Islam Karimov’s Currency Reform

Uzbekistan’s rules for buying and selling foreign currencies changed in early February. President Islam Karimov approved a proposal by the Central Bank of Uzbekistan with the decree “Measures on the Further Liberalization of the Procedure for Selling Foreign Currency to Individuals.” As a result, lending institutions can no longer sell citizens of Uzbekistan foreign currency in cash, but there are no restrictions concerning purchases of dollars and euros by banks.

Previously, there were two exchange rates for the general population: the official rate and the “black market” rate, and they were very different.

A brief history of the “Uzbek” dollar

The illegal foreign exchange rate appeared in Uzbekistan 20 years ago when first som coupons and then soms were introduced as the country’s currency. However, a strict policy to prevent inflation led to the emergence of a “market” rate for the dollar that was two and a half times higher than the official rate.

By the early 2000s, the IMF had asked Karimov to put his house in order and make the two foreign currency exchange rates that existed in the country equal. The Uzbek government promised to convert the national currency for current account transactions by 2002, and the parties signed a Memorandum of Economic and Financial Policies. The official rate for the dollar and the actual rate in Uzbekistan gradually began coming together. Operating account convertibility was introduced in 2003; residents became able to buy or sell currencies in currency exchange offices; and the som-to-dollar exchange rates on the black market and in commercial banks were becoming equal. That did not last long, however, and the difference between the black market exchange rate and the official rate started increasing again in 2008, reaching 55% by the beginning of 2012. The situation had both advantages and disadvantages.

First of all, there were government agencies that were allowed to buy dollars at a discounted rate and then sell them to authorized individuals on the black market at a good markup. Second, state-owned companies could buy currency cheap for business purposes, and that benefited the state.

Tourists also benefited. They exchanged dollars at the black market rate in bazaars and paid for meals and hotel rooms with soms, that is, with the local currency, which was pegged to the official rate.

However, not everyone benefits from the existence of two exchange rates. That is especially true for foreign companies that sell their products in Uzbekistan. They have to wait for months to receive payment because the convertible sums are determined by the country’s Central Bank.

Currency exchange in Uzbekistan is complicated

Every bank in Uzbekistan has a currency exchange counter, and they are happy to buy US dollars at the Central Bank’s official rate, but they do not sell dollars to just anyone. Uzbek citizens are allowed to buy $2000 quarterly, and purchases are recorded in their passports. As a result, there is an extensive semi-criminal currency exchange system in operation throughout the Republic. For a small fee of five dollars, a foreign currency speculator would find a villager or a student to buy currency legally placed with them at the government rate. They would give it to
“money changers,” and they would sell the dollars in markets at the actual rate and keep a 20-30% profit.

In order to buy non-cash foreign currency now, a citizen must have an international VISA or MasterCard and prove to a bank that he is traveling abroad on business or holiday. Then, the bank must sell (exchange) no more than $2000 at the official exchange rate and place it on the international card.

To do this, a resident of the country needs to go to the foreign exchange office in an authorized bank, present identification documents, file an application for purchase of foreign currency and provide a card containing the amount of local currency to be converted.

The bank verifies the card and the amount of local currency on it, exchanges it for the foreign currency at the bank’s exchange rate and issues a document certifying completion of the currency transaction and the purchase of non-cash foreign currency.

In its decree, the Central Bank of Uzbekistan says it is doing this in order to “ensure that funds are safeguarded and can be securely accessed since they remain in a bank account and available to their owners even if the payment card is lost.” The Central Bank also says it is doing this in order to “strengthen the national currency” and comply with “international standards against legalization of illegally earned income.”

This procedure for exchanging foreign currency does not apply to foreigners, legal entities or currency transfers into Uzbekistan. When exchanging foreign currency at a bank, nonresidents of Uzbekistan must present a passport and customs declaration certifying that the foreign currency was brought into the country legally. To buy foreign currency in a foreign exchange office, a nonresident must present a passport and a document certifying that he had previously exchanged foreign currency at a foreign exchange office. (The customs regime governing the import and export of currency remains unchanged — an amount equivalent to $2000.)

The decree prohibits payments using foreign currency in retail outlets and bazaars. Foreigners and citizens who violate the decree will be subject to criminal prosecution and receive sentences of up to three years imprisonment for the illegal purchase or sale of currency in Uzbekistan (Article 177 of the Uzbek Criminal Code).

The market’s nervous reaction

The black market exchange rate for the dollar in Uzbekistan rose dramatically after the news broke that cash trading was being eliminated. One dollar bought 2900 soms (by comparison, the official rate is 2022 soms per US dollar).

Then the exchange rate for converting dollars into the local currency plummeted — after mass arrests of “currency exchangers” it became difficult to buy or sell foreign currency with black market brokers. At the same time, it became clear that under the new rules people who converted non-cash local currency to dollars and traveled to neighboring republics in order to cash out their cards for foreign currency could no longer do so.

In fact, Uzbek citizens can spend non-cash dollars in other countries only “to pay for goods and services received in any currency accepted in that country.” However, the government of Uzbekistan has limited the online payment system using international cards in order to prevent currency from being brought into the Republic’s black market. Uzbek banks have now limited foreign currency transactions outside the country using cards to $100 per day regardless of whether the transactions are for making purchases in stores or for withdrawing cash from ATMs. And Uzbek banks charge a 3% fee for payments made by card at foreign points of sale in addition to fees imposed by foreign banks.

Because the authorities closed the black market without offering an alternative, it is again gaining momentum after a lull. The dollar exchange rate has risen again: it is now at 2730 soms.

And citizens have no alternative. For example, they are forbidden to sell their own property for dollars, and the state only allows them to put $2000 on a card per quarter. That means the owner of a $30,000 apartment must wait almost 4 years to cash out that sum. Moreover, since only $100 can be withdrawn from a card per day, he would need at least a year to withdraw that money outside the country. Under such conditions, the shadow currency market clearly is not going away.

Why not synchronize the black market rate and the actual rate and put an end to the double standard?

There are several reasons. An abrupt devaluation of the som would devalue the local currency bank deposits of citizens and damage foreign trade and the competitiveness of Uzbek goods. Perhaps most importantly, however, it would have a negative impact on the image of President Islam Karimov, who would have to acknowledge the actual
inflation rate in the country and the poor state of its economy, and that would be unacceptable for the Republic’s authoritarian leader.

There is another question: Why has Karimov banned cash dollars?

Experts believe that the main reason foreign currency has been banned from circulating in cash is that it is scarce. The shortage of foreign currency was caused by the worsening of foreign economic conditions and a drop in cotton prices on the world market. In addition, expectations for the amount of natural gas that would be produced in the country were not met.

These factors probably prompted Karimov to impose strict administrative measures to prevent the free circulation of foreign currency in Uzbekistan.

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