

TAXATION SYSTEM OF UZBEKISTAN: INFLUENCE OF TAX REFORMS ON SMALL ENTERPRISES

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ABSTRACT

The problems of SME development and high tax rates have always been one of the most important social problems in any state. In recent years the taxation issue has gained a very big importance from the government policymakers. Politicians suggest further decrease of tax rates for small and medium enterprises and also improvement of single tax policy.

This paper is dedicated to the analysis of influence of tax reforms on small enterprises in Uzbekistan.. Particularly it analysis how single tax effects the development and functioning of the SMEs. The base hypothesis used in this research paper is Laffer' hypothesis, which states that decrease of tax rates will encourage the development of the enterprises and will raise more government revenues. This effect will be achieved through better business conditions, which ensures the financial sustainability of the business. Another point is the lower avoidance rate, where enterprises will not be more needed to hide their revenues and avoid taxes.

The research results showed that implementation of lower tax rates and single tax policy, positively effect the development of the SME sector. Despite the policies and actions taken by government authorities, there is still space for improvements.

JEL CLASSIFICATION & KEYWORDS

■ H25 ■ M89 ■ I01 ■ Tax System ■ Revenue ■ Government ■ Small Enterprises.

INTRODUCTION

The purpose of the analysis was to examine the whether single tax payment encourages the development of small enterprises in Uzbekistan. For better research results I had to review all known methods. For example time comparison method, is suitable for research where data will be analyzed over the time. The specific period of time is taken and method shows changed happened during that time. This method might be used if we had for example objective examining tax changes since 1991 till 2008. The result will show effects taken within given period of time.

The aims of the article were:

Identification of the historical trend of tax reforms for small enterprises of Uzbekistan; to learn the evolution of tax reforms in foreign countries for small and medium sized enterprises; to investigate single tax versus multi tax payments systems in Uzbekistan; Identification of tax reforms' effect for small enterprise development in Uzbekistan.

The research hypothesis was: Does single tax payment encourage the development of small enterprises in Uzbekistan?

Main Text

In many respects success of the country's development depends on the rightness of the chosen strategy. One of the successful ways of achieving fast and prosperous development is supporting and encouraging the SME sector

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which plays crucial role in the economy of any government. According to the world experience, the SME sector provides significant government revenues, employment opportunities and enhances the expansion of the state's economic power in most states of the world. Therefore, development of this sector is one of the most significant objectives for any government. Uzbekistan's government has been paying special attention to the development of SME sector since its independence. The government of Uzbekistan implements actions and measures for supporting and improvement of the business environment for enterprises. There are different issues which create barriers for the establishment and the performance of the SMEs. One of the most significant areas which have direct impact on any business is the taxation.

Tax system is one of the key tools for sustainability and development of any government. The primary function of a tax system is to raise revenue for the government for its public expenditure. By means of manipulating tax rates and other fiscal instruments, a government stimulates or structure suppresses business activity, creates necessary conditions to increase competitiveness of national enterprises, sets protectionist policies or provides freedom to the commodity market.

There is always debating question about tax system: what kind of tax system is better, should be there multiple type of taxes or single tax policy should be applied. Should the country have high or low tax rates?

There have been many studies on the tax policies. One of the ways of evaluating tax efficiency is referring to seven 'Canons of Taxation' – which was developed by Adam Smith, and further devised by modern economists:

1. The cost of collection must be low relative to the yield
2. The timing and amount to be paid must be certain to the payer
3. The means and timing of payment must be convenient to the payer
4. Taxes should be levied according to ability to pay
5. A tax must not hinder efficiency or should involve the least loss of efficiency
6. A tax should be compatible with foreign tax systems (in Uzbekistan case with CIS states)
7. Tax should automatically adjust to changes in the rate of inflation (particularly important in high inflation economies)

The next tax theory worth mentioning is the theory of progressive, flat or regressive taxes. The progressive taxation of income proposes that the more people earn, the greater the proportion of tax rate they are levied. At regressive taxation, the more people earn the less tax represents as a proportion of their income. The tax neutral to the levels of taxable income is called the flat tax, where everybody the poor and the rich are levied at the same rate, regardless of income amount. Depending on the taxation system chosen at the given development stage of the country, state tax revenue may alter.

Another method of evaluating of tax burden of taxes was proposed by classical economist Professor Art Laffer, who has become quite well known through his 'Laffer curve'. He suggested that, as taxes increased from fairly low levels, tax revenue received by the government would also increase. However, as tax rates rose, there would come a point where people would not regard it as worth working so hard. This lack of incentives would lead to a fall in income and therefore a fall in tax revenue. The logical end-point is with tax rates at 100% where no one would bother to work and so tax revenue would become zero. Laffer argues that the central objective of the government is to determine an optimal tax rate T that is beneficial for the efficiency of work and state tax collections. In other words, the Laffer hypothesis proposes that government can achieve high tax revenues with lower tax rates. According to this hypothesis, the decrease of tax rates will stimulate the business environment through minimization of tax burden for enterprises. In the environment of tough competition, especially in the developing countries, the decrease of tax rates provides stimulus and support for operations, investment and innovations. These factors could be achieved due to the following features:

- The decrease of tax rates encourages entrepreneurs not avoid taxes
- The business conditions creates favorable environment for establishment and improvement of new businesses
- Most enterprises leave the underground economy due to better business conditions

This fact support the Laffer's hypothesis which states that government can receive same levels of taxes with smaller tax rates, and at the same time decrease the tax burden for enterprises and encouraging them to leave the underground economy.

After the collapse of Soviet Union, newly established governments had to move from planned to market-oriented economy. This simultaneous movement challenged all economies, as its structure

and mechanisms had to be totally changed and within short time. One of the first objectives which should be properly established was the taxation system, as it is the primary source of the government budget. The efficient system proposed establishment of favorite business conditions while tight policy would negatively affect the businesses. Since independence in 1991, Uzbekistan has pursued a gradual approach to the transition from a planned to a market economy.

The special attention in major tax reforms that have taken place in Uzbekistan were given to the simplified method of taxation used for micro-firms and small businesses. The government aims at building a socially oriented market economy, and developing industrial and manufacturing capacity in a predominantly agricultural economy using substantial and direct central control (Gemayel, E. & Grigorian, D. (2005).

At present time the tax system of Uzbekistan is developing in line with the country's course of reforms and elements of a modern tax system, administrative and institutional capacity evolved in successive steps. This tax reform was compromised to preserve government revenues in the early years of independence. The essential provisions of Uzbekistan's current tax system were laid down as part of a major set of tax reforms introduced during the 90s. These reforms prevented major fiscal crises and allowed to sustain essential public expenditures during the past decade. Early tax reforms were mainly directed towards the fiscal role of

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taxation and underestimated regulatory, social and stimulating roles of taxation.

More recent reforms in taxation were directed towards the reduction of the tax burden, optimizing the structure and rates of taxes, simplification and unification of tax system, as well as increasing the stimulatory and regulatory functions of tax policy. During the period of 2000 – 2007, the tax burden in the economy reduced from 40% to 27%.

W. Huebner, in his research for the UNIDO, says that "SME sector is important for politicians and governments because it can replace the government in the difficult task of job creation, which is one of the most sensitive issues during the transition period, when thousands of people lose their jobs" (Huebner, 2000).

Data for Uzbekistan confirm the reality of these assumptions and show that SMEs accounted for about 66% of total employment in Uzbekistan at the end of 2005 (from 56% in 2003) and 85% of newly created working places. "Small businesses and individual entrepreneurship became the prime source in providing employment and improving living standards in our country" said Karimov in his January speech (Karimov, 2010). Moreover, unlike in many countries of the former Soviet Union, SMEs in Uzbekistan play the same social role as they do in Europe and other OECD member-countries. The movement to single tax payment system influenced primarily wholesale/retail sale and catering enterprises, which were subject to tax on their gross profit, with monthly reporting obligations to tax agencies. Even under new tax system some enterprises are subject to additional payments to local budgets above the single tax payment. These payments are usually in the form of trade duties for selling alcohol, tobacco products, items made of precious metal and stones. Enterprises also have to pay excise tax, custom duties and VAT if they import materials or supplies. The biggest advantage from single tax payment system receives service enterprises that usually pay only single tax.

The SME sector provides significant government revenues and employment in most states of the world. Therefore, development of this sector is one of the most significant for each government. For instance, the republic of Belarus tries to take necessary measures to stimulate small businesses and attract foreign investment. This is done through minimizing constraints for small businesses, allowing them to be easily able to obtain financial and technical resources (Belarus. 2005-2009)

Many world known organisations such as the UNDP, OECD, IFC and other universities have undertaken research in many countries to see how small enterprises are developing and how do they effect the economy.

The small businesses all over the world are increasing and developing at a faster rate. For example, in Hungary, the small firms increased by 175%, 109% and 30% from 1990-1993 (Shleifer, 2000). The research undertaken in Canada, showed that self-employment is also rising significantly especially among the population below the age 30 and above 55 (Tai, B., 2006.) In Russia however, the number of self employed people has decreased from 8500 to 6200 from the year 1994-1999 (Polishchuk, L.). The taxation policies towards small enterprises are very important, by using this tool, the governments of countries tries to develop and encourage the development of small businesses. The research undertaken in China by Yaobin (2007) has showed that tax policies are made easier for small enterprises in order to construct a fair tax competition environment, to encourage technology innovation, financing,

human capital training and to reduce the adverse effect of taxation on cross-border investment and trade (Yaobin, Sh., 2007). According to the research made by the OECD, there are different tax structures which a country may impose, they include: classical taxation of distributed profits or capita gain, increased cost of new equity finance or retained earnings (Clark, S., 2007).

Revenue authorities around the world are making great efforts to streamline administrative processes and modernize payment systems. In the past four years 126 reforms aiming at reducing tax rates or the time or cost to comply with tax laws have been recorded. The trend across all regions of the World has been to lower the total tax rate paid by businesses. In 2004 the average total tax rate was 50.6% of commercial profits and by 2007 it had fallen to 49.3%. About 50% of economies have implemented reforms making it easier to pay taxes in the past four years. Among regions, Eastern Europe and Central Asia has had the most reforms, followed by Africa. South Asia has had the fewest. Cutting Rates Reducing corporate income tax rates has been the most popular reform feature. More than 60 economies have done this. Countries can increase tax revenue by lowering rates and persuading more businesses to comply with the more favorable rules. Look at the Russian Federation's large tax cuts in 2001. Corporate tax rates fell from 25% to 24%, and a simplified tax scheme lowered rates for small business. Yet tax revenue increased – by an annual average of 14% over the next three years. One study shows that the new revenue was due to greater compliance (Paying taxes 2009, the global picture).

According to the official definition, SME include individual entrepreneurs, micro-firms (up to 20 persons), small businesses (100), dekhan farms and private farms. But this tends to underestimate the real weight of this sector in the economy. For instance, in Europe (with much less labor-intensive production) organizations with less than 250 people could be classified as SME, in America the number is even higher (500) (RCSE, 2004 & IFC, 2005b), even Uzbekistan's neighbor, Kyrgyzstan, has the limit of 200 (Tokochev, 1999). Therefore, if the European definition was applied, SME share of the country's GDP could already equal to (or even exceed) the set objective. But even with this narrow definition, it is easy to see that this sector plays a significant role in Uzbekistan.

In many respects success of the country's development depends on the rightness of the chosen strategy. The government of Uzbekistan aims at increasing SME share of GDP up to 50% by 2010. Some organizations say that this is an ambitious project (IFC, 2005a), but this could be mistaken.

During the last 8 years, its GDP share rose from 31% to 50%. Besides, in the speech on final results of 2009 at the Cabinet of Ministers, the President of Uzbekistan mentioned that SME share of GDP was as large as 50%, what is approximately 7 times more than that in 2000, in absolute terms (Karimov, 2010). While this figure is well above that in Belarus or Russia, it is still considerably lower than that of developed countries and CIS on average.

Uzbekistan's tax system is in the process of rapid change. The history of tax system has started in 1991 and passed 3 phases. At present time it is passing the 4th phase. Early tax reforms were mainly directed towards the fiscal role of taxation and underestimated regulatory, social and stimulating roles of taxation. This short-sighted fiscal policy negatively affected private sector development, investment

and employment and led to the rapid growth of an informal economy. More recent reforms in taxation were directed towards the reduction of the tax burden, optimization of the structure and rates of taxes, simplification and unification of tax system, as well as increasing the stimulatory and regulatory functions of tax policy (D.Tadjibayeva, 2008).

In 2008 the new Tax Code was adopted by the parliament. Tax rates are subject to regulation by the Cabinet of Ministers (Akromov, 2009). This led to the reducing tax burdens, equalization of tax treatment, enhancing the role of taxes, stabilizing the tax system and improving the tax administration.

For the small enterprises simplified taxation system is envisaged on the voluntary basis. It envisages single tax payment (the unified tax) instead of all common state taxes including levies to the non-budget pension funds, Republican Road fund, and Republican fund of school education development, as well as local taxes and charges, charged by local authorities, excluding fee on commercial activity, including licensing fees, registration fee, compensation payments for environmental pollution and wastes. In 2008 single tax payment rate was 8 % and 7% in 2009 (O'zbekiyengilsanoat, 2008). But the rates of single tax may vary due to the business type of enterprise. According to the socio-economic results of the first 6 months of 2008, changes in the new edition of the Tax Code increased government revenue from corporate income tax to 42.6% and from single tax payment to 36.0% compared with the same period of previous year. Figures on the fulfillment of the State Budget show that Revenues of the State Budget as a share of GDP decreased in the first quarter of 2006 compared to the corresponding period of the previous year and made up 28.5% against 29% (Uzbekistan economy, 2006).

Table 1. Structure of the State Budget (% of total)

Indicator/ Year	2000	2001	2002	2003	2004	2005	2006	2007
Revenues	100	100	100	100	100	100	100	100
1. Direct taxes	26,4	28,5	27,2	26,3	26,5	27	27,6	28,1
2. Indirect taxes	56	51,8	54,6	57,8	56	46,4	47,6	41,7
3. Resource payments and property tax	9,9	9,3	7,5	9,5	11,5	20,2	18,1	19,4
4. Social infrastructure development tax	1,1	1,3	2,1	1,7	1,7	1,8	2,1	2,1
5. Other revenues	6,6	9,1	8,6	4,7	4,7	4,7	4,6	8,6

Source: The State Statistical Committee of the Republic of Uzbekistan

This trend was caused by the reduction of the share in indirect taxes (11.9% against 13.9%). Despite the fact that the income tax rate for legal entities was lowered by 3%, the ratio of direct taxes against GDP did not change and amounted to 8.0%. Reduction of revenue tax (profit) made it possible for enterprises to retain UZS 12.0 billion for their own needs. For the efficient use of natural resources of the country, there was an indexation of the resource tax rate and payments. As a result, this tax revenue to the budget made up 5.6% of GDP against 5.3% in the previous year. According to the figures of the 1st quarter of 2006, the structure of the revenues for direct incomes remained unchanged and made up 28.1% of the Total State Budget revenues. Revenues for indirect taxes made up 41.7% in the given time period, which was 5.9% less compared to the corresponding period of the previous year. Despite the fact that as of January 1 2006 the ecology tax was abolished, the share of resource payments in the Structure of

Revenues within the expired time period rose from 18.1% to 19.4%. The period assessed shows a significant rise in other income.

The majority of the structure of direct taxes includes revenues from the individual income tax, which makes up more than 46%. Despite the reduction of the rate, the share of enterprise income tax within the structure of direct taxes rose and reached 31.8% against 30.7% in the corresponding of the previous year. It should be noted that the Decree of the President of Republic of Uzbekistan from 20.06.2005 requires the imposition of the Unified Tax Payment for SMEs instead of the previously paid Single Tax and compulsory payments to targeted state funds; also, the general tax burden for micro-firms and small enterprises decreased from 15.2% to 13%. Despite all this, revenues for this tax increased but their share in the structure of direct taxes decreased slightly. In spite of the lowering of the maximum individual income tax rate by 1% as of January 1, 2006, this tax increased in both amount and relative share within the period.

Table 2. The Structure of Taxes

Indicators	2000	2001	2002	2003	2004	2005	2006	2007
Direct taxes	100	100	100	100	100	100	100	100
1. Value added taxes	47,3	48,8	43,9	39,6	42,5	51,1	50,6	59,6
2. Excise	48,4	46,3	48,3	51,3	48,8	37,7	38,5	25,5
3. Customs tariffs	2	2,7	2,9	3	3,6	4,7	4,8	5,6
4. Single customs fee from individuals	2,3	2,2	2,4	3,3	2,5	2,1	2,4	4,6
5. Individual tax on consumption of gasoline	0	0	2,5	2,8	3,2	4,4	4	4,7

Source: The State Statistical Committee of the Republic of Uzbekistan

Indirect taxes make up more than 41% of the government's revenues from the budget. Value added tax made up the greatest share of indirect taxes, rising from 50.6% to 59.6%. As the potential payers of this tax are consumers of goods and services, one can presume growth of internal and external demand. The rise in the share of value added tax in the structure of indirect taxes to the government budget resulted from a decrease in the share of excise taxes from 38.5% to 25%.

The world experience shows that in 2007/08 36 economies made its taxes easier to pay. The most popular reform feature was reducing the profit tax rate, which happened in more than 21 economies. The second most popular practice was introducing and improving electronic filing and payment systems. This reform, carried out in 12 economies, reduced the frequency of payments and the time spent paying taxes and filing returns. Eight economies reduced the number of taxes paid by businesses by eliminating smaller taxes such as stamp duties.

The Survey

The purpose of the conducted survey was the attempt for understanding of the business and taxation environment from the entrepreneurs' point of view. This approach enables understanding how the taxation policies affect the business operation on the example of the specific firm.

The number of the firms which were covered by survey is only 5. Of course this number of sampling is insignificant for proposing some serious conclusions. But it enhances to see more realistic view, rather than reports from secondary data which has large number of firms and which usually provide subjective information.

- "OxyMed" – Chain of drugstores

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- "Zamona Rano" – Producer of herbal teas and products
- "Olmaliq Sut" – Production of milk and milk products
- "Nika Pharm" – Producer of pharmaceutical goods
- "Murad" – Production of bread

The managers of the abovementioned companies kindly agreed to participate in the survey. The general opinion is that single tax payment has decreased number of taxes to be paid as well as reports to be made to the local tax authority. At present time the taxation burden is less than it was in the previous years. But there is still space for improvement - in order to enhance business environment, following steps should be taken:

1. Inspections – International experience shows that the most effective method of selection enterprises for inspection is based on the analysis of the potential risks involved in the business. This system should be also implemented to local tax system.
2. The qualifications of tax personnel - The tax and customs authorities qualification need to be improved. The procedural and technical reforms will work only if they are supported by adequately qualified staff.
3. Electronic submission of reports - Computerization of reporting processes will reduce time for both taxpayers and tax authorities for preparing and accepting financial statements and other tax forms. But most importantly, it will reduce the significance of the human factor in assessing reports, i.e. it increases objectivity and transparency of tax authorities' work. International practices demonstrate greater efficiency in administration and fewer opportunities for corruption and abuse in governance when electronic systems and technologies are used.
4. Offering specific service and information programs – Small entrepreneurs should know their rights and obligations. Designing and offering specific information material or training courses will improve the knowledge of entrepreneurs
5. Tax burden – Despite the single tax payments some taxes such as income tax is relatively high. This fact encourages both employer and employee to decrease the official salary rate. The tax rates should be reviewed and optimized.

The econometric analysis

The purpose of the given econometric analysis is to check whether there is relationship or correlation between single tax rate and revenues government receives from this type of tax. Due to the difficulty with obtaining necessary information the observation period was reduced. In our analysis we are taking period of 2002-2009. The data on government revenue on single tax was received from the Ministry of Finance of Republic of Uzbekistan. The descriptions of the findings are as follows:

The effect of single tax rate on single tax revenue in Uzbekistan has produced the regression output and graph shown below.

Before discussing the marginal impacts, it is reasonable to look whether the found estimators of the regression are statistically significant. The t-statistics of single tax rate (slope coefficient) is negative 4.5; it implies that the following null hypothesis can be easily rejected.

According to the research held by IFC, one percent decrease in tax rates results in 0.5-2.1% increase in the government revenues (The research is held in the CIS

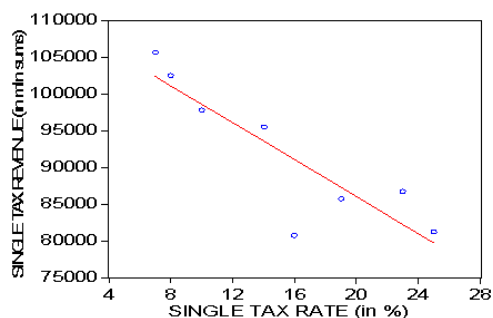
states, the percentage differs with the state). This also adds up to the increase in the enterprise revenues which could be further invested or used for the payment for their employees. In the scale of the whole economy, one percent decrease results in comparatively higher budget revenue, better business conditions for enterprise and more opportunities for enterprise sustainability, investment and financial stability.

Table 3. Econometric model of dependency taxes revenue collections on single tax rates

Dependent Variable: SINGLE TAX REVENUE (in mln sums)				
Method: Least Squares				
Sample: 2002 2009				
Included observations: 8				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
SINGLE TAX RATE (In %)	-1257,549	278,8669	-4,509496	0,0041
C	111194,3	4603,416	24,15473	0
R-squared	0,772171	Mean dependent var		92016,65
Adjusted R-squared	0,7342	S.D. dependent var		9668,401
S.E. of regression	4984,624	Akaike info criterion		20,07842
Sum squared resid	1.49E+08	Schwarz criterion		20,09828
Log likelihood	-78,31369	F-statistic		20,33556
Durbin-Watson stat	1,944643	Prob(F-statistic)		0,004063

Source: Author

Figure 1. Single tax revenue vs. Single tax rate



Source: Author

The representative "Nika Farm" which was established in 2004 also showed positive opinion about structural changes in tax system. The manager stated that government of Uzbekistan pays special attention and support for creation of favorable business environment for the development of national pharmaceutical industry. This sector is one of the most significant sectors, and the state which doesn't have its own pharmaceutical companies, will 100% depend on the import and will be vulnerable to the changes in foreign states. The development of local pharmaceutical sector has been facilitated by different actions. The primary steps are taken by government are implementation of protectionism policy for local market, the decrease of custom fees and obligations and reduction of tax rates and exemption from some types of taxes.

"Zamona Rano" is private company engaged in production of tea and herbal products. It was established in 2006 and by present time it became the leading company in its sector. The manager who kindly agreed to participate in the survey shared his ideas about tax environment in Uzbekistan.

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The tax reforms have positive influence on the performance of their business. At present time this company benefits from single tax rate system, at present time it equals to 7% for this company. This company is also included into the list of "localization program" under the government project.

$$H_0: \beta = 0$$

$$H_1: \beta \neq 0$$

Hence, our slope result found from sample is statistically significant under 10%, 5%, and 1% significance levels. There, it can be concluded that the true population beta is not equal to zero and there is a relationship between single tax rate and tax revenue. This outcome can be also achieved with the help of probability value which is quite low in our case (p -value=0.41% for slope and 0.00% for intercept).

Having being confident about the significance, the marginal impact of Uzbek single tax rate on single tax revenue of Uzbek SMEs can be now discussed. It is found that single tax revenue is negatively related to single tax rate. In particular, the negative slope coefficient indicates that one percent decrease in single tax rate results in 1257.549 mln sums increase in government's single tax revenue. This calculated marginal impact obviously, has significant implications for the Uzbek government. Thus, if the government wants to increase its SMEs tax revenue, it is recommended to decrease the single tax rate which it is doing now.

As for the "goodness of fit" of the model, one can easily see from the above graph that the regression line fits very closely around the actual observations. In fact, a rather high R-squared indicate that 77.21% of total variations in dependent variable (single tax revenue) are explained by the independent variable (single tax rate).

Conclusion

In the conditions of market economy, taxes play an important role - so important that it can be definitively stated that without an efficient tax system, an effective market economy is not possible. The effective functioning of the economy depends on how correctly the tax system is built. Taxation is a major tool by which governments direct and influence how resources necessary for economic and social objectives are allocated. Taxation also plays the role of one of the most important economic regulators.

Furthermore, the importance of a tax policy is due to the fact that taxes are a major source of governmental funds, and every government must rely on taxes to finance all or part of its operation and spending. Thus, one of the most important objectives of taxation is to generate sufficient revenues. Meeting this objective has become very important in countries in transition. Many ex-socialist countries have experienced serious budgetary problems. Tax reform was needed to meet the revenue needs of government budgets in the transition period and to achieve macroeconomic stabilization.

Tax reform was needed not only for achieving this stabilization and revenue raise, but also because tax reform actually facilitated and support many other economic reforms necessary for economic restructuring.

Implementing tax reform faces enormous technical and informational, not to mention political, difficulties in all countries. Transition processes are not simply reforms, but complex changes in systems that affect nearly all spheres of social life—cultural, moral, psychological, sociological, economic and political. These changes involve painful contradictions between old and new mechanisms: shocking situations and general instability.

The main directions of tax reform were aimed at raising more revenue in the short term, ensuring the tax burden was distributed equally, broadening the tax base to reflect the changing structure of the economy, easing the tax burden on the general population, creating favorable conditions for the development of the private sector and furthering the ongoing adaptation of the tax structure to fit a market economy.

Tax reforms have brought some success. Evidence of it can be seen in increased revenues during this time period, which contributed to the reduction of the budget deficit. This was possible because of substantial improvements in tax revenue collections. But we should note that with the increase of revenues, increases in tax arrears also took place, implying that there is still much room for improvement.

This is reflected in the ratio of taxes to GDP, which still remains lower than in other formally planned countries. In 1997, revenue as a percentage of GDP was 17% in Uzbekistan, whereas the average for the NIS group was 25% and for the CEE/NIS group was 32%. The percentage of revenues to GDP in Uzbekistan is half that it is in countries like Estonia, Latvia or Poland. This low ratio can be explained by a number of reasons: many exemptions, which narrow the tax base; the creation of special incentives, which complicate tax administration. One of the biggest set of reasons comes from problems in tax administration, ranging from such trivial ones as a lack of equipment to major ones such as the large size of the hidden economy, a high level of corruption, weak enforcement powers, a lack of professionals, weak audit functions and a lack of systematized computer systems.

According to the international experience, the most effective method of selecting enterprises for inspection is based on the analysis of the potential risks involved in the business. Under this method, selection for inspection and frequency of inspection depends on the extent of potential danger the operation of a business may pose to public health, the environment, or the country's economy.

The major disadvantage of existing tax inspection system is the absence of a link between the financial index of an enterprise and its inclusion to tax inspection plan, which minimizes efficiency of tax audits.

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