and method of its release.

[371] In this sense, it is primarily reminiscent of the recent Chinese approach to SOEs reform.
[372] For details, see: EBRD, "Uzbekistan Country Strategy 2018-2023", 16.
[373] ADB Concept Paper, "Proposed Programmatic Approach and Policy Based Loan for Subprogram 1 Republic of Uzbekistan: Economic Management Improvement Program" Project Number: 51350-001, January 2018, p.7 https://www.adb.org/sites/default/files/project-documents/51350/51350-001-cp-en.pdf

In Uzbekistan the legal basis for access to information is specified by the Constitution[374] and other legal acts[375] that regulate disclosure information and access to official reports. Despite the existence of a wide range of legal acts regulating information access and disclosure information by the government, significant problems on this issue still remain. For instance, according to the latest OECD report the vague definitions of 'state secret' and 'another secret provided by the law' was the basis for the restriction of access to information in Uzbekistan.[376] The problems of ensuring transparency are not limited to issues concerning the underdevelopment, conflict, and duplication of the relevant legislation, but also extend to implementation and enforcement issues. The mechanism of monitoring the implementation of the right to access information is one such issue. According to the OECD report the government "does not perform monitoring over the implementation of the right to access information, as seen by the absence of any reports, analytical research or general statistical data."[377]

The second issue of transparency and accountability of SOEs is related to disclosure information by SOEs themselves. Currently SOEs in Uzbekistan operate in the following three legal-organizational forms: JSCs, LLCs, and as state unitary enterprises. By October 12, 2018, the Center for Management of State Assets of Uzbekistan had been managing state shares in 502 JSCs, 352 LLCs, and 1955 state unitary enterprises.[378]

The legal basis concerning SOEs transparency and accountability in Uzbekistan mainly relates to the Law on Securities Market of 3 June 2015;[379] the Law on Joint-Stock

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[374] Particularly, Article 29 that declares the right of everyone to "seek, receive and disseminate any information, except for information aimed against the existing constitutional system and other restrictions set by law". Also, Article 30 of the Constitution provides that all state authorities, public associations, and officials of Uzbekistan are required to ensure that citizens be able to get acquainted with documents, decisions, and other materials concerning their rights and interests. See the following link for the full text of the Constitution of Uzbekistan: http://lex.uz/docs/35869

[375] The most relevant laws are as follows: the Law on Guarantees and Freedom of Access to Information of April 24, 1997 (http://lex.uz/docs/2118); the Law on Principles and Guarantees of Freedom of Information of December 12, 2002 (http://lex.uz/docs/52268); the Law on Openness of State Authorities and Public Institutions Activities of May 5, 2014, (http://lex.uz/docs/2381138); the Law on E-government of December 9, 2015 (http://lex.uz/ru/docs/2833855#2858663); and the Resolution of the Cabinet of Ministers of Uzbekistan on Measures for Further Improvement of the Uzbekistan Governmental Portal of Data Providing on the Internet Network of August 7, 2015. (http://lex.uz/ru/docs/2718602).

[376] See details in OECD, "Anti-Corruption Reforms in Uzbekistan: Round 3 Monitoring of the Istanbul Anti-Corruption Action Plan", 2015, 90-95, http://www.oecd.org/corruption/acn/Uzbekistan-Round-3-Monitoring-Report-ENG.pdf

[377] Ibid., at 95.

[378] See the website of the Center for Management of State Assets under the State Competition Committee of Uzbekistan – for JSCs: http://csam.uz/info/CompanyList.aspx?t=AO; for LLCs: http://csam.uz/info/CompanyList.aspx?t=OOO; and for State Unitary Enterprises, see: http://csam.uz/info/CompanyList.aspx?t=GUP

[379] Particularly Chapter 6, Articles 43-51. See details at http://lex.uz/docs/2662539?ONDATE=04.06.2015%2000#2662584

Companies and Protection of Shareholders Rights of 26 April 1996;[380]and the Law on Companies with Limited and Additional Liability of December 6, 2001.[381] These laws mainly regulate relations connected to JSCs and LLCs, including to state shares, and provide the legal basis for transparency and accountability. There are also several by-laws, including special acts regulating disclosure information by SOEs (mostly JSCs). For instance, the Decree of the Cabinet of Ministers on Measures for the Further Enhancement of Corporate Management System in Joint-Stock Companies of July 2, 2014, defines the types of information that are mandatory for JSCs to publish on their corporate websites.[382] Another effective regulative measure on ensuring corporate transparency, including SOEs, is provided by the Presidential Decree on Measures for the Implementation of Modern Corporate Governance Methods in Joint-Stock Companies of April 24, 2015. Based on this, in December 2015, the Single Portal of Corporate Information (openinfo.uz)[383] was launched to publish financial statements and audit reports, information on substantial facts in JSCs activities, information about shares, share capital, changes in the corporate governance of JSCs, and other useful for shareholders and investors information about JSCs.[384] By October 16, 2018, on the single portal of corporate information, there are disclosed 8967 items of information concerning 756 JSCs, including SOEs.[385] Unfortunately, a significant part of the rules on corporate transparency and accountability focus on JSCs alone, with insufficient attention on LLCs and state unitary enterprises.

In the case of SOEs set up as LLCs form transparency and accountability issues are relatively limited both in legislation and at the level of enforcement. In terms of legislation, there is only one piece of legislation, mentioned above, according to which the company must disclose information in mass media in specific cases.[386] There are also limited opportunities in relation to enforcement. According to the relevant legislation, LLCs do not have the right to issue securities, and, consequently, they are not burdened by the obligations of securities issuers such as that of mandatory disclosure of information.

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[380] Particularly articles 107-109. http://lex.uz/docs/6567#9197
[381] The text of this legislation is available at the following link: http://lex.uz/docs/18793
[382] The text of the Decree is available at the following link: http://lex.uz/docs/2420413
[383] At present this portal (www.openinfo.uz) remains unavailable (last accessed on February 8, 2019). The data on JSCs can be accessed on the website of the authorized body of securities market regulation of Uzbekistan at the following link: http://openinfo.csm.gov.uz/view.php?tbl=annual_companies
[384] Clause 35 of the Program on measures for the Fundamental Improvement of Corporate Governance System, approved by the Presidential Decree on April.24, 2015 No. UP-4720. http://lex.uz/docs/2635199#2638254
[385] See details on the website of the authorized body of securities market regulation of Uzbekistan at the following link: http://openinfo.csm.gov.uz/view.php?tbl=annual_companies
[386] For instance, according to Article 19, the company must inform creditors and publish information in mass media about the decrease of the charter capital decision. See details in http://lex.uz/docs/18793#19523

Undoubtedly, this relates to the legal nature of LLCs. However, in the case of LLCs with state shares, there should be an organized platform for sharing information to the principal (state) and the ultimate owner (public).[387] Currently the only available to the public sources of such information are the websites of such companies,[388] the webpage and reports of the Center for State Assets Management,[389] and any publications of the state statistical committee.[390]

As for state unitary enterprises, despite their prevailing current quantity of other SOE forms, it has not been possible to locate any particular law or other legal act regulating disclosure information by this type of SOE.[391] Were one to consider the main legal feature of unitary enterprises, which comprises the fact that they are founded by a sole owner (usually by state) and its charter capital is not divided in shares, one may recognize the importance of detailed legal regulation of their activity, especially for transparency and accountability.[392] Most state unitary enterprises in Uzbekistan are established to fulfill the state functions in several areas, but at the same time, according to the Civil Code, they are commercial entities, and, consequently, are not treated as public entities. Therefore, the requirements of and procedures for transparency and accountability under the regulations mentioned above do not, on the face of it, apply to state unitary enterprises.

Overall, current data availability and quality on SOEs in Uzbekistan requires additional regulations and improvements. Implementing international standards would be an effective way of making such improvement. In this regard, it would be useful for Uzbekistan to adhere to the OECD Guidelines on accountability and transparency for state

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[387] In most cases, even the state does not possess the real, reliable, and current information about the scale, management, and effectiveness of state assets. This is a reality also encountered concerning the regional peers of Uzbekistan.

[388] For instance, at the website of one of the largest SOEs, formed as an LLC in the automobile industry of Uzbekistan, *SamAuto*, we could not find any related information about state ownership levels, the process, or the results of state assets management, http://www.samauto.uz/ru/about/history/

[389] The website of the Center for State Assets Management contains relatively extensive information. At least there is information concerning quantity, related industry, region, and amount of charter capital. Unfortunately, there is no information on state share, http://csam.uz/info/CompanyList.aspx?t=OOO.

[390] Above the features and reliability of data taken from the website of the State Statistics Committee have been briefly described, https://stat.uz/en/

[391] Uzbekistan National Law Resources Database on the website www.lex.uz, currently includes in excess of 34,000 legal acts, yet does not contain any particular legal act on State Unitary Enterprises, except the general provisions of unitary enterprises provided in the first part of the Civil Code of Uzbekistan.

[392] See Article 70 of the Civil Code of Uzbekistan, http://lex.uz/docs/111181. See also the Commentary to Articles 70-72 of the Civil Code of Uzbekistan, 2011, 202-211. https://www.osce.org/ru/uzbekistan/74874?download=true

ownership, which provide appropriate disclosure and transparency practices, and coherent disclosure policy for companies with state shares. [393]

5.3.2. Competitive neutrality

Competitive neutrality is the term that is often used in the SOE-related studies to explain the different treatment of companies based on ownership criteria. [394] Central to this term is the misbalance in the regulation and conduct of SOEs and POEs that provides a considerable advantage to SOEs, and causes the growth of anticompetitive conditions and practice. Direct and indirect preferential treatment of SOEs creates an uneven playing field in the market, whereby SOEs may become a monopoly and abuse their dominant position.

Competitive neutrality is usually examined through an analysis of several factors, which include regulatory neutrality, financial and debt neutrality, imbalanced privileges, below cost sales, preferential ban and so on. Unequal treatment of POEs and SOEs by the state is a characteristic feature of most transition countries, including Uzbekistan. In the case of Uzbekistan, competitive neutrality is mainly influential in financing and subsidies, regulatory neutrality, privileges, and preferential bans.

Due to issues with transparency, including those covered above, it has not been possible to find any publicly available information from official sources to provide a general picture of competitive neutrality in Uzbekistan. [395] There are some conclusions in the reports and publications of international financial institutions. For instance, according to a recent EBRD report, gaps in competitiveness and the significant presence and preferential treatment of SOEs in Uzbekistan have constrained the development of the private sector. [396] This report is critical not only because it shows the situation of competitive neutrality in Uzbekistan, but also because it determines enhancing

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[393] OECD, Accountability, and Transparency: A Guide for State Ownership, 2010. http://www.korupce.cz/assets/protikorupcni-strategie-vlady/na-leta-2013-2014/1a---Guide-OECD-for-state-ownership.pdf

[394] A Capobianco and H. Christiansen, "Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options", OECD Corporate Governance Working Papers, No. 1, OECD Publishing, Paris, 2011. http://dx.doi.org/10.1787/5kg9xfgjdhg6-en

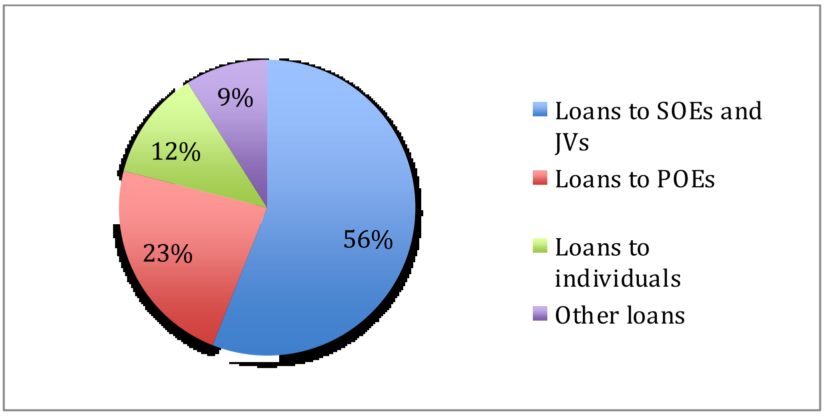
[395] Except for some sporadic and fragmented information that does not however provide a general picture of competitive neutrality in Uzbekistan. There are limited sources that highlight some aspects of competitive neutrality. For instance, in the Speech of the Deputy Director of State Committee on Development of Competition, Mr. Yunusov mentions that exclusive rights and individual privileges to separate companies are limiting the development of the competition in the market. November 1, 2017. https://gkk.uz/ru/novosti/vystupleniya-i-zayavleniya-rukovodstva-gkk/2878-davlat-ra-obat-mitasi-raisi-rinbosari-d-yunusovning-ma-ruzasi. The special portal devoted to competition (www.raqobat.uz) is unavailable (last accessed on February 8, 2019)..

[396] The strategy devoted to competitiveness has been termed "enhancing competitiveness by strengthening the private sector's role in the economy". See details in EBRD, Uzbekistan Country Strategy 2018-2023, approved on 19 September 2018, 8

competitiveness as one of three strategic priorities of EBRD in Uzbekistan for the period 2018-2023.[397]

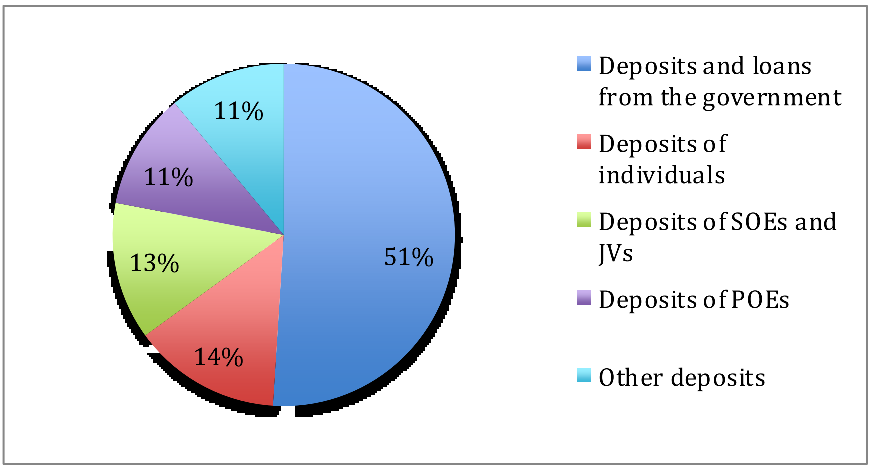
There is also an extensive analysis regarding financial and debt neutrality. An IMF country report states that in 2017 loans on preferential terms extended to SOEs accounted for more than half of all loans (Figure 10).[398] An IMF analysis of the structure of bank funding also shows that domestic banks in Uzbekistan are highly dependent on government financing (Figure 11).

Figure 10. Structure of loans in Uzbekistan (2017)



Source: IMF Country Report No.18/117, May 9, 2018. p.33

Figure 11. Structure of funding in Uzbekistan (2017)



Source: IMF Country Report No.18/117, May 9, 2018. p.33

There are also serious concerns about ensuring regulatory neutrality in the treatment of SOEs and POEs. The term *regulatory neutrality* here mainly means impartial

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397 Ibid.

398 For details, see: IMF Country Report No. 18/117, May 9, 2018. p.33 https://www.imf.org/en/Publications/CR/Issues/2018/05/11/Republic-of-Uzbekistan-2018-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-45873

regulation at substantial and procedural levels. In the significant level of regulatory neutrality at a glance it seems that there is no direct discrimination of companies based on their ownership factor. At least, the necessary legal acts regulating business relations (namely, the Civil Code, the legislation on companies, on competition, and so on) treat both SOEs and POEs under the same principles. However, in some by-law acts[399] individual companies (mostly SOEs) may enjoy various advantages (financing, tax exemptions, exclusive export/import right and so on) that may assist these companies to become dominant, and to lead the market towards monopoly or oligopoly, rather than competition.[400] The case of 'General Motors of Uzbekistan', which has been a monopoly for more than two decades, is the quintessential example of such one-sided direct state support of an SOE that eventually led to ineffectiveness, a rise in expenses, and the collapse of competition in the automobile industry of Uzbekistan.[401] Recently, even the head of the state commented on the fact that despite it having been provided a wide range of privileges, the 'General Motors of Uzbekistan' could not even meet expectations both in terms of localization of production and in terms of employment issues.[402] In this sense, the state needs to take severe measures on enhancing competition and preventing any kind of barriers to ensuring competition.[403]

The second part of regulatory neutrality relates to ensuring impartiality in enforcement practice – this is not less essential than the substantive aspects of regulatory neutrality. It is much more complicated than the adoption of laws or other legal acts. In relation to this aspect of regulatory neutrality, every subject and institution involved in law enforcement needs to be treated and improved. The following excerpt from a US Department of Commerce Report helps to understand the role of enforcement practice in regulatory neutrality:

> "Many foreign investors prefer international arbitration in cases of investment disputes with local SOEs because court processes in local courts are not always transparent and non-discriminatory due to pressure from the government. Judgments against state-owned enterprises are particularly difficult to enforce. Nearly all U.S. businesses operating in

[399] In CIS countries by-law acts stronger than laws and their number prevails over the laws several times.
[400] For instance, the Presidential Decree on Additional Measures to Stimulate the Expansion of the Production of Domestic Non-food Consumer Goods", January 28, 2009. http://lex.uz/docs/1433996.
[401] See Presidential Decree on the foundation of 'General Motors Uzbekistan' – an Enterprise with Foreign Investments, PP-800, dated February 21, 2008. The extract of the document is available here http://lex.uz/docs/1318292.
[402] The President of Uzbekistan, Shavkat Mirziyoyev, had mentioned this issue during his visit to Andijan region on May 19, 2018. An official report is available at the following link: https://www.youtube.com/watch?v=EaycFLZf8e0.
[403] Some of the recent reforms and initiatives in relation to this issue are presented in section 2.4 of this article.

> Uzbekistan do so in partnership with state-owned enterprises or firms, which are often affiliated with the political elite".[404]

The same US Department of Commerce report also mentions the issue of tax neutrality in Uzbekistan, where most SOEs enjoy several advantages, including different tax holidays, and better access to markets, easier access to finance, and various government subsidies.[405]

At a glance, it would seem that competitive neutrality is purely the government's responsibility and fault. However, a comprehensive approach to this issue shows that every subject, even a foreign investor, who is thought of as introducing and implementing international business standards, could be equally responsible for ensuring a competitive environment. The case of British American Tobacco (BAT), the world's second-largest tobacco company,[406] provides one such example.[407] The results of the analysis of BAT documents during litigation in the US revealed that the company had engaged in anti-competitive practices contrary to its code of conduct and established international business standards. BAT had acquired the former state-owned tobacco company and created its private monopoly in Uzbekistan.[408] One may reasonably argue that one case alone cannot sufficiently portray the situation concerning privatization, SOEs, and competitive neutrality issues in Uzbekistan. The present author would agree. But were one to consider the fact that the amount of investment by BAT is estimated to be one third of all foreign direct investment received by Uzbekistan between 1992 and the end of 2000,[409] this case merits consideration, and appropriate lessons should be withdrawn.

Despite the concerns about SOE competitive neutrality outlined above, currently, there are several projects, including with the involvement of international financial institutions, which allow for a degree of optimism on the improvement of the present situation. The ADB project adopted in January 2018 would be a great example in this sense, which seeks to improve access to bank finance and facilitate competitive financing

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[404] See US Department of Commerce, Uzbekistan Country Commercial Guide, 2017. https://www.export.gov/article?id=Uzbekistan-7-State-Owned-Enterprises.
[405] Ibid.
[406] https://www.statista.com/statistics/259204/leading-10-tobacco-companies-worldwide-based-on-net-sales/
[407] See details in Anna B. Gilmore, Martin McKee, and Jeff Collin, "The Invisible Hand: How British American Tobacco precluded competition in Uzbekistan", *Tobacco Control* 16, no. 4 (2007): 239-247.
[408] Ibid.
[409] See Anna B. Gilmore, Martin McKee, "Tobacco and Transition: An Overview of Industry Investments, Impact, and Influence in the Former Soviet Union. *Tobacco Control* 13, (2004):136–142.

of the private sector.[410] Such initiatives are a sign of rising confidence of the international community in recent government efforts towards implementation of market economy principles.

Improvement of competition law and its enforcement practice can help to address competitive neutrality concerns, and stimulate more competitive conditions both in Uzbekistan and other CIS countries. An OECD report recommends taking measures in line with competitive neutrality, and emphasizes the necessity of transparency rules, specific competitive neutrality policies, and the role of competition authorities in ensuring a level playing field between SOEs and POEs.[411] Also, privatization and corporatization of government business lead reducing state share in the economy, which increases competitive atmosphere and consequently raises company efficiency.

5.3.3. SOE Efficiency

SOE efficiency is another hot issue that is usually discussed in most SOE related studies. The notion of SOE efficiency generally refers to the productivity and profitability of SOEs when compared to POEs. In general, a significant part of the existing literature found that SOEs are comparatively less efficient than POEs.[412] Most scholars agree that the inefficiency of SOEs is not necessarily connected to the ownership factor. Inefficiency in SOEs is caused by a complex issue, which involves various factors, including institutional, organizational, political, and behavioral.[413] For instance, some of the recent studies found that management culture, legislation, political goals, and competition negatively impact on SOEs efficiency much more than does the issue of state ownership.[414]

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[410] ADB Concept Paper, "Proposed Programmatic Approach and Policy Based Loan for Subprogram 1 Republic of Uzbekistan: Economic Management Improvement Program" Project Number: 51350-001, January 2018. https://www.adb.org/sites/default/files/project-documents/51350/51350-001-cp-en.pdf accessed on October 18, 2018.

[411] Antonio Capobianco and Hans Christiansen, "Competitive Neutrality and State-Owned Enterprises", (2011), 20.

[412] See, for instance, Brigitta Jakob, "Performance in Strategic Sectors: A Comparison of Profitability and Efficiency of State-Owned Enterprises and Private Corporations", *The Park Place Economist* 25, no. 1 (2017): 8; David G. Victor, David R. Hults, and Mark C. Thurber, eds. *Oil and Governance: State-owned Enterprises and the World Energy Supply*, (Cambridge, UK: Cambridge University Press, 2011); William L. Megginson and Jeffry M. Netter. "From State to Market: A Survey of Empirical Studies on Privatization", *Journal of Economic Literature* 39, no. 2 (2001): 321-389; Aidan R. Vining and Anthony E. Boardman, "Ownership versus Competition: Efficiency in Public Enterprise." *Public Choice* 73, no. 2 (1992): 205-239.

[413] See, for instance, Ha-Joon Chang, *Globalization, Economic Development and the Role of the State*, (Zed Books, 2003); Kathryn L. Dewenter and Paul H. Malatesta, "State-owned and Privately Owned Firms: An Empirical Analysis of Profitability, Leverage, and Labor Intensity", *American Economic Review* 91, no. 1 (2001): 320-334.

[414] See, for instance, David G. Victor, David R. Hults, and Mark C. Thurber, eds. *Oil and Governance: State-owned Enterprises and the World Energy Supply*, (Cambridge, UK: Cambridge University Press, 2011);

In general, the cause of SOE inefficiency compared to POEs could be the following: 1) the monopoly and dominant status of SOEs;[415] 2) SOE activity may often combine business and political interests and thus cause a conflicts of interest;[416] 3) SOE managers may have fewer incentives to pursue efficiency than in POEs;[417] and 4) the weak disciplinary system of managers may contribute towards lousy performance.[418] Recent comparative research on efficiency concerning SOEs and POEs suggests that SOEs are less efficient and have lower profitability compared to POEs due to soft-budget constraints[419] and lack of autonomy caused by policy burdens.[420] All of these reasons have a place to consider in case of CIS countries, including those three within the scope of the present thesis.

In the case of Uzbekistan, recent reforms mostly focus on SOEs efficiency rather than transparency and competitive neutrality issues. The scope of current SOE reforms in Uzbekistan is not only limited to the government's efforts – there is considerable support from international financial organizations too. The recent projects of EBRD and ADB could be an excellent example on this point. According to EBRD most SOEs in Uzbekistan lack effective governance and institutional capacity, and this needs to be changed within the scope of the latest EBRD Country Strategy for 2018-2023.[421] Also, in the latest ADB concept paper the prevalence of large and inefficient SOEs is mentioned as one of the

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Filippo Belloc, "Innovation in State-owned Enterprises: Reconsidering the Conventional Wisdom", *Journal of Economic Issues* 48, no. 3 (2014): 821-848.

[415] See for instance, Mary Shirley and Patrick Walsh, *Public versus Private Ownership: The CurrentSstate of the Debate*, World Bank, 2000; Andrei Shleifer, "State versus private ownership", *Journal of Economic Perspectives* 12, no. 4 (1998): 133-150.

[416] See, for instance, Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure", *Journal of Financial Economics* 3, no. 4 (1976): 305-360; Ha-Joon Chang, *Globalization, Economic Development and the Role of the State*, (Zed Books, 2003).

[417] See, for instance, Elizabeth M. Freund, "Fizz, Froth, Flat: The Challenge of Converting China's SOEs into Shareholding Corporations", *Review of Policy Research* 18, no. 1 (2001): 96-111; Ravi Ramamurti, "A Multilevel Model of Privatization in Emerging Economies", *Academy of Management Review* 25, no. 3 (2000): 525-550.

[418] See, for instance, Ha-Joon Chang, *Globalization, Economic Development and the Role of the State*, (Zed Books, 2003); Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, Vol. 25. (Cambridge, Mass: Harvard University Press, 1970).

[419] The term 'soft budget constraint' relates to the financial conditions for the operation of SOE, which include the non-obligation to make a profit as conditions for the efficiency of the enterprise, poor control over expenditures, and the availability of funds to cover losses.

[420] For further details, see: Brigitta Jakob, "Performance in Strategic Sectors: A Comparison of Profitability and Efficiency of State-Owned Enterprises and Private Corporations", *The Park Place Economist* 25, no. 1 (2017): 8.

[421] EBRD, Uzbekistan Country Strategy 2018-2023, 8 , as approved by the Board of Directors on September 19, 2018.

critical deficiencies in management.[422] The efforts of international financial institutions suggest increasing trust by the international community in ongoing reforms in Uzbekistan, and the urgency of SOE efficiency issues in the country.

Severe steps for the improvement of SOEs efficiency have been taken at the national level too. In 2014 some measures had been taken in Uzbekistan to increase efficiency and the implementation of corporate governance systems in JSCs (mainly SOEs), including some reorganized companies. New legislation – namely, the Law on Joint-Stock Companies and Protection of Rights of Stockholders –[423] has established standards for implementation of monitoring of JSC activities, and has adopted the program on the improvement of the corporate governance systems, the publication of annual financial statements, and in relation to external audit.[424] Also, recently unprecedented action was taken by the government towards ensuring the effectiveness of one of largest SOEs in the country. According to the Decree of the Cabinet of Ministers, the *United Investment Healthcare Group LLC (USA*) is to be involved as trust manager of the state share in the authorized capital of JSC *Dori-Darmon* (Uzbekistan's largest pharmaceuticals company).[425]

Improving SOEs efficiency is a long and complicated process involving a variety of measures not only by government, but also by companies themselves, investors, and society as a whole. These measures should take into account the unique nature of SOEs, their double-aimed features, and their considerable influence on the market for, both, its growth or its restraint. Improving the efficiency of SOEs should involve both SOE management reforms and the strengthening of elements of competition in the sectors where SOEs operate. Ensuring healthy competition could provide the appropriate conditions that could in turn give rise to solutions to all the issues and concerns relating to SOEs discussed throughout this chapter.

422 ADB Concept Paper, "Proposed Programmatic Approach and Policy Based Loan for Subprogram 1 Republic of Uzbekistan: Economic Management Improvement Program", Project Number: 51350-001, January 2018, 6, https://www.adb.org/sites/default/files/project-documents/51350/51350-001-cp-en.pdf

423 The Law of the Republic of Uzbekistan, adopted on May 06, 2014, No.ZRU-370.

424 Decree of the President of the Republic of Uzbekistan on Measures for Implementation of Modern Techniques of Corporate Governance in JSCs of April 24, 2015.

425 Decree of the Cabinet of Ministers of Uzbekistan on Measures to Improve the Efficiency of the JSC *Dori-Darmon* and the Financial Stability of the State Unitary Enterprise *O'zmedimpeks* No.849, October 22, 2018, http://lex.uz/docs/4013375

5.4.Future perspectives of SOE reforms in CIS countries

An overview of state participation in the economy of CIS countries from the perspectives of their role and influence on ensuring a competitive environment in the market has been provided in the foregoing. Taking into account the specific features of the countries examined in this thesis, the present author considers that CIS countries cannot entirely hand over their huge SOEs arsenal. Theoretically, there is no necessity for the privatization of all state assets. If SOEs were to be treated equally to POEs and their activity were to not cause restricting competition, SOEs would theoretically have an equal right to exist. In such scenario, an optimum way to increase SOE transparency, competitiveness, and efficiency, and to also ensure healthy competition in the market would be to reform SOE activity based on a comprehensive strategy, which should include not only privatization – a common trend in CIS countries and not always effective – but also should include extensive measures on fostering an active competitive environment, on separating business and political SOE aims, and on enhancing transparency in state assets management.

There are many mechanisms for developing a competitive environment, including privatization, deregulation, de-monopolization, the development of small- and medium-sized enterprises and so on. Whether they are to be relied upon would depend on, among other things, the situation in the relevant markets of the country, on the degree of growth of the economy as a whole, and on the impact of external and internal factors. In the case of CIS countries, it this author’s opinion, the measures on the creation of an active competitive environment should include several actions. For instance, the elimination of state monopoly in the economy, which requires deep institutional reforms aimed at creating more favorable conditions for the development of entrepreneurship and for improving the system of state management of the economy. Also, preventing the abuses of market-based monopolies by their dominant position in the market. State institutions should ensure the development of competition, without which it is impossible to increase the competitiveness of the entire economy. Additionally, there should include the strengthening of the role of market mechanisms in regulating business activities, the removal of administrative obstacles to market entry, and the creation of competitive conditions for all economic actors. And, lastly, reforms should provide consumers the opportunity to consistently receive high-quality public services for economically reasonable prices.

CIS countries should also take measures to ensure that SOEs function on the basis of market and not political considerations, which would require the determination of the authorized body responsible for exercising state ownership rights, and the clarification and separation of ownership from regulatory functions that ensure equal conditions even between SOEs and POEs.

If one is to consider state assets as public wealth, there should be appropriate measures aimed at achieving maximum transparency and accountability in all aspects of the state assets management process, starting from privatization and ending to dividends. This kind of system should allow regular public access to the necessary information mentioned in the foregoing through an Internet portal, mass media, periodicals, and through accountability in terms of parliamentary control. Hopefully such kind of measures not only provides systemic details on the management of state assets but also allows for the public to consistently scrutinize and oversee their management, officials and state asset managers to be more accountable, and for there to be greater investor confidence in the whole system.

Summary

This chapter has sought to outline the role of SOEs in the economy of CIS countries, to outline the theoretical basis of state participation in economics, and to address some urgent issues connected with SOE activity in Uzbekistan. Among the findings of this thesis is that despite extensive privatization reforms implemented since the 1990s, SOEs are still having a significant role in the economy of Uzbekistan and the other CIS countries examined in this thesis. In most cases, SOEs enjoy privileges and immunities that are not based on their better performance, but due to the fact that they belong to the state or state-related officials. Such kind of exclusive privileges and immunities ultimately distorts market conditions by weakening competition, and by leading to SOEs abusing their dominant position in the market. A further finding is that one of the core causes of SOE inefficiency is their double-aimed (business and political) feature that should be addressed in subsequent reforms. A crucial conclusion of the research behind this thesis is the recognition that securities market development reforms can provide practical solutions for SOE reforms in CIS countries. Securities market development can assist privatization process with offering more public assets to private owners (through various IPOs and SPOs), which may also lead to increases in the transparency and accountability of SOEs, through, for instance, mandatory information disclosure and effective corporate governance systems).

CHAPTER 6. IMPLICATIONS FOR FURTHER SECURITIES MARKET DEVELOPMENT IN CIS COUNTRIES

6.1. Main findings and conclusions

The securities market in the CIS countries examined in this thesis, despite the apparent progress in some of its areas – such as the formation of collective investment institutions, the development of infrastructure, and the improvement of the regulatory framework – remains one of the least developed sectors of the financial system. A distinctive feature of the securities market in CIS countries, as well as other emerging economies, are high levels of concentration: for instance, about 85% of the capitalization of the securities market is provided by the ten largest companies mainly representing state-owned banks and industrial giants. In general, less than 30 percent of existing JSCs are included in the official list of Stock Exchanges. As a result, the liquidity of the securities market (the ratio of trade turnover to capitalization) is at a low level. Furthermore, the capitalization of the securities market amounts to 0.1% of the global capitalization of the securities market. Another significant reason for the low liquidity of securities markets is the lack of high-quality financial instruments and, accordingly, the lack of investor interest in attracting investments through the securities market.

Also, the securities market of CIS countries today is not efficient enough given that it cannot ensure fair pricing, free market access for investors, and the protection of their interests. The majority of JSCs created during privatization have not developed a consistent dividend policy; many issuers either do not pay at all, or pay meager dividends, so the shares lose their attractiveness for ordinary investors and are purchased based on the growth of their market value, and not to receive dividends. Therefore, small stock transactions have more of a speculative than an investment character. For some JSCs, it is tough to establish the ownership structure of a company. The cross-ownership of shares of various companies leads to the fact that it is impossible to determine who is the real owner. This causes serious caution for potential investors and leads to limited demand for stocks.

Currently, the primary source of business financing is bank loans that are usually given at state-subsidized rates. Banks also involve money from the securities market through issuing securities, and investors provide them with money because they are reliable borrowers. This seriously affects competition in business financing. The competition of banks and the securities market is that banks earn on credit, and it is not profitable for them when companies prefer securities market financing to bank credit.

Moreover, in order for companies and individual investors to buy securities, they withdraw money from bank deposits, which is also unprofitable for banks. The interaction of these sectors is that banks go out with their securities into the market and sell them. The money that banks make from such transactions is often used towards loans with interest rates. This means that instead of directly involving money from the securities market, companies end up obtaining funds from banks at a greater expense. On the other hand, state subsidies and cheap credit lines under various state programs further weaken competition in business financing. The relatively underdeveloped level of securities market infrastructure, low public awareness about the opportunities of this market, and the lack of a competitive and encouraging legal framework further weakens the already limited ability of companies to access necessary funds from the securities market.

6.2. Suitable measures for further SMD in CIS countries

Further securities market development reforms in the CIS countries examined in this thesis are necessary for the improvement of business financing and for enhancing investment opportunities of national, regional, and global companies and investors. The subsequent increase of competitive conditions in business financing should entail an improvement in the quality and expansion of the range of financial services provided by securities market institutions. Appropriate measures should be taken to create competitive financial services and to achieve an efficient securities market in CIS countries. In the author's opinion, the necessary reforms in this sense should aim at increasing the capacity of securities markets of CIS countries', raising public awareness of investment and financing opportunities of the securities market, and at improving public confidence.

The analysis of the research involved in this thesis suggests that a key issue in the securities market of CIS countries concerns the so-called supply-side problem, which relates to the lack of subjects and objects mainly caused by regulatory, rather than economic, factors. In this sense, it is necessary to introduce in CIS countries proper regulatory mechanisms of enhancing the range of investors. The core goal of this measure is to create tools that allow attracting and investing financial resources using opportunities of securities market infrastructure for not only large enterprises but also SMEs. In the three countries examined herein, particularly in Uzbekistan, it is only JSCs that may issue securities and attract financial resources from the securities market. However, JSCs only comprise less than 1% of all existing companies in Uzbekistan, most of which are set up as

LLCs. In such conditions, it seems advisable to design reforms that would allow full access to LLCs and other companies to issue securities, to invest in securities, and to be listed in the stock exchanges. In other words, CIS countries should eliminate securities market entry conditions that are based on criteria concerning a company's legal-organizational form and capital. Instead, the central principle for access to the securities market should be a company's credibility, transparency, and effectiveness. This task may be achieved in different ways, depending on the specific features of, and prevailing conditions in, the country in question. There are plenty of examples from across the globe that allow such companies to participate in the securities market. For instance, by the end of 2016, there were over 7,000 companies listed on the SME platforms across over 40 countries.[426] In the case of CIS countries, the creation of special trading platforms for SMEs, LLCs, and other 'new subjects' would be a good incentive for the increase of securities market capacity.

However, simply enhancing the range of subjects in the securities market cannot sufficiently solve the issues surrounding securities market capacity in CIS countries. Significant improvements should be pursued in expanding the range of financial instruments circulating in the securities market, and in balancing its regulatory framework with the legal and regulatory framework of bank instruments. Global practice has already also presented clear examples for this initiative. Notably, projects related to the promotion of sustainability in energy efficiency, renewable energy, water sustainability, agriculture and forestry, waste and pollution, and low-carbon transport could all be excellent examples for boosting the securities market of CIS countries.[427] In this sense, the creation of individual financial instruments that feature sustainability and cultural factors would be another excellent example in the case of CIS countries. In this regard, the implementation of unique financial tools in transport, energy, housing, and social infrastructure using the model of green bonds, Islamic bonds, and social business practices could be useful for CIS countries.

Another set of measures that equally assist the development of both subjects and objects of the securities market relate to creating opportunities for broad range securitization of state assets. The analysis in the present thesis suggests that in all three

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[426] For further details, see: UNCTAD, World Federation of Exchanges, "The Role of Stock Exchanges in Fostering Economic Growth and Sustainable Development", 2017, 12. https://unctad.org/en/PublicationsLibrary/WFE_UNCTAD_2017_en.pdf

[427] For instance, currently there are 11 stock exchanges globally that have been trading in so-called green bonds since 2007. By the end of 2016, the value of the green bond market had exceeded USD 180 billion. For further details, see: UNCTAD, World Federation of Exchanges, "The Role of Stock Exchanges in Fostering Economic Growth and Sustainable Development", 2017,17. https://unctad.org/en/PublicationsLibrary/WFE_UNCTAD_2017_en.pdf

countries studied herein the state has a significant share in the economy, which is directly reflected in the securities market where there is a relatively high level of ownership concentration. The research behind this thesis also indicates a current tendency in CIS countries of an increase of the share and presence of SOEs, and that reforms that were mostly devoted to improving SOE efficiency have not been enough for fostering real competitive conditions in the market. A wide range of securitization of state assets helps to diversify ownership, reduce the dominant position of SOEs, and strengthen the competitive environment in the market.

Public awareness and confidence are further crucial issues that require comprehensive and immediate action. Such actions should also aim at lifting another serious barrier towards securities market development in CIS countries. Despite the existence of securities market institutions for almost three decades, the populations of the countries examined remain reluctant to use whatever opportunities the securities market presents. That is partly caused by low levels of public awareness and public confidence, and by the cultural features of some countries. Consequently, the savings of the general public usually go to investment in foreign currency or to short-term deposits of banks. To raise public awareness about the opportunities and risks of investing in the financial market, the following measures are proposed: the identification of the target audience in order to carry out activities aimed at attracting people to the securities market, as well as developing guidelines for carrying out operations for each of the target groups; the identification of the reasons for the lack of public confidence in financial market instruments, and the preparation and implementation of measures aimed at informing the general public about its rights and about opportunities in the securities markets for investing personal savings.

The implementation of these proposals should lead to a change in the investment behavior of the general public, and to attracting the savings of the general public to the financial market.

6.3. Design of the reforms in the example of Uzbekistan

In this part of the thesis, more detailed measures are proposed on securities market development in the case of Uzbekistan. In the last two years Uzbekistan is witnessing extensive reforms in every area, including market development. The Strategy of Actions on Five Priority Directions of Development of the Republic of Uzbekistan determines the main guidelines of these reforms in 2017-2021 (hereinafter, ‘the

Strategy').[428] In this part, the third direction of the Strategy – namely, concerning the Development and Liberalization of the Economy – is being examined.

At clause 3.1, titled 'Strengthening Macroeconomic Stability and Maintaining High Economic Growth' the task is to work out the Concept for medium- and long-term development of the financial market of Uzbekistan, aimed at attracting capital and developing the financial market as an alternative source of funding for enterprises, financial institutions and the population (cf., paragraph 9). Despite the fact that the deadline for the development of the Concept was the third quarter of 2017, no information has yet been published about the fulfillment of this task. At the very least, by November 5, 2018, no information has been found concerning the fulfillment of the aforementioned task neither at the websites of the institutions responsible, including the Ministry of Finance,[429] Central Bank,[430] Ministry of Economy,[431] State Committee of Competition,[432] and the Institute of Forecasting and Macroeconomic Research,[433] nor at the website of the Strategy.[434]

The only document found is related to a part of the financial market[435] – namely, to the securities market. It is the 'Concept of the Development of the Secondary Securities market in 2017-2018 in Uzbekistan (hereinafter 'the Concept')[436]developed by the Center for Research on Privatization, Development Problems Corporate Governance, and the Securities Market under the State Committee of the Republic of Uzbekistan to promote privatization and competition (hereinafter, 'the Research Center').[437]

6.3.1. Opinion on the Concept of development secondary securities market in 2017-2018 in Uzbekistan

The Concept is one of the essential documents that provide official background information[438] about the progress chronology, development obstacles, current situation, and the perspectives of improvement of the secondary securities market in Uzbekistan.

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[428] For further details, see: www.strategy.gov.uz
[429] For further details, see: www.mf.uz
[430] For further details, see: www.cbu.uz
[431] For further details, see: www.mineconomy.uz
[432] For further details, see: www.gki.uz
[433] For further details, see: www.ifmr.uz
[434] For further details, see: www.strategy.gov.uz
[435] No notice appears in the text of the Research Center's Concept about the relation of it to the Strategy.
[436] Resolution of the Board of the State Committee on Competition of the Republic of Uzbekistan No. 06-36-KR of March 6, 2017.
[437] For the text of the Research Center's Concept (in Russian), see: https://research-center.uz/info/concept/
[438] In the case of Uzbekistan, despite several liberalization reforms, it is still difficult to get reliable, on time, and full information about the securities market and its participants' activities.

Recognizing all useful features of the Concept both in a theoretical and practical sense, this author expresses his opinion on conceptual issues for its further improvement.

The first remark concerns the compatibility of the content and timeframe of the Concept. According to the title, the Concept is focused on the development of the secondary securities market in 2017-2018. The fact that the adoption of the Concept had meant to be at the end of the first quarter of 2017, the chiefly descriptive and informative content,[439]and the fact the Concept relates to far-reaching measures[440]in the last part of its content, all point towards the low feasibility level of the Concept.

There are numerous key proposals and recommendations in the adopted Concept on the development secondary securities market in 2017-2018 in Uzbekistan. More particularly, there are measures aimed at the improvement of transparency in securities market relations, the institutional development of the market, the necessity of a unified taxation policy for market intermediaries, usage of a 'golden share'[441] opportunities aimed at boosting secondary market, the development of a dividend payment system, and so on.

On the other hand, some ideas conceptually need to be reconsidered and revised. For instance, in the Concept, the development of speculative deals is proposed as a state policy on the development of the secondary securities market in Uzbekistan (cf., p.16). This author recognizes that risky deals are a core feature in any securities market, and it provides the first impulse on increasing market activity. However, the analysis of the most

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[439] Three-fourths of the Concept's content is devoted to background issues.

[440] These measures comprise the following: state policy on secondary market development; formation of resource base of secondary market; working out special programs on the development of secondary securities market; legal bases of the development of secondary securities market; price formation in the secondary securities market; tax policy in the sphere of secondary securities market; improvement of disclosure information system of issuers; increasing liquidity level of securities; improvement of clearing operations in the secondary securities market; improvement of corporate actions, including payment dividends; development of organized and non organized OTC market; usage of 'golden share' opportunities; development of IPO projects, Company choice for IPO; and the development of infrastructural institutions of the secondary securities market.

[441] According to the Uzbekistan legislation the "golden share" presents being a special right of the state's participation in management of certain companies which is applied on basis of a decision by the Cabinet of Ministers of the Republic of Uzbekistan at privatization of the SOEs or sales into private ownership of the state-owned packages of shares of the companies possessing strategic significance, and provides protection of economic interests of the country. The "golden share" does not possess any cost, is not subject to alienation and transfer into a pledge, is not taken into account at definition of a size of the Charter Capital of a Company and at the dividends' accounting. The "golden share" may be applied at companies where the state-owned share is absent or does not exceed twenty five percent of the Charter Fund (Charter Capital) of a Company. The Cabinet of Ministers of the Republic of Uzbekistan establishes the order of use of the "golden share" by the state. See: Article 22, Law of the Uzbekistan "On the Joint-Stock Companies and Protection of the Shareholders' Rights" N 223-I DATED OF 26.04.1996.

recent financial-economic crisis[442] and of the Russian experience concerning securities market development[443] shows that relying on speculative deals in the development of the securities market is not a desirable alternative, especially for transition countries such as Uzbekistan. Here the author's focus is mostly on artificially promoted speculation. The author completely agrees that the speculation based on natural economic conditions and collective desires of market participants will not give the illusion of market development indicators, instead, it would provide an opportunity to market participants to easily trade in their stock.

6.3.2. Securities market development concept in Uzbekistan

It would be perhaps unfair on the part of this author to criticize the efforts of the Research Center without providing some suggestions and sharing his own ideas. Taking into account contextual and formal limits, here follows only a brief overview of the securities market development Concept (hereinafter 'the SMD Concept') in Uzbekistan.

The SMD Concept aims at increasing long-term investments through the modernization and development of the securities market, at improving the attractiveness of the securities trading platform for domestic and foreign investors and issuers, and the professional participants of the securities market, and at increasing the potential of the securities market as an alternative institution for business financing.

This author expects to fulfill the SMD Concept in three steps. The first step, the so-called 'standing up' stage, includes the institutional and legal development of the national securities market, implementing international standards, and at least reaching the level of regional peers (Kazakhstan and Russia). The second step, the so-called 'strengthening ties' stage, focuses on the development of the securities market at the regional level, and developing the structural and legal bases of mutual possession of stocks between partner companies in export-import operations[444] as well as building the necessary infrastructure

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[442] For further details, see: The Financial Crisis Inquiry Report, Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, Official Government Edition the Financial Crisis Inquiry Commission, Submitted by Pursuant to Public Law 111-21, January 2011, https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf

[443] The unique privatization experience of Russia held through the securities market caused the development of a speculative model of the market between 1995 and 2008, that is to be shifted towards a stabilized and more balanced model. See: Mirkin Yakov, "Strategy of Capital Market Development – 2020", *Journal of Economic Strategies*, 2011, Vol.11, 16-23.

[444] This method was widely used by Japanese companies in the 1970s and had helped the growth of their cooperation, and, consequently, the development of the country's economy.

for a regional financial hub in Tashkent.[445] And the third step, the so-called 'realization of full membership opportunities' stage, chiefly includes measures on promoting national companies to the listing of the world's leading securities markets, including in the listing of the Tashkent Stock Exchange foreign companies' stocks, and participation in the standard setting, evaluation, and dispute resolution activity of international organizations in the sphere of securities market regulation.

Some main measures of the Concept comprise the following:

I. Actions on improving the supply side (instruments and issuers) of the securities market

1. Increasing volume of traded financial instruments
   - Promoting IPOs by JSCs, especially JSCs with state shares;[446]
   - Launching Islamic bonds – *Sukuk* based on the experience of Kazakhstan;
   - Introducing a particular type of securities for LLCs and medium businesses; and
   - Providing to financial instruments at least equal legal privileges, incentives, and status with the bank credits and deposits.
2. Increasing quantity and quality of issuers
   - Enhancing the scope of companies that have the right to issue securities;
   - Establishing a unique platform for trade with the stocks of LLCs and medium businesses;
   - Improving issuers' disclosure information system, making it more transparent and accessible to investors;
   - Launching alternative ways of realization shareholders' managerial rights: remote voting and e-voting mechanisms;
   - Simplifying and making more transparent dividend payment system of issuers; and
   - Developing activity of reliable auditor companies, including international ones.

II. Measures on increasing investment potential of the securities market

[445] Currently, Kazakhstan and Russia also announced to build similar financial centers respectively in Astana and Moscow. For further details, see: Decree of the President of Kazakhstan on the establishment of the International Financial Center 'Astana', May 19, 2015, No. 24; http://mfc-moscow.com/index.php?id=41
[446] In this regard, the present author supports the recommendation about the usage of the 'golden share' opportunity, proposed in the Research Center's Concept (cf., at p. 26).

- Simplifying the procedure of trading with securities through implementing technology of online trading (such as forex);
- Improving transparency of issuer companies, and information about paid dividends;
- Easing the repatriation system of foreign funds invested in securities;
- Taking measures on reducing transaction fees with securities;
- Stimulating local companies and individuals on investing through securities; and
- Providing to portfolio investments at least equal legal privileges, incentives, and status with other types of investments.

III. Measures on assisting the further development of the securities market

1. Development of market intermediaries (brokers, dealers, investment funds, market makers, rating agencies and others)
   - Increasing quantity of market intermediaries through providing tax incentives and other privileges to the business activity in the securities market;
   - Easing access of foreign market intermediaries in the Uzbekistan securities market; and
   - Supporting the creation of Uzbekistan securities market participants' association and providing them with self-regulatory powers.
3. Improving public awareness and information supply
   - Creation of mass media (TV, radio, newspaper, website, etc.) specialized in the securities market news and information;
   - Promoting the establishment of rating agencies, including international ones, providing a reliable analysis of issuer companies' activity to a wide range of investors;
   - Developing particular software applications for smartphones and tablets for easing access to securities market information and trading;
   - Promoting individual courses and master classes on increasing public awareness about investing in the securities market; and
   - Supporting the establishment of private educational institutions, including the foreign ones that specialized in business administration, project management, investment strategies.

Due to the thematic and format limits on the present thesis, it has not been possible to discuss all of above listed measures in any depth within the scope of this research. They have been included in the securities market development Concept in order to avoid presenting a one-sided proposal, and to show the complexity involved in designing reforms for SMD in relation to CIS countries. It is hoped that the issues that could not be analyzed in greater depth in this thesis, yet mentioned in the SMD Concept, would be the subject of future research and studies.

Summary

In this part of the research, the author has attempted to outline some possible reforms towards SMD in CIS countries. More particularly, the measures proposed include specific measures on enhancing companies who have the right to invest in, and access funding from, the securities market, initiatives towards the diversification of the types of securities, and reforms on raising public awareness and public confidence. The proposals contained in the present thesis concerning the improvement of SMD in the case of Uzbekistan may also prove useful for other CIS countries.

CONCLUSION

In this research, it has been attempted to explore SMD issues in selected CIS countries from the perspective of ensuring alternative options to maintain a competitive environment. These alternative options cover both theoretical and practical problems of SMD. Notably, the findings of this research suggest that theory has a significant impact on securities market regulation, the current theoretical underpinning of regulation that focuses mostly on self-interest, wealth maximization, and microeconomic consideration does not adequately reflect the features of the market and of human agency/actors, and there should be substantive research and consideration towards supplementing business (including securities business) with alternative aims, market participants with alternative values, and securities market regulation with a balanced approach. Therefore, modern securities market relations need to be underpinned by a principled theoretical framework capable of activating and developing the moral values of market participants, at least up to the level that will provide some counter-balance concerning their advanced material interests. It is hoped that this issue will be a promising field of future research.

As for the practical issues, this research considers improving the role of the securities market as an alternative financial services institution. More specifically, increasing the role of the securities market in business financing and fund accumulation, where banks remain dominant, would provide a competitive alternative financing source for companies. Moreover, implementing sustainable, social, and cultural based securities, such as green bonds, infrastructure bonds, Islamic bonds and so on, will enhance the financing options, as well as increase the competitiveness of financial instruments.

This research also found an imbalance in the ownership structure of the securities market and economy as a whole, where public ownership has significant volume and influence. It is proposed that the private sector be enhanced and stimulated in order to foster and maintain competitive conditions in the financial market.

And, lastly, this thesis argues in favor of balancing the material interests and moral values of market participants, which is crucial, both, for ensuring fair competition and for the development of the whole economy. Market participants are the driving force of any community, and the quality of relations mostly depends on the behavior of these participants. Unfortunately, in recent decades there are very few initiatives on the equal promotion of moral values among market participants. Instead, almost all measures focus on the artificial upsurge of material values, which often results in greediness, and has provided humanity with at least three big financial crises within a century. Due to limits to this research limits it has not been possible to comprehensively study this issue further – it is hoped that future initiatives will explore these issues further.

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