DISTINCTIVE FEATURES OF THE BANKING SYSTEM OF UZBEKISTAN AND ITS DIFFERENCES FROM MARKET-BASED BANKING MODELS

Azizbek Ilkhomzoda

Tashkent International University

azikilhom@gmail.com

ABSTRACT

This thesis analyzes the distinctive institutional and structural features of the banking system of Uzbekistan. It focuses on the historically large role of state-owned commercial banks, development-oriented and directed lending, the gradual expansion of private banking, the importance of bank finance relative to capital markets, and rapid digital transformation. The thesis compares these characteristics with more market-based banking systems and evaluates the main reform priorities, including privatization, corporate governance, risk-based supervision, competition, financial inclusion, and cybersecurity.

Keywords: Uzbekistan, banking system, state-owned banks, privatization, directed lending, digital banking, financial reform

A banking system performs several essential functions: it mobilizes savings, allocates credit, processes payments, manages risks, and supports investment. The structure of banking differs across countries because it reflects history, legal institutions, ownership patterns, monetary arrangements, and the level of capital-market development. Uzbekistan's banking system has features typical of a transition economy in which state-led development institutions coexist with increasingly market-oriented private banks.

Since the start of broad economic reforms in 2017, Uzbekistan has taken steps to liberalize markets, strengthen regulation, attract foreign investment, modernize

payment infrastructure, and reduce direct state involvement in commercial activity. Banking reform is central to this transition because banks remain the main external source of finance for many firms and households.

The purpose of this thesis is to identify the main differences between Uzbekistan's banking system and more mature market-based systems, assess the advantages and risks of the current model, and outline priorities for further reform.

The most distinctive feature of Uzbekistan's banking system has been the prominent role of state-owned commercial banks. These institutions have financed strategic sectors, state-owned enterprises, infrastructure, agriculture, housing, and government development programs. This model can mobilize resources rapidly for national priorities, especially where private capital markets are underdeveloped.

However, state ownership can create conflicts between commercial objectives and public-policy mandates. A bank may be expected to maximize profitability, preserve financial stability, support employment, and lend to preferred sectors simultaneously. If non-commercial lending is not transparently compensated from the budget, losses may remain on bank balance sheets and weaken credit discipline.

The International Monetary Fund's 2025 Financial Sector Assessment Program reported that Uzbekistan's strategy aims to increase the role of private banks and improve the operations of the remaining state-owned commercial banks. It also noted that several state-owned banks had already been privatized and others were in the process of privatization (International Monetary Fund, 2025a).

A second difference is the historical importance of directed and preferential credit. In a fully market-based system, banks generally allocate loans according to expected return, borrower creditworthiness, collateral, and risk-adjusted capital requirements. In Uzbekistan, lending programs have also served industrial, agricultural, regional, housing, and social policy objectives.

Directed lending can address market failures and finance projects with broad social benefits. Yet it can also distort competition if some borrowers receive credit below market rates or without adequate risk assessment. It may crowd out independent private firms and encourage repeated refinancing of weak borrowers. For this reason, policy lending should be clearly separated from ordinary commercial banking and its fiscal cost should be disclosed.

Uzbekistan's financial system is strongly bank-based. Companies generally rely more on bank loans and retained earnings than on corporate bonds, listed shares, venture capital, or other market instruments. In advanced financial systems, firms can choose among a wider range of financing sources. This diversification reduces dependence on banks and allows risk to be distributed among investors.

A bank-centered system is not inherently inefficient, but it makes the quality of banking supervision and credit allocation particularly important. When banks dominate finance, weaknesses in underwriting or governance can have economy-wide consequences. The development of local bond and equity markets would give larger firms alternatives and allow banks to focus more effectively on households and small and medium-sized enterprises.

The expansion of private banks and foreign participation is gradually changing the competitive environment. Private institutions tend to focus more strongly on customer experience, speed, retail products, and digital services. Competition can lower transaction costs, improve deposit products, and encourage banks to develop more accurate credit-scoring technologies.

Privatization alone is not sufficient. It must be accompanied by transparent ownership, strong corporate governance, fit-and-proper requirements for managers and shareholders, and effective prudential supervision. Otherwise, state influence may simply be replaced by concentrated private influence or related-party lending.

The Central Bank of Uzbekistan has been developing risk-based supervision and modern financial-stability tools. Its 2025 annual and financial-stability reporting describes continued reforms aimed at safeguarding banking-system stability and strengthening regulation (Central Bank of the Republic of Uzbekistan, 2026a, 2026b).

A major area of rapid progress is digital finance. Mobile banking, remote account opening, instant transfers, electronic commerce, QR payments, and app-based lending have increased convenience and reduced the need for physical branches. Digital-first banks can serve customers at lower marginal cost and may expand access for young people, migrants, microenterprises, and residents outside major cities.

Digitalization also creates new risks. Cyberattacks, identity theft, misuse of personal data, operational outages, and aggressive automated lending can damage trust. Regulation must therefore combine innovation with cybersecurity standards, data protection, transparent pricing, complaint mechanisms, and responsible-lending rules.

Small firms often struggle to obtain bank credit because they have limited collateral, incomplete financial statements, irregular cash flow, or short credit histories. This problem exists internationally but is especially important where alternative financing channels are limited. Research on Uzbekistan has highlighted the need for diversified formal financing and improved SME credit infrastructure (Tadjibaeva, 2019).

Possible reforms include movable-asset registries, partial credit guarantees, cash-flow-based lending, open-banking data, digital invoices, and credit information that captures utility, tax, and transaction histories. These tools can reduce information asymmetry without requiring banks to abandon prudent risk management.

Compared with mature market-based banking systems, Uzbekistan is characterized by a larger state ownership footprint, a stronger role for policy-oriented lending, greater dependence on banks rather than securities markets, and a reform process that is still building supervisory and governance capacity. At the same time,

Uzbekistan may have an advantage in digital leapfrogging because new technologies can be introduced without replacing as much legacy infrastructure as in older banking systems.

The objective of reform should not be to copy one foreign model mechanically. An effective system must reflect domestic institutions and development needs. The key principles are transparent ownership, commercial accountability, equal competition, sound risk management, protection of depositors and consumers, and clear separation between fiscal policy and bank balance sheets.

First, the privatization of selected state-owned banks should continue through transparent and competitive procedures. Second, banks that remain state-owned should have clearly defined mandates, professional boards, and publicly reported costs of non-commercial activities. Third, risk-based supervision and stress testing should be strengthened in line with international standards.

Fourth, authorities should promote capital-market development so that larger enterprises can use bonds and equity, leaving more banking capacity for smaller firms. Fifth, financial inclusion policies should support digital access, financial literacy, and regional connectivity. Finally, cybersecurity and consumer-protection frameworks must develop at the same speed as digital banking.

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