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Uzbekistan:
Selected trade and economic issues

Abstract

Uzbekistan is the Central Asia Republic that suffered the less from the collapse of Soviet Union. GDP was restored to pre-independence levels as early as 2002, and the country has since enjoyed a protracted phase of sustained economic growth. Uzbekistan is currently a medium-low income country, and living conditions in the country have significantly improved, though mainly in urban areas. Regional and social disparities are high.

Rather than liberalise its economy and adopt the economic reforms suggested by international financial institutions, Uzbekistan has preferred to set-up a system based on import substitution under strict state control. This has had the merit of protecting the country from external shocks but has also led to a relatively inefficient system where state interference in the economy is the rule rather than the exception.

The external trade sector is largely dominated by gas, gold and cotton exports, and exchanges with the European Union are very limited. The EU signed a Partnership and Cooperation Agreement with Uzbekistan in 1999. The European Parliament opposed to the ratification of a protocol extending PCA provisions to the textile sector, initialled in 2010, because of persistent and serious exploitation of child labour in the Uzbek cotton sector.

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AUTHOR:

Roberto BENDINI
Directorate-General for External Policies of the Union
Policy Department
WIB 06 M 55
rue Wiertz 60
B-1047 Brussels

Editorial Assistant: Jakub PRZETACZNIK

CONTACT:

Feedback of all kinds is welcome. Please write to:
administratorsname.surname@europarl.europa.eu.

To obtain paper copies, please send a request by e-mail to:
poldep-expo@europarl.europa.eu.

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Table of contents

1. Introduction

Uzbekistan is the Central Asia Republic that suffered the less from the collapse of Soviet Union. GDP was restored to pre-independence levels as early as 2002, and the country has since enjoyed a protracted phase of sustained economic growth. Uzbekistan is currently a medium-low income country, and living conditions in the country have significantly improved, though mainly in urban areas. Regional and social disparities are high.

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2. A (relatively) successful post-Soviet transition

The 'Uzbek way' to development is heterodox.

Unlike Kyrgyzstan and to a lesser extent Kazakhstan, Uzbekistan adopted a very cautious approach to economic reform and generally preserved the economic and financial settings inherited from the Soviet Union. President Islam Karimov openly criticised the free market-oriented policies adopted by its neighbours in his 1992 publication, 'Uzbekistan, its road to independence and progress', judging such policies unsuitable for his country. In a more recent publication, the Uzbek President stressed that 'the own model of reforming and modernization adopted in Uzbekistan […] has meant from the onset the denial of the methods of shock therapy, which were persistently imposed on us, as well as naïve and deceptive conceptions about the self-regulating nature of market economy'[1].

Taking inspiration from the Turkish – and, lately, the Chinese – model of development, Uzbekistan choose to follow 'an evolutionary approach to the process of transition from an administrative-command to a market system of regulation […] acting in line with a well-known principle – "do not destroy the old house until you build a new one"'[2].

[1] Islam Karimov, The global financial-economic crisis, ways and measures to overcome it in the conditions of Uzbekistan (2009)
[2] Ibid.

Relations with international organisations have often been difficult.

After its independence, Uzbekistan became a member of several international organisations, including the as the Organisation for Security and Co-operation in Europe (OSCE), International Monetary Fund (IMF) and Asian Development Bank, but this did not necessarily affect its domestic financial and economic policies. Relations with international institutions have therefore often been difficult. In 2001, the IMF withdrew its permanent representative in the country after Tashkent failed to meet its obligations as a member of the Fund. In April 2004, the European Bank for Reconstruction and Development (EBRD) also suspended most of its assistance as a result of the country's poor record on economic and political reform[3].

In more general terms, the IMF's requests to secure wide-range economic reforms and reduce the government's controls over the economy in the area of foreign trade, foreign exchange market and financial systems have been largely disregarded by Tashkent.

For these reasons, Uzbekistan has faced widespread criticism among international organisations and western analysts, who consider that Tashkent has maintained a tight control over the economy inspired by Soviet models and failed to implement meaningful market economy reforms. This perception was partially confirmed in 1996, when Uzbekistan re-introduced controls over foreign exchanges to better control external trade[4].

Despite these criticisms, Uzbekistan's prudent economic policies post-independence helped the Central Asia country better face the difficult transitional period that accompanied the collapse of Soviet Union. Like other Soviet republics, Uzbekistan was confronted with the sudden collapse of the Moscow-led planned economy, losing most Soviet inputs and subsidies[5] and entering a phase of severe economic recession.

Uzbekistan is the first former republic of the Soviet Union Republic to regain pre-independence GDP levels.

Against all predictions, Uzbekistan's economy returned to growth in the late 1990s, averaging a rate of 4 % from 1997 onwards. By 2002, the country's GDP was slightly higher than it had been in 1989, making Uzbekistan the first former Soviet Union Republic to regain its pre-independence levels.

Academic Richard Pomfret (and others) have acknowledged the merits of the 'Uzbek road'[6] to development while stressing that 'the Uzbekistan economy has been well-managed, in the narrow sense of, for example, maintaining infrastructure, collecting taxes and keeping up expenditures on education and social security'. Pomfret concludes that 'the economy

[3] Ibid.

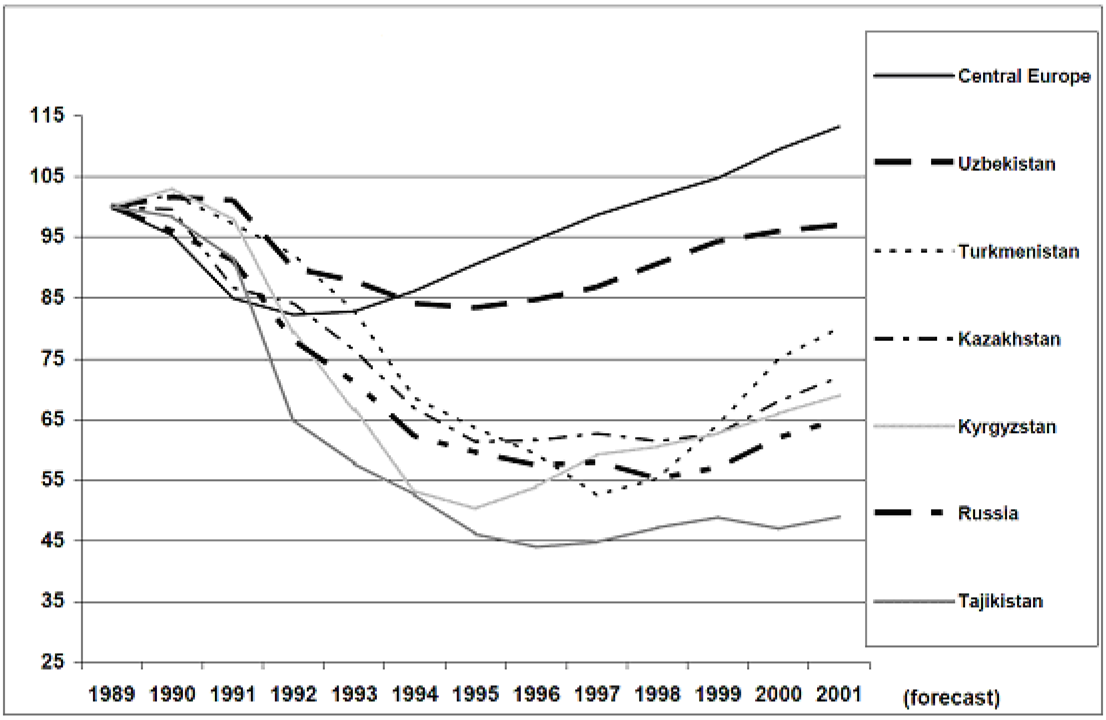
[4] Partly lifted in 2003.

[5] Representing about 7-9 % of Uzbek RSS in the late 1980s. See CDPR (Centre for development policy and research), The Puzzling success of the Uzbekistan's heterodox development (January 2010).

[6] Vladimir Popov, Economic miracle of post-Soviet space: why Uzbekistan managed to achieve what no other post-Soviet state achieved (30 July 2013).

may have performed even better with better policies but slow reform plus good management has produced reasonable outcomes'[7].

Figure 1:
GDP change, 1989=100



Source: R. Pomfret (see footnote 4)

The Uzbek 'miracle' was essentially due to the availability of energy and the high demand for domestic commodities.

According to the IMF, the success of Uzbekistan's transitional period can be attributed to a combination of several factors, including (a) the country's relative low degree of initial industrialisation, (b) domestic cotton production and (c) the country's self sufficiency in energy[8]. The country's economic policies have been (relatively) successful because sectors to be subsidised were small, and the country could count on cheap sources of energy and on revenues from exports of commodities such as gold and cotton.

The situation slightly deteriorated in the following decade. While economic growth continued in the 2000s and living standards increased, Uzbekistan lost the net advantage vis-à-vis other Central Asia countries – and notably Kazakhstan – that it enjoyed in the first years of independence.

In the 2000s Kazakhstan replaced Uzbekistan as the most dynamic central Asian economy.

In the late 1990s, the Uzbek government launched a new set of initiatives to ensue a deeper liberalisation of the country's economy. The priorities for economic reform included reducing state intervention, strengthening

[7] Richard Pomfret (OECD working paper No. 212), Central Asia since 1991: the experience of the new independent states (July 2003).
[8] IMF Working Paper (Author: J. Zettelmeyer): The Uzbek growth puzzle (September 1998).

businesses' legal protection from such intervention, and liberalising the foreign exchange market.[9] Most of these goals are still far from achieved, and those reforms that have been effectively implemented have not significantly changed the structure of the state or the national economy.

The government also began to actively promote the privatisation of major enterprises in a number of key economic sectors. Government resolutions passed in 2005, 2006 and 2007 envisaged an ambitious privatisation programme for the forthcoming years. As of January 2013, few of the major enterprises covered by these resolutions have been effectively privatised[10].

In 2012 the government announced that it would privatise 500 state-owned assets in the energy, metals, agriculture, electronics and pharmaceuticals industries. Its announcement, however, failed to convince the international business community, which has expressed deep scepticism about the real intentions of Tashkent[11].

Uzbek import substitution policies are hardly compatible with the World Trade Organisation.

The economic development strategy implemented so far by Uzbekistan is largely based on import substitution and export promotion. Both of these practices are inconsistent with the World Trade Organisation (WTO), which explains why Tashkent's early (1994) application to the Geneva-based organisation has not led the country to WTO mebership.

By means of import substitution policies[12], the Uzbek government intended to promote the industrialisation of the country and secure energy and food self-sufficiency. Tashkent also aimed to diversify its economic structure and reduce reliance on revenues from cotton exports[13]. These policies have been relatively successful thanks to the fact that Uzbek exports are dominated by commodities whose prices are only partly subject exchange rate fluctuations. In this way, Uzbekistan was able to reduce dependency on imported food and energy and to secure the emergence of new industrial sectors, such as the automotive industry[14].

While these policies have yielded some clear benefits, they have also produced some obvious difficulties, particularly when longer-term

[9] Alexandr Akimov and Brian Dollery (Griffith University): The Uzbek approach to financial system development: an analysis of achievements and failures (May 2009).
[10] Baker and Mackenzie: Doing Business in Uzbekistan (2009).
[11] The Washington Times, Uzbek privatization plans cast doubt (8 June 2012).
[12] Import substitution (definition): Government strategy that emphasizes replacement of some agricultural or industrial imports to encourage local production for local consumption, rather than producing for export markets. Import substitutes are meant to generate employment, reduce foreign exchange demand, stimulate innovation, and make the country self-reliant in critical areas such as food, defence, and advanced technology.
[13] CDPR: The puzzling success of Uzbekistan's heterodox development (January 2010).
[14] UNDP, Assessing development strategies to achieve the MDGs in the Republic of Uzbekistan (2010)

perspective in considered; the economy as a whole would probably be unable to face foreign competition in free market conditions[15].

Uzbekistan is only partly integrated in the world trading system.

The economic structure of Uzbekistan is therefore only partly integrated into the world trading system. Due to the prevailing system of price control and the large financial subsidies for key sectors, the country's economy is far from fully market oriented, and the private sector plays a very limited role in a system dominated by the state. While this has probably impacted the overall economic performance of the country, it also had some positive by-effects. For instance, Uzbekistan was largely sheltered from the worst effects of the 2009 global financial crisis, in part because the Government launched timely stimulus packages to offset the decrease in foreign demand for exported commodities.

3. Economy

From a distance, Uzbekistan's economy looks good.

The country has great potential for development but suffers from its landlocked position.

The country experienced sustained economic expansion over the last decade, with real growth rate averaging 8.3 % annually in the 2005-2012 period. Growth is expected to continue at around 7-7.5 % over the medium term, supported by government spending and investment[16].

Uzbekistan also has strong development potential. The country is rich in natural resources (gold, copper, natural gas, oil and uranium) and has a strong agricultural base. Its size and population (as the most populous Central Asia nation), its large workforce and its position (the country shares a common border with all other former Central Asia republics) makes the country a natural regional leader in both political and economic terms.

Yet the country also suffers from some evident – and some less evident – disadvantages. Geographically, Uzbekistan lacks an access to the sea[17] and is a 'doubly landlocked' (i.e. a country surrounded by landlocked countries) – a distinction it shares only with Liechtenstein. This handicap makes external trade both more difficult and more expensive. More generally, the country's strong potential is far from fully exploited. Despite its GDP growth – even during the global economic recession – Uzbekistan still suffers from its incomplete transition to a fully market oriented system. The country is excessively reliant upon a handful of commodities (gold, oil and gas and cotton), which represent more than 60 % of its exports as well as a significant share of the country's GDP.

Uzbekistan ranks low in the World Bank's 'Doing Business' report.

The business climate also suffers from the lack of a market economy, and the system is far from transparent or competitive. In 2012, Uzbekistan ranked 152 of 185 economies in the World Bank's Doing Business

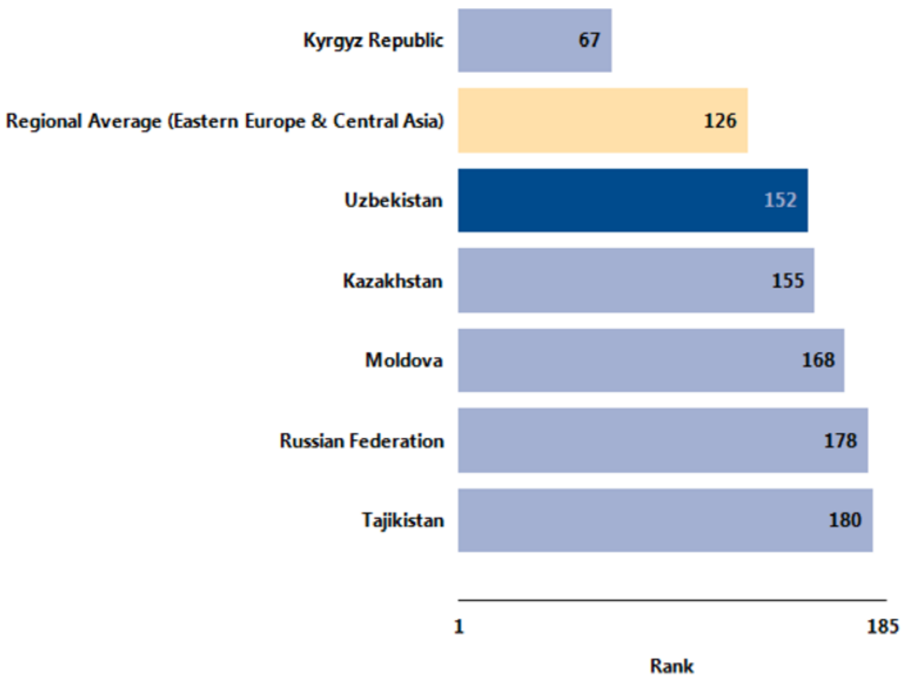
[15] Richard Pomfret (EUCAM): Central Asia and the Global Economic Crisis (2009).

[16] Deutsche Bank, Uzbekistan, Frontier country report (22 February 2013)

[17] And not even to the regional larger water basin, the Caspian Sea.

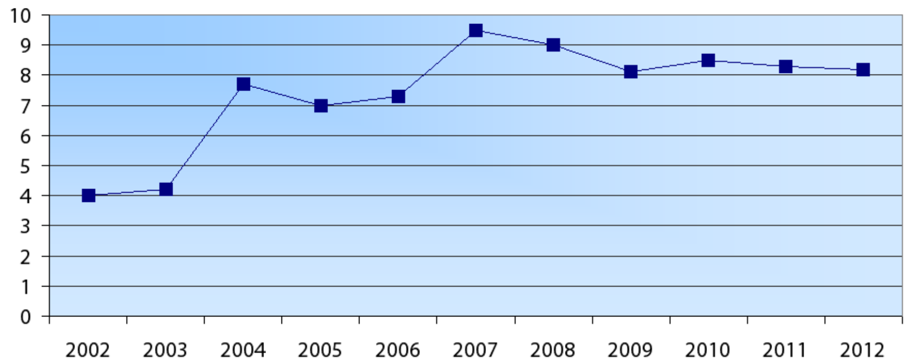
assessment (in line with the average index for former Soviet Union republics)[18].

Figure 2:
Business environment in Uzbekistan and other former Soviet Union countries



Source: Doing Business database

Figure 3:
GDP growth



Source: World Bank

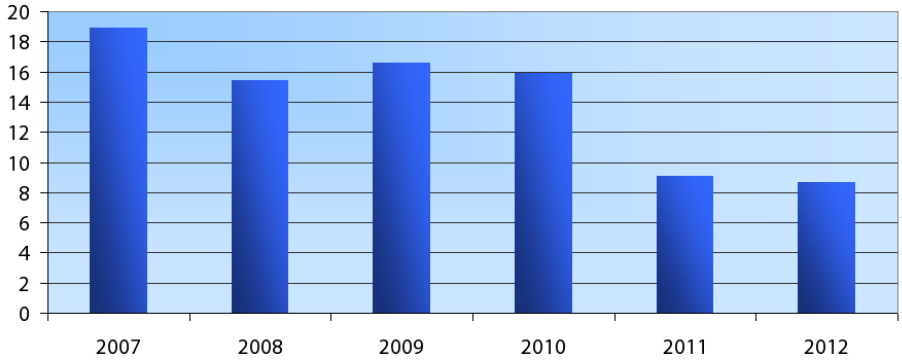
Economic growth and prudent policies on external loans have significantly reduced the country's foreign debt.

External debt: The ratios of gross public debt and external debt to Uzbekistan's GDP have been substantially reduced and remain at sustainable levels of around 10 % and 20 %, respectively (see chart below). This decrease, made possible by Uzbekistan's positive account balances over the last decade, was achieved by pursuing a policy of no net-borrowing. As a result, foreign debt exposure fell from 64 % of GDP in

[18] World Bank, Ease of Doing Business in Uzbekistan (2013).

2001 to only 12.8 % in 2012. Uzbekistan is classified among the world's net creditors[19].

Figure 4:
Public debt

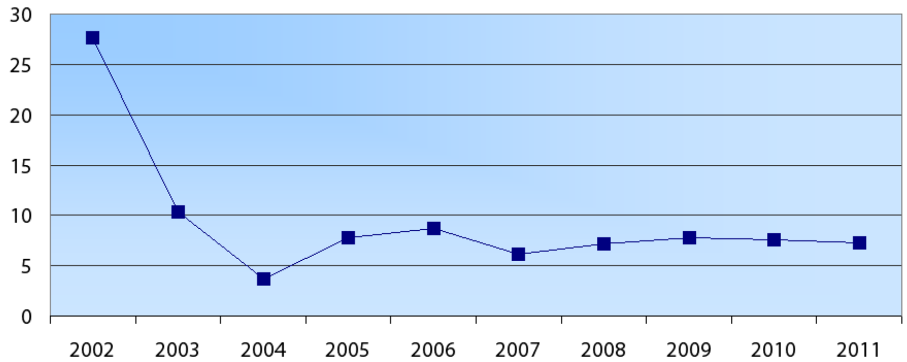


Source: www.tradingeconomics.com

Inflation is high, but much lower than in the past.

Inflation is expected to remain below 10 % in the medium term. This is an improvement over the very high rates that Uzbekistan recorded in the first years after independence. The government has successfully stemmed dangerous inflationary pressures resulting from the country's protracted phase of economic growth over the last decade.

Figure 5:
Inflation



Source: Asian Development Bank

Corruption is rampant.

Corruption is endemic in Uzbekistan and affects all aspects of the country's economic and public life. Uzbekistan ranked 170 of 176 countries in the 2013 'Corruption Index' report published by Transparency International[20].

Most aspects of the economic life of the country are influenced by corruption or nepotism. A recent report the German Bank Bayern Landesbank concludes: 'it is to be assumed that a substantial portion of the foreign exchange flowing into the country via export earnings and foreign investment ends up in the foreign bank accounts of the leadership hierarchy'[21].

[19] World Bank, Uzbekistan partnership: country progress snapshot. (March 2013)
[20] Transparency International, Corruption Perceptions Index 2012 (2013)
[21] Bank Bayern Landesbank , Country Report Uzbekistan (January 2013).

Remittances of workers from Russia and Kazakhstan are significant.

Remittances are an important source of revenues for Uzbekistan. About 7.0 % of the country's active population live and work abroad. Most Uzbek workers have emigrated to the Russian Federation, Kazakhstan[22] and Ukraine, but there a sizeable groups of Uzbek immigrants in other Central Asia republics, as well as in Israel, Latvia, the United States and Germany.

Among the CIS countries, Uzbekistan is the largest recipient of remittances from Russia, accounting for close to one-third of total Russian remittances[23]. According to Russia's Central Bank, migrant workers' remittances sent from Russia to Uzbekistan totalled USD 5.7 billion in 2012, up 32.6 % from 2011. Given that Uzbekistan's 2012 GDP has been calculated at USD 35 billion (EUR 26.5 billion), remittances from Russia alone account for the equivalent of 16.3 % of the Uzbek economy (or 12 % when using the official exchange).

The informal economy is widespread. The Uzbek currency exchange rate is fixed byb the Government and not allowed to freely fluctuate. Due to foreign exchange restrictions, the currency black market is flourishing. Limited data availability and the questionable quality of official statistics make it very difficult to precisely assess the size of informal economy in the country.

Poverty has declined but remains present in rural areas and the west.

Economic growth has had a positive impact on **poverty reduction**. The share of the population living below the national poverty line declined from 27.5 % in 2001 to 17.7 % in 2012.[24] This is largely the result of specific measures implemented by the government. The support and development of small businesses and private entrepreneurship have facilitated job creation and employment.

Nevertheless, the distribution of income from economic growth is not equitable among the population. Poverty is still widespread in the countryside (almost twice as prevalent as in urban areas). Remote regions such as Karakalpakstan (suffering, *inter alia,* from the progressive disappearance of the Aral Sea) and the districts bordering war-affected Afghanistan are also disproportionately poor. While Uzbekistan's rural population represents about 64 % of the total population, 73 % of Uzbekistan's poor are rural.

The World Bank classifies Uzbekistan as a **lower middle-income country** with a GDP per capita (USD 3 500, or EU 2 650, in 2012) that, despite recent significant improvements due to the positive economic situation, remains one of the lowest among the former Soviet Union republics; only Tajikistan and Kyrgyzstan have a lower GDP per capita[25].

[22] For the situation in Kazakhstan (the second destination of Uzbek emigrants after Russia) please refer to: Bhavna Dave, Informal practices and corruption in Regulation of Labour migration in Kazakhstan (2012)

[23] Oxford Analytica, Russia tougher migration rules threatens Central Asia (13 March 2013)

[24] Ibid. footnote 19.

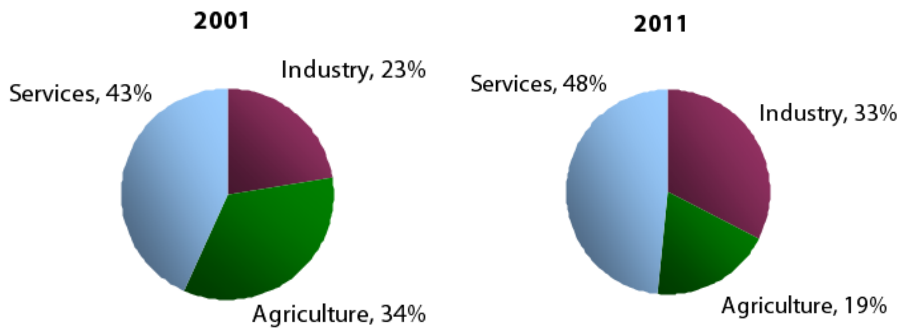
[25] CIA World Factbook, Uzbekistan (2013)

The economy of Uzbekistan is still characterised by strong industry and agriculture. The service sector, on the other hand, is undersized.

** ** **

The Uzbek economy did not experience the rapid de-industrialisation that many other former Soviet Union republics did. Bolstered by the mining and energy sectors, as well as by the government's import-substitution policies, the country's industrial base has been preserved and gradually adapted since independence. The service sector grew at the expense of the primary sector. Agriculture remains very important, representing slightly under 20 % of GDP and employing 27 % of total workforce.

Figure 6:
Economic sectors



Source: World Bank

As the table below demonstrates, the structure of the Uzbek economy has not substantially altered since independence. The service sector remains undersized compared with the relatively strong industrial and agricultural sectors.

Table 1:

Change in economic sectors, 1990-2011

	1990	2001	2011
Industry	33	23	33
Agriculture	33	34	19
Services	34	43	48

Source: World Bank

3.1. Agriculture

Agriculture plays a central role in Uzbekistan's economy.

The agricultural sector continues to play a central role in Uzbekistan's economy, representing about one fifth of GDP and employing about 40 % of the country's active population. Only 11 % of the land, mostly located in irrigated river valleys, allows intensive agriculture, while another 40 % is occupied by natural pastures.

Uzbekistan's agricultural sector is still largely dominated by cotton farming, although production has dropped by 35 % since 1991. Uzbekistan is now the world's fifth largest cotton exporter and sixth largest producer (see below).

Wheat is the second major crop. Smaller areas are occupied by fodder crops, grapes, apples, barley, tomatoes, potatoes and rice. Although the area planted with fruit and nut trees is relatively small in comparison to wheat and cotton fields, the prevailing climatic conditions are suitable for expanding their production[26].

Uzbekistan has not instituted land reform. All land belongs to the state. Farmers lease land and are indirectly state employees. Private sector agriculture includes 81 000 private leasehold farms in the country, with an average size approaching 150 hectares. More than 1.5 million people are employed on these lands. In 2010, private farms accounted for 35 % of total agricultural output and *'dekhan'* (family) farms, which have small allocations of up to one hectare of land, accounted for 63 %[27].

Poor environmental policies and an excessive exploitation of water resources have led to an environmental disaster in and around the Aral Sea.

Despite reforms and improvements, agriculture in Uzbekistan, remains largely inefficient and exposed to severe environmental risks. The progressive shrinking of the Aral Sea, due to excessive exploitation of water resources, is a prominent example. In the early 1960s, the Soviet government promoted intensive cotton culture in Central Asia, with a view to developing self-sufficiency and possibly creating a surplus to export to friendly countries. Excessive irrigation and high evaporation rates substantially decreased the flow of water to the Aral sea, which resulted in a rapid diminution of the basin's surface (see map below). The original coastline of the sea receded by several dozens of kilometres, exposing large surfaces that had once been covered by waters and contaminating them with salt and other hazardous substances. This completely destroyed the wildlife habitat and caused severe health problems, including respiratory infections and parasitic diseases, for people living nearby. Local economies, which had largely depended on agriculture and fisheries, collapsed, and some inhabitants were forced to migrate. Efforts to address the crisis have focused on preventing further shrinkage of the Aral Sea – particularly on the Kazakh side – but have produced limited results so far[28].

Water management is a serious issue in Uzbekistan.

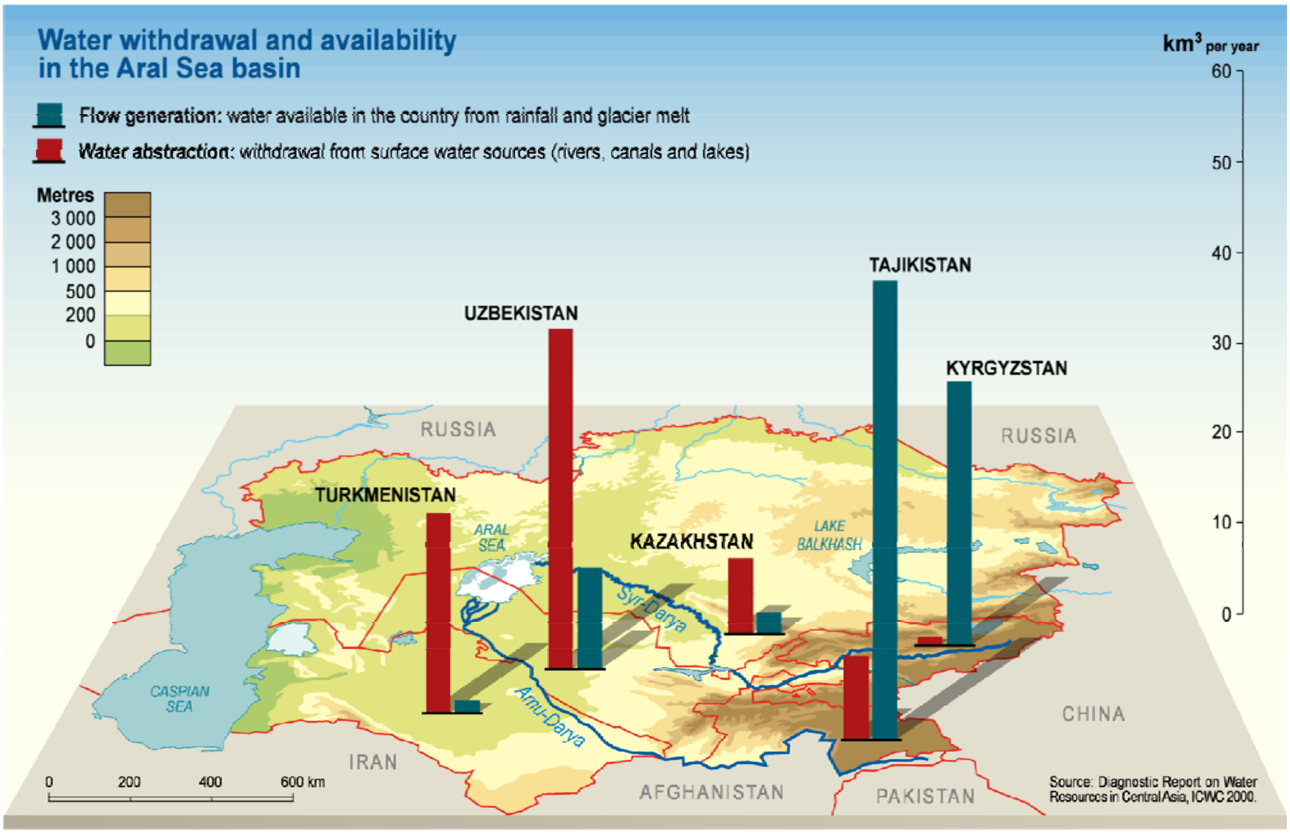
Water scarcity is a serious issue in Uzbekistan. Limited rainfall, inefficient and obsolete irrigation systems and a concentration on certain crops (such as intensely water-consuming cotton) have dramatically impacted the primary sector. According to the World Bank, the country's water deficit is projected to increase from 2 km^3 in 2005 to 11-13 km^3 in 2050[29].

[26] The World Bank, Uzbekistan, Climate change and agriculture country note (September 2010)
[27] FAO; Eastern Europe and Central Asia agro-industry development country brief, Uzbekistan (2012)
[28] The construction of the Kok-Aral dam (a USD 64 million project co-financed by the World Bank with the view of trapping water from the Syr Darya river in the Kazakh side of the former sea basin has been criticised by Uzbekistan. In fact, Kazakhstan seems to be more active in the preservation of the Aral Sea. Tashkent has done little to halt the progressive desertification of the area apart launching public awareness campaigns), please refer to EurasiaNet, Kazakhstan, Uzbekistan: differing approaches on Aral Sea (22 March 2012).
[29] Ibid. footnote 25.

Map produced by Zoi Environment Network, December 2010

Source: water flow and water use data http://www.cawater-info.net/

Uzbekistan is therefore largely dependent on 'imported' water from its two neighbours, Kyrgyzstan and Tajikistan, which are situated on higher ground (see map).



THE MAP DOES NOT IMPLY THE EXPRESSION OF ANY OPINION ON THE PART OF THE AGENCIES CONCERNING THE LEGAL STATUS OF ANY COUNTRY, TERRITORY CITY OR AREA OF ITS AUTHORITY, OR DELINEATION OF ITS FRONTIERS AND BOUNDARIES.

MAP BY VIKTOR NOVIKOV AND PHILIPPE REKACEWICZ - UNEP/GRID-ARENDAL - APRIL 2005

Uzbekistan strongly opposes Tajikistan's the Rogun dam project.

This dependence underlies Tashkent's vehement opposition to the construction of a new dam on the Tajik river Vakhsh. The 'Rogun' project, which would be the tallest dam in the world, is intended to enable Tajikistan to reach self-sufficiency in terms of power generation, but is also likely to wreak dramatic effects on the fragile Uzbek agricultural sector.

What the real impact of Rogun will be on downstream agriculture in Uzbekistan is disputed. In one academic study, the authors conclude that water shortages may cost up to USD 600 million (EUR 450 million) annually in agricultural losses, with a potential 2 % reduction in the country's GDP. In this scenario, irrigated area may be reduced by 300 000 hectares, with a 35-40 % drop in water available for cultivation[30].

3.2. Industry

The mining sector is the major drive of Uzbek economic growth.

Uzbekistan has large mineral reserves, notably of copper, gold and uranium. Gold reserves are estimated at about 5 300 tonnes. In 2012 production was about 90 tonnes, making the country the world's ninth-largest gold producer[31].

The country has also significant oil and natural gas reserves, another

[30] S. Jalilov, T. DeSutter, J. Leitch, (International Journal of Water Resources and Environmental Engineering): Impact of Rogun dam on downstream Uzbekistan agriculture (September 2011).

[31] US Geological Survey (2013) Gold.

Manufacturing is on the rise.

important source of revenues. Uzbekistan imported about 60 % of its energy needs during Soviet times. After independence, the government prioritised making the country self-sufficient, a goal that was achieved in the early 2000s. However, due to lack of investment, some oil field technology has gradually become obsolete, and production has steadily decreased since 2003. Uzbekistan plans to revitalise the sector by signing a number of joint ventures with foreign oil companies, in particular LukOil of Russia and National Petroleum Corporation of China.

Natural gas production is significant, and despite growing internal consumption, increasingly exported to China and Russia. Uzbekistan traditionally supplied gas to other central Asia republics such as Kyrgyzstan, Tajikistan and (to a lesser extent) Kazakhstan. In 2010 the state-controlled Uzbekneftegas signed agreements with the Russian Gazprom and the Chinese National Petroleum Corporation with a view to increase domestic productions and triple gas exports by 2020[32].

Industry has been protected from external competition by protectionist measures.

Industrial production has benefitted from the government's protectionist measures. The country is progressively increasing its industrial base, with the food processing, machinery, chemicals and automotive sector playing principal roles. Uzbek cotton consumption has grown in recent years, representing greater foreign investment and an effort by the government to increase the share of fibres processed locally rather than exported. Many textile enterprises are joint ventures, with the government the main shareholder.

Uzbekistan is the only central Asia country that produces motor vehicles on a large scale. General Motors and Daewoo are the two (related) companies to have opened car production facilities in the country. While cars manufactured in Uzbekistan are largely intended to satisfy internal demand, they are increasingly exported to Russia and other Central Asia countries[33].

Two 'special economic zones' created by the government are intended to attract foreign industrial investments to the country. The two zones are located near the cities of Navöi and Angren, and have attracted mostly Chinese or Korean companies as investors[34].

3.3. Services

In the past five years, the service sector in Uzbekistan has emerged as a key source of value added and new jobs. The sector grew by 13.3 % annually between 2007 and 2011, even higher than the rate of overall

[32] Elena Safirova, The mineral industry of Uzbekistan (US Geological Survey Yearbook 2010)

[33] UNDP, Development Focus Survey. The Uzbekistan Auto Industry: Sources of Growth Outside the Sector (2013)

[34] Embassy of Uzbekistan in the US, Economy and Trade: Investment Climate (2013).

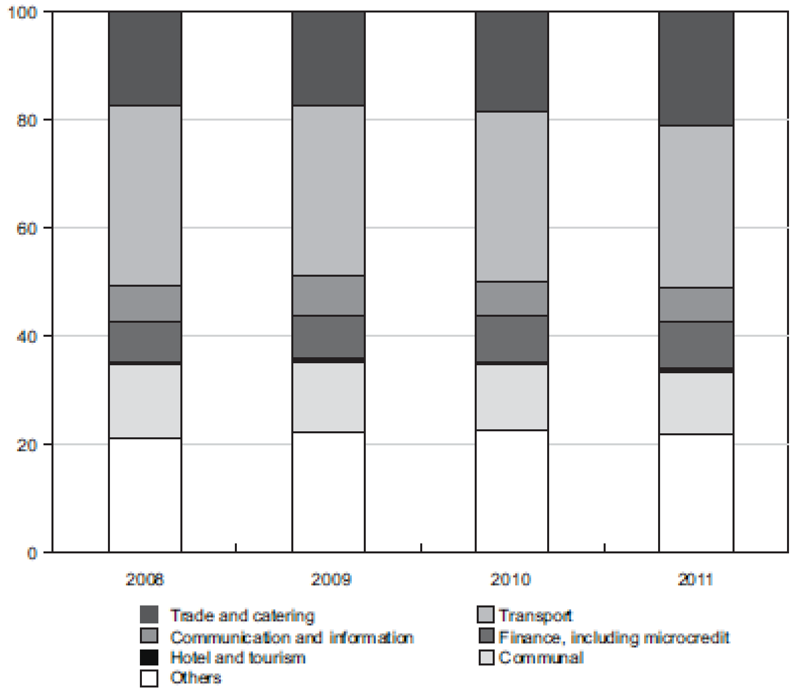
Services are gradually developing, although the sector remains small and often inefficient.

economic growth. Strong growth in services was underpinned by macroeconomic stability and benefitted from trade and fiscal surpluses[35].

Financial services and telecommunications have been the main drivers of growth in the service sector. The banking sector is healthy but not very developed. Financial intermediation in the country is limited, with credit to the private sector amounting to roughly 20 % of GDP. The practice of channelling funds via state banks to state-owned firms is widespread.

Despite the impressive growth in services that marked the last decade, the sector is still characterised by several barriers to entry and other severe bottlenecks, especially for foreign investors.

Figure 7:
Composition of service sector output in Uzbekistan (in %, 2011)



Source: Uzbek State Statistics Committee

With its rich history and culture, Uzbekistan has enormous potential to develop the tourist industry. Uzbekistan has the highest number of UNESCO-designated world heritage sites (four) in the region, although tourism accounts for only 0.2 % of the service sector's output and has seen little growth over the past five years. Although the tourist sector is almost fully private, it would need government support to realise its potential, including with a comprehensive state-led development strategy combineing improved tourism infrastructure with incentives for private sector operators.

[35] Asia Development Bank, The Service Sector in Lower-Income Asian Economies (April 2013).

3.4. Foreign direct investment

The Uzbek government only encourages foreign direct investments in select sectors.

The government regularly stresses that attracting foreign direct investment is a top priority, but in reality Tashkent follows a very selective approach. The government generally welcomes investments that are in line with its import-substitution and export-oriented industrialisation policies, and discourages investments in import-consuming sectors[36].

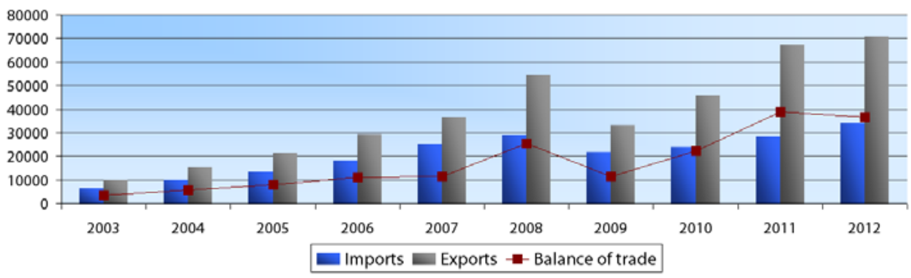
Foreign direct investment is therefore lower than in other Central Asia countries and plays a marginal role in the country's economic development strategy; in 2012 FDI stocks represented less than 2 % of Uzbekistan's GDP[37]. Investment is concentrated in the oil and gas sector and comes largely from Russia and China. South Korea has also heavily invested in the creation of the Uzbek automotive sector. The European Union recently eased the sanctions against Uzbekistan it had imposed because of the country's poor human rights record; this may result in more activity on the part of European investors. Middle Eastern investors have also shown some interest in the country. Nevertheless, unless current restrictions are eased by the government, the level of total FDI in the near future is unlikely to grow substantially.

4. External trade issues

Thanks to its natural resources, Uzbekistan's balance of trade is largely positive.

Uzbekistan has experienced a trade surplus in recent years, mostly due to the increase of price of Uzbek gas. Exports, which had slowed with the global financial crisis, have recovered to their pre-crisis levels since the first quarter of 2010. Uzbekistan's average custom tariffs are in line with other low-income countries (12.6 %) but twice as high as the regional average in Europe and Central Asia (6.7 %). Tashkent does not apply any import quotas but does wield a number of behind-the-border non-tariff measures that discourage foreign trade.

Figure 8: Merchandise export/import (in EUR million)



Source: World Bank

Uzbekistan is not member of the WTO, and negotiations for its accession,

[36] US Department of State (Commercial Service), Doing Business in Uzbekistan: 2012 Country Commercial Guide for U.S. Companies (2012).
[37] Source: Trading Economics.

started in 1994, have been suspended since 2005, when the working party on accession held its last meeting[38]. Part of the country's reluctance to engage with international economic institutions stems from Tashkent's unwillingness to adopt the (deep) reforms required to join the international economic community. Moreover, the country's exports — essentially energy, gold and cotton — already benefit from a reliable market access ensured by the sustained global demand for these commodities.

Russian and China are Uzbekistan's two biggest trading partners.

Russia, China, South Korea and Kazakhstan are among Uzbekistan's principal trading partners. The EU plays a limited role in the Uzbek economy. Tashkent seems to privilege relations with emerging Asian countries (most of its cotton is shipped to China or to South Asian countries) or with the former USSR republics and, notably, Russia.

Table 2:
Uzbekistan's top five trading partners, 2012

Origin of imports				Destination of exports				Trade partners				
#	**Origin**	**€ million**	**%**	**#**	**Destination**	**€ million**	**%**	**#**	**Partner**	**€ million**	**balance**	**%**
1	Russia	1,913	20.6	1	China	767	17.9	1	Russia	2,451	-1,375	18.1
2	China	1,529	16.5	2	Kazakhstan	612	14.3	2	China	2,296	-762	16.9
3	South Korea	1,513	16.3	3	Turkey	576	13.4	3	Kazakhstan	1,796	-572	13.2
4	EU27	1,304	14.0	4	Russia	538	12.5	4	South Korea	1,543	-1,483	11.4
5	Kazakhstan	1,184	12.8	5	Ukraine	526	12.3	5	EU27	1,426	-1,182	10.5
	All imports:	*9,285*			***All exports:***	*4,291*			***Balance of trade:***		*-4,994*	

Source: DG Trade

In 2011 Uzbekistan exported energy products, cotton, gold, mineral fertilizers, ferrous and nonferrous metals, textiles, food products, machinery and automobiles. Its principal imports consisted of machinery and equipment, foodstuffs, chemicals, ferrous and nonferrous metals.

Trade with the EU is limited.

Uzbekistan has signed bilateral free trade agreements with Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan and Ukraine. Uzbekistan also signed the 1994 agreements between the countries of the Commonwealth of Independent States (CIS), which contained a limited chapter on trade. On 31 May 2013, Tashkent joined the Russia-led CIS free trade area. The Generalised System of Preferences (GSP) benefits apply to products from Uzbekistan.

Trade with the EU has gradually developed over the last 20 years but

[38] WTO, Uzbekistan (page on Accession)

remains relatively small — and completely negligible for the EU. Russia has gradually retaken its position of prominence in Uzbek foreign trade, largely at the expenses of the EU. The EU imports some chemical and manufactured goods from the Central Asia country, while exporting manufactured goods and chemical products. Imports of energy from the country are limited, and the EU does not import cotton harvested in Uzbekistan[39].

Table 3:

Uzbekistan's trade in goods with the EU

	Exports to EU:	Imports from EU:
Value 2012:	EUR 259 million	EUR 1219 million
EU's rank (for Uzbekistan), 2012:	4	9
Uzbekistan 's rank (for EU), 2012:	111	77
% total, 2012:	2.8 %	14.0 %
% EU total, 2012:	<0.1 %	0.1 %

As with other Central Asia Republics, the EU's trade relations with Uzbekistan, are governed by a Partnership and Cooperation Agreement (PCA), which was signed in 1996 and entered into force in 1999. In terms of trade, PCAs are non-preferential agreements – ensuring that there are no tariff reductions applied and that quantitative restrictions are prohibited in bilateral trade. The agreements also envisage progressive regulatory approximation of the partner countries' legislation and practices to the most important EU trade-related standards, including technical regulations, sanitary and phytosanitary requirements, intellectual property rights' protection and customs issues. The Uzbek PCA did not cover trade in textiles products, which was instead regulated by a separate bilateral agreement. This bilateral agreement expired on 31 December 2004.

The European Parliament rejected the protocol on textiles of the Partnership and Cooperation Agreement due to concerns about child labour.

A **Protocol on textile products** amending the EU-Uzbekistan PCA was initialled on 1 July 2010. The ratification of the protocol has yet to be concluded. The European Parliament withheld its consent until the moment that 'ILO [the UN's International Labour Organisation] observers have been granted access by the Uzbek authorities to undertake close and unhindered monitoring and have confirmed that concrete reforms have been implemented and yielded substantial results in such a way that the practice of forced labour and child labour is effectively in the process of being eradicated at national, viloyat and local level'[40].

[39] University of Central Asia, Uzbekistan: trade regime and recent trade developments (20212)

[40] European Parliament Legislative Observatory, EC/Uzbekistan Partnership and Cooperation Agreement: bilateral trade in textiles. Protocol (2010/0323(NLE))

5. The cotton sector in Uzbekistan

Russia and the USSR invested heavily in Uzbekistan's cotton sector.

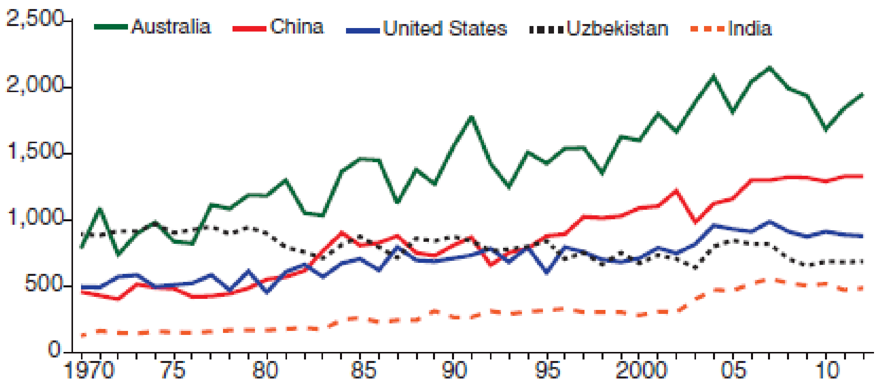
The Tsarist conquest of Central Asia paved the road to the development of the region. The Russians invested heavily in the cotton sector with a view to securing reliable (and cheap) supplies of cotton for their nascent textile industry. The area cultivated with cotton expanded more than ten-fold before World War I, often at the expenses of cereals and other food crops. Later, the Soviet Union sought to ensure full sufficiency in the cotton production and invested heavily in infrastructure and irrigation[41]. Cotton output reached five millions tonnes in the 1980s (ten times more than in 1913), while the land devoted to cotton exceeded 60 % of the total arable land in the region.

Increasing cotton production did not, however, result in the creation of a modern textile sector in the Socialist Soviet Republic of Uzbekistan (UzSSR). Instead, following a quasi-colonial approach, raw cotton was shipped to Western Russia, where most Soviet textile and clothing mills were located. Intensive cotton farming involved the extensive use of pesticides and other chemical agents and led to the progressive shrinking of the Aral Sea, with a devastating impact on the environment, especially in the west of the country.

After Uzbekistan's independence, cotton production declined due to a number of adverse factors.

After the independence, Uzbekistan reformed the primary sector to the preserve foreign exchange revenues from cotton exports. Tashkent successfully faced the decline of its traditional markets in Russia and Ukraine and re-directed its exports to Asian countries, notably China and Bangladesh. Despite government efforts, a steady reduction in cotton production and in output per hectare occurred as the result of reduced mechanisation, environmental constraints (e.g. soil degradation due to a lack of proper crop rotation) and water scarcity.

Figure 9:
Uzbekistan's cotton yields lag (kilograms per hectar)



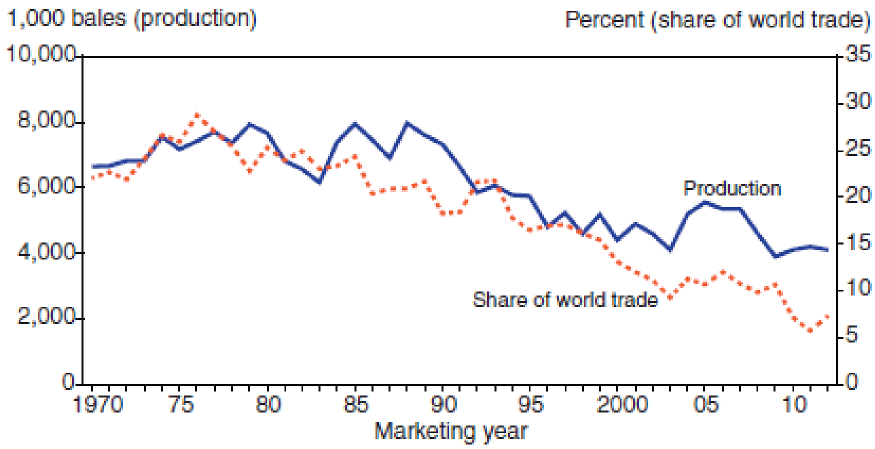
Source: USDA, Foreign Agricultural Service, Production, Supply and Distribution Online data, 2012; USDA, Foreign Agricultural Service, 1977.

Uzbekistan's share of the world trade in cotton declined accordingly (see chart below). Nevertheless, the country remains one of the leading

[41] Cornell University, Pros and Cons of Cotton production in Uzbekistan, (2010).

producers and exporters of cotton in the world (respectively sixth and fifth).

Figure 10: Uzbekistan cotton production and share of world trade, 1970-2012



Source: USDA, Foreign Agricultural Service, Production, Supply and Distribution Online data, 2012; USDA, Foreign Agricultural Service, 1977.

Arable land is owned by the state and leased to farmers.

As mentioned above, the Uzbek state retains exclusive ownership of the country's land. Farmers are granted non-transferable, usufruct rights based on land lease contracts of up to 50 years. Farmers are prohibited from selling, mortgaging or exchanging the leased land[42]. The cotton sector is heavily subsidised by the state, which also maintains the irrigation networks and provides, via local representatives, fertilizers, fuel and machinery services.

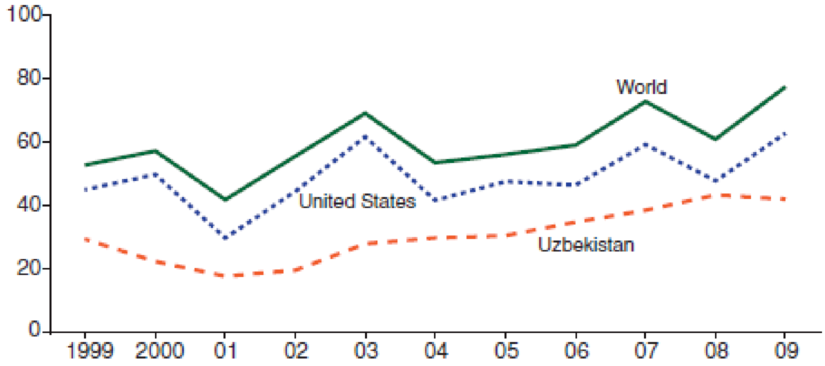
The 'state order' system that oversees the two 'centralised crops' (cotton and wheat) is largely inspired by Soviet collective systems. The Uzbek administration designs planting areas, sets production quotas and monitors farmers' efforts year-round, from planting to harvest.

Cotton prices are imposed by the government.

Cotton prices are not free to fluctuate and do not respond to free-market rules. At the beginning of each year, the government fixes cotton prices on the basis of global market prices, minus ginning, transportation, custom and certification costs and taxes. The difference between domestic cotton prices and global market prices is significant (see chart below).

[42] USDA, Economic Policy and Cotton in Uzbekistan (October 2012)

Figure 11:
World, United States, Uzbekistan cotton prices (cents per pound)

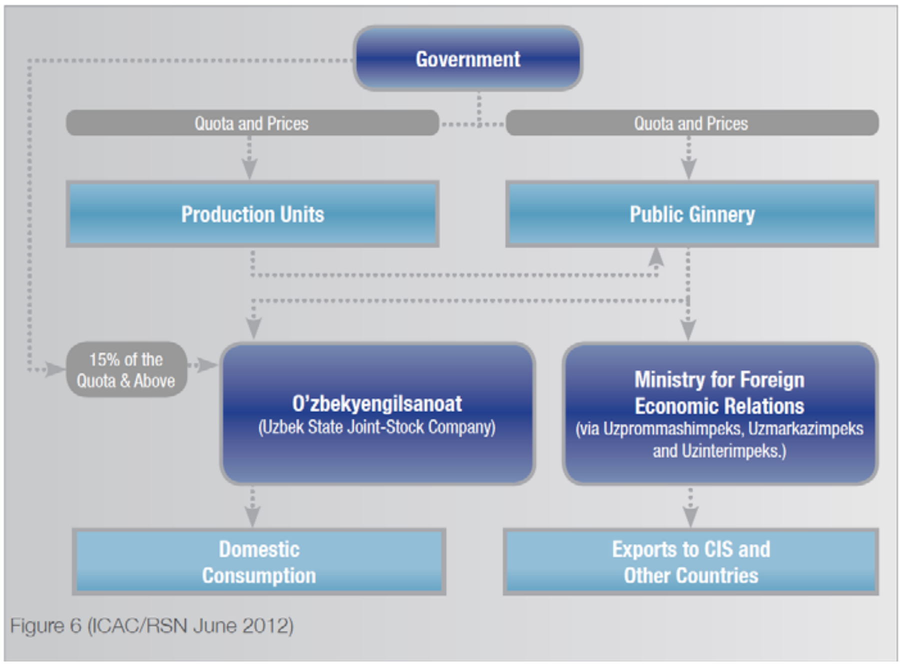


Sources: State procurement prices (SPP) from USDA's attaché in Tashkent and the International Cotton Advisory Committee (ICAC). U.S. cotton price from USDA, National Agricultural Statistics Service, 2011. World cotton price from Cotlook Ltd. Exchange rates from the United Nations Development Programme (2006) and TCX Investment Management Company B.V.

Cotton cannot be freely exported but must be sold to state-controlled intermediaries.

Producers have no choice but to sell their output exclusively through official channels in a context where international trade is strictly controlled. All cotton intended for export is sold to the three Uzbek government-controlled trading companies, Uzprommashimpeks, Uzmarkazimpeks, and Uzinterimpeks. As a result, the difference between local and global prices represents a sort of hidden levy imposed on farmers and guarantees an important source of revenues for the government. The requirement that farmers sell to the national trading companies limits global price transmission and allows resources to be transferred from producers, either directly by the government or indirectly through semi-governmental bodies[43].

Figure 12:
Uzbek export system



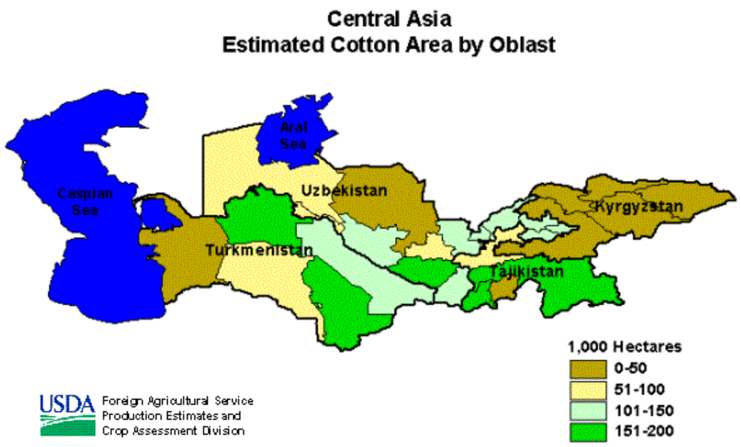
Source: Responsible Sourcing Network

[43] Responsible Sourcing Network: From the Field: Travels of Uzbek Cotton Through the Value Chain (2012).

Cotton revenues are not re-invested in rural communities.

A large share of cotton revenues are not returned to farmers or to the countryside in general, but are instead invested in the development of other economic sectors[44].

Typically cotton is planted in April and early May, while the harvest starts in September. Most of Uzbek cotton is planted along the Aydar-kul lake near Bukhara. Cotton is also grown along the border with Turkmenistan, next to the Amu Darya river, as well as in the region of Tashkent[45]. It has been calculated that about 90 % of all Uzbek cotton is picked by hand.



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Cotton is picked by hand, often by schoolchildren forced to work by local authorities.

During the autumn harvest, children as young as 10 years, have been forced to work as the result of a governmental system that requires local administrators and farmers to meet cotton harvest quotas. The numbers of children labouring in the fields has been estimated in the hundreds of thousands. Despite some limited improvements[46], most local officials continue to close schools for four to eight weeks during the harvest and oblige children to pick cotton to reach the mandated quotas.

Working conditions are often extremely harsh. Children frequently have insufficient food and clean drinking water. They work long hours, are carry heavy loads and are exposed to extremely high temperatures as well as hazardous chemical products. Children working in the fields may miss weeks of school, likely with a negative impact on their education.

[44] Ibid, footnote 40.

[45] International Cotton Advisory Committee: Cotton Fact Sheet Uzbekistan (2012)

[46] 2012 and 2013 reports indicate that the government, facing strong international pressure, has slightly changed its attitude and tends to restrict forced work to young people, including high school and university students.

They are paid very little, if anything, and their wages may be withheld at discretion. Those who refuse to participate in the cotton harvest may receive low marks or be expelled from school, and parents who complain may be fined[47].

Uzbekistan's use of forced child labour in hazardous conditions is unique in that it 'is not driven by criminal groups or by parents in desperate poverty forced to use their children to make ends meet'[48].

The government generally denies coercion, maintaining instead that children's work is performed on a voluntary basis or requested by individual families.

Uzbekistan has a proper set of laws on child labour, but they are hardly applied.

In theory, underage work in the fields is illegal in the country. The Labour Code of Uzbekistan and the Law on the Guarantees of the Rights of the Child, as amended in 2009, fix the minimum working age at 16 and the minimum age for part-time light work at 15. Hazardous activities, including the manual harvest of cotton, are expressly forbidden for children younger than age 18[49]. Unfortunately, the law has never been enforced.

Facing growing external pressure, on 26 March 2012, the Uzbek government adopted the Decree on Additional Measures for Implementation in 2012-2013 of ILO Convention 29 on Forced or Obligatory Labour, and ILO Convention 182 Concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour. The Decree requires the Ministry of Labour and Social Security to monitor cotton fields each year from August to October to ensure that children are not working.

International Labour Organisation inspectors are prevented from monitoring the implementation of international conventions on child labour.

However, despite this formal progress, there is little evidence that the Uzbek government is seriously working to put an end to this shameful practice – and this despite the fact that forced child labour has given the country a very poor image. The government has also stubbornly refuses to allow ILO inspectors to verify the situation in the fields.

The strength of the Uzbek economy and the increasing availability of public capital have apparently not led Tashkent to invest in modern cotton pickers, which can reduce recourse to manual workforce during the harvest[50]. The investment could be made by the farmers; however, as some authors have commented, 'the context is not conducive to investment in machinery, and economically less appealing given the availability of cheap labour. But more importantly, the price set by the government at which they purchase the cotton, leaves little surplus

[47] Ibid.

[48] EUCAM (Central Asia Monitoring): Harvesting the "white gold" (September 2011).

[49] US Department of Labour, 2011 Findings on the Worst Forms of Child Labour (2012)

[50] Centre d'Etudes en Géopolitique et Gouvernance (Université de Grenoble): Forced Child Labour in Uzbekistan, Some changes but not for better (March 2012).

[51] Ibid.

income for farmers to invest in machinery'[51].

The EU and the US have pushed Uzbekistan to end this unacceptable practice.

On 19 June 2013, the United States Department of State announced that it had lowered the rank of Uzbekistan's ranking in the US's annual 'Trafficking in Persons Report' because Tashkent had failed to end forced labour and curb human trafficking in 2012. The US urged Tashkent to address this issue [52].

Similarly, at the 102nd International Labour Conference held in Geneva in June 2013, the European Union pushed 'Uzbekistan to resolutely step up its efforts towards implementing ILO Convention 182 by re-engaging with the ILO on a broad-based, time-bound and long term cooperation work-plan, including relevant field activities related to harvest monitoring mechanisms, with a view to eradicating child labour in the cotton sector over a concrete time-span'[53]. (For the position of the European Parliament on this issue, see above.)

6. Conclusion

After its independence, Uzbekistan implemented a heterodox set of policies that – against all expectations – proved relatively successful. The country was able to achieve a comparatively smooth transition and resume credible rates of economic growth by the late 1990s. With the goal of achieving internal stability, the Uzbek government promoted import substitution policies to secure self-sufficiency in critical sectors such as energy and food.

Uzbekistan's road to a market economy is, however, far from complete, and the state retains an almost-total control over the country's economy. The system is also relatively murky, driven by elites and characterised by severe distortions. The overall business environment remains difficult, and foreign investments is encouraged only in selected cases. Social development has consistently lagged behind economic growth, and poverty has shrunk more slowly than could be expected.

Given the high international demand for raw materials and energy, Uzbekistan is likely to proceed with its own peculiar form of development. Yet it remains questionable for how long a system characterised by dominant state ownership and heavy public interference can resist before it needs consistent economic and social reforms.

[52] US Department of State, Global trafficking in persons (Uzbekistan): (2013)
[53] European Union statement on Uzbekistan, 102nd International Labour Conference (Geneva 5-13 June 2013).