

Republic of Uzbekistan: possible formats of interface and engagement with the Eurasian Economic Union

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Overview of the current situation

The foreign trade volume of Uzbekistan with the countries of the Eurasian Economic Union (EAEU) exceeds the volume of foreign trade with other trading partners (China, Turkey, South Korea). This trend is steady and apparently has a long-term nature.

Table 1. The foreign trade volume of the EAEU with Uzbekistan (2016-2017, mln. USD)*

	Trade turnover	Export	Import	Share in the trade with third countries (%)
2016	4 498	3 053	1 445	0,88
2017	6 081	4 118	1962	0,96

*Due to the fact that there are discrepancies in the trade statistics of Uzbekistan with external trade partners (in particular, with the EAEU countries), the author used the statistics published by the Eurasian Economic Commission to ensure the accuracy of the study and the comparability of the results.
http://www.eurasiancommission.org/ru/act/integr_i_makroec/dep_stat/tradestat/tables/extra/Pages/2017/12_180.aspx

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The foreign trade of the Republic of Uzbekistan with the countries of the EAEU with the exception of Armenia has a steady upward trend in recent years. However, the share of Uzbekistan in the foreign trade of the EAEU with third countries is less than one percent (0.96%).

**Table 2. The foreign trade between the EAEU member states and Uzbekistan
(2016-2017, mln. USD)**

	2016				2017			
	January-December			Share in trade turnover (%)	January-December			Share in trade turnover (%)
	Trade turnover	Export	Import		Trade turnover	Export	Import	
Belarus/Uzbekistan	63,7	35,8	27,8	0,26	130,9	96,1	34,7	0,43
Kazakhstan/Uzbekistan	1512,9	925,1	587,7	3,13	1985,3	1249,2	736,1	3,29
Kyrgyzstan/Uzbekistan	192,2	125,1	67,2	5,49	309,8	146,2	163,6	8,04
Russia/ Uzbekistan	2726,1	1965,3	760,7	0,63	3651,4	2625,1	1026,3	0,68
Armenia / Uzbekistan	3,3	1,8	1,4	0,09	3,5	2,2	1,2	0,08

The Russian Federation and Kazakhstan (3,7 bln. USD and 2 bln. USD respectively) are the two largest foreign trade partners of the Republic of Uzbekistan among the EAEU member countries.

EAEU - Uzbekistan: politics vs economy

As to the entry of Uzbekistan into the EAEU, the principle of refusing to participate in integration projects initiated by the power centers external to the Central Asian region remains unchanged. In the medium term, Uzbekistan is not planning to join the EAEU.

However, the country realizes that from the economic point of view the participation in the EAEU is beneficial for Uzbek business. In case of entry into the EAEU, Uzbek producers will get equal access to the market of the EAEU countries (primarily Russia and Kazakhstan), there will be created equal conditions for labor migrants and access to Russian investment resources and technologies will be obtained.

Uzbekistan is already experiencing certain problems when exporting its goods to the EAEU countries. The most striking example is the cars produced in Uzbekistan. As a result of restrictions within the EAEU where there are serious restrictive measures in relation to the Uzbek cars con-

nected with the level of localization of car production, in 2016 the export of cars produced in Uzbekistan to the Russian Federation and the Republic of Kazakhstan collapsed. As a result, Uzbekistan had to set up a joint production / assembly of Uzbek cars at the AZIA AVTO car factory. New car joint ventures in Kazakhstan should allow to sell cars produced by GM Uzbekistan in the EAEU countries under a preferential regime.

Meanwhile, the government of Uzbekistan believes that (based on the Kazakh and Kyrgyz experience of joining the EAEU) under the present circumstances the entry of the Republic of Uzbekistan into the EAEU will bring an increase in prices and a widespread and uncontrolled penetration of more competitive Russian goods into the Uzbek market. There is an awareness that the Uzbek business is not yet ready for the fierce competition with Russian manufacturers.

However, these aspects are not crucial to Uzbekistan in matters of participation / non-participation in the integration associations promoted in the post-Soviet area by Russia. The main reason for Uzbekistan's non-participation in the EAEU is the unwillingness to share sovereignty, to transfer a part of its sovereign authority to the supranational level. In particular, within the framework of its economic policy, Uzbekistan is not ready to transfer to the Eurasian Economic Commission (EEC) even a part of the authority to implement customs and tariff policies, regulate the banking sector and set phytosanitary standards, which is envisaged by the EAEU documents.

Thus, political considerations prevail over economic logic as far as the participation / non-participation in the EAEU is concerned.

Currently, after ratifying the Treaty of Accession to the Treaty on the Free Trade Area of the CIS, Uzbekistan has expanded its access to the markets of the EAEU countries (which are also members of the CIS). Uzbekistan feels comfortable in this format, as the Treaty on the FTA of the CIS does not imply the transfer of any sovereign authority to the supranational level but provides preferential access to the markets of the CIS countries. In 2019, when the preferential period of trade with the member countries of the FTA of the CIS expires for Uzbekistan, the country will have to begin a gradual reduction of protective tariffs and excise taxes on a range of goods.

In the near future, Uzbekistan has a task to move towards an export-oriented economy capable of attracting and effectively absorbing both domestic and foreign investments. Therefore, the national economy should be more open and integrated into the regional and global economies. The very logic of economic reforms that Uzbekistan plans to implement in the coming years will stimulate the search for acceptable forms of regional cooperation and integration.

In this context, it makes sense to launch new initiatives aimed at developing cooperation between Uzbekistan and the EAEU.

In particular, one of the options could be the creation of the EAEU Free Trade Zone - Uzbekistan. This initiative is being discussed in closed session in expert and government circles of Uzbekistan.

The formation of such FTA can be an important basis for deepening cooperation and a gradual harmonization of the legislative and regulatory framework, standards and norms of the EAEU and Uzbekistan. If the EAEU is ready to create a FTA with Vietnam, Israel and Egypt, then Uzbekistan has no less reasons to be considered such a partner. It seems that Russia, in view of the prospects for the development of Uzbek-Russian relations, can also encourage a dialogue on this issue with Uzbek expert and government circles.

There is no need to “drag” Uzbekistan into integration structures (causing protest, rejection and distrust from Uzbekistan). It is necessary to continue working in the format of bilateral relations in order to gradually bring them to a deeper interaction, first in the format of the Uzbekistan-EAEU and then, in the future, as a full participation of Uzbekistan in the EAEU.

At the same time, it should be underlined that **Uzbekistan’s policy of distancing itself from the integration projects dominated by the outside regional powers concerns not only Russia, but also, for example, China which is actively promoting the idea of creating a free trade area within the SCO.** But Uzbekistan perceives this Chinese initiative negatively. If such a FTA is established, China will gain a predominant influence due to the size of its economy and after a short time, the Uzbek business (and, by the way, not only Uzbek) will be under severe pressure from Chinese goods and Chinese business.

Areas of cooperation between Russia and Uzbekistan within and outside the EAEU

Bearing in mind the particular role and importance of the Russian Federation in the EAEU, economic cooperation with the Russian Federation is a priority for Uzbekistan in terms of foreign trade activization.

By 2030, Uzbekistan plans to implement 657 projects in the strategic sectors of the economy worth over \$40 billion. This list includes projects in industry, as well as those aimed at modernizing the transport infrastructure. The implementation of these projects will enable to increase the share of the industrial sector in GDP to 40 % by 2030 against 32.9 % in 2016.

To this end, it is only in 2017-2020 that Uzbek enterprises will allocate \$2.9 billion to replace heir obsolete equipment. The funds will be disbursed to purchase almost 23.1 thousand units of equipment which constitutes 11.8 % of the total equipment stock of the Uzbek industry. 14.35 thousand units of equipment worth \$1.88 billion will be replaced within the framework of investment projects while 8.7 thousand units worth \$1.037 billion will be replaced within the framework of sectoral technical renewal programs. Until January 1, 2021 equipment, materials and components imported as part of the projects included in the program are exempted from all customs duties.

Russian manufacturers can actively participate in the implementation of these programs through the supply of technology and equipment. For the Russian machine-building industry this is a chance to secure a foothold in the market of Uzbekistan. They need to work directly with the central government bodies and national companies (Uzbekneftegaz, Uzbekenergo, "Uzbekistan Railways" JSC and others) that develop sectoral modernization and technical re-equipment programs and are responsible for their implementation and financing.

On Uzbekistan's side, the main problems of institutional and financial nature which are currently becoming obstacles on the way to speed up the growth of trade between the countries are as follows:

1. The expansion of exports of high value-added products requires, firstly, considerable financial resources for their production (pre-export financing) and secondly, more complex financing instruments to promote such goods in the existing highly competitive global commodity markets (post-export financing). However, these tools are not yet used in Uzbekistan. Most commercial banks limit their activities to the issuance of short-term commodity loans, and their participation in investment processes is minimized. Banks provide loans for private business mainly under the pledge of property, guarantees or third-party sureties or a bad loan insurance policy. Such export financing schemes are characterized by relatively high prices and increased requirements for collateral security of bank loans.

2. Considering the fact that in Uzbekistan exports valued in Russian rubles are not recognized as hard currency exports, enterprises are not entitled to export goods for rubles using the "zero" VAT rate. This automatically leads to a rise in the cost of goods by 20%. Moreover, the export valued in rubles does not give the company the rights to the benefits that are provided to the exporters trading in hard currency. Under these circumstances, it is hard to ensure the growth of exports from Uzbekistan to Russia.

3. The gradual implementation of the policy of reducing the share of the US dollar in interstate settlements and the gradual transition to settlements in national currencies carried out by the leadership of Russia puts making foreign trade transactions between Uzbek and Russian exporters / importers in national currencies on the agenda.

Russia is one of the two largest (along with China) foreign trade partners of Uzbekistan, and this trend will continue. In order to provide opportunities for export growth to Russia, the government of Uzbekistan needs to make changes to the foreign exchange legislation. Particularly, one of the solutions could be a permission to export Uzbek products to Russia in rubles (an indication of the value of goods in Russian rubles without reference to the US dollar) with the use of privileges and preferences provided for the export of goods in hard currency. It should be noted that switching to rubles when exporting would allow Uzbek exporters to directly purchase industrial products of Russian origin not produced in Uzbekistan for rubles, without taking the unnecessary steps of conversion. This will allow preserving the currency balance of the country by reducing the need

for dollars for the purchase of products which Uzbekistan does not manufacture but Russia does. Addressing this issue should undoubtedly become an agenda item for serious intergovernmental discussions.

On the Russian side, several aspects of the organization of the Russian exporting system and promoting Russian industrial products limit the capabilities of Russian exporters (primarily in high-tech spheres).

A number of institutions have been established in the Russian Federation to support exports: Russian Export Center JSC (REC) is the key player, with a 100% government stake. The Eximbank of Russia and EXIAR insurance agency are parts of REC JSC.

The Eximbank of Russia finances the following:

- manufacturers - in order to prepare their manufacturing for the export contract (pre-export financing);
- bank of the country of the foreign customer for the export contract;
- the company that buys Russian products (tied loan).

Interest rates are 7.5% in rubles, 2.5% in USD, 1% in euros.

In order to obtain a loan from the Eximbank of Russia, financial and tax reports should be submitted for the last 3 years by a foreign company and a bank and for 5 reporting periods by a Russian company. This requirement makes it possible to work in this format only for large state-owned enterprises or companies that have long been operating in the market. But the principal customer of new technological equipment is small business and enterprises that are just starting their activities and cannot provide reports for the required period. This requirement would render the Eximbank of Russia credit lines meaningless. Accordingly, SMEs will go to buy Chinese equipment because the Eximbank of China does not impose such requirements.

The Republic of Kazakhstan

Uzbekistan and Kazakhstan are the two largest and most populated countries, the largest economies of the Central Asian region. At the same time:

1. The economies of Uzbekistan and Kazakhstan do not compete with each other and in many industries complement each other. Unlike Russia, with which Kazakhstan has strong competition in such sectors as oil production and hydrocarbon exports, grain production and exports, Uzbekistan and Kazakhstan have almost no sectors where national producers would compete with each other.

2. Kazakhstan and Uzbekistan have interdependence in the transport sector. Transit from Uzbekistan in the northern and eastern direction goes through Kazakhstan and a significant part

of the ever-increasing goods flow from Kazakhstan to the southern direction passes through Uzbekistan. Expanding cooperation in the transit of goods between Uzbekistan and Kazakhstan is not a matter of politicians' goodwill but an imperative requirement of the economy.

Kazakhstan and Uzbekistan are the largest trading partners in Central Asia. In 2017, the mutual trade between Kazakhstan and Uzbekistan amounted to about \$2 billion. In the medium term, the countries intend to increase this figure to \$5 billion.

After China and the Russian Federation, Kazakhstan steadily ranks the third in the list of the main foreign trade partners of Uzbekistan. Meanwhile, at the end of 2017 Uzbekistan was not in the list of the 10 largest foreign trade partners of Kazakhstan.

If we consider the composition of this trade, it turns out to be not a particularly rosy picture. For many years, natural gas, cotton fiber, fertilizers, fruits and vegetables remained the main exports of Uzbekistan to Kazakhstan. Kazakhstan mainly exports grain/flour as well as ferrous and non-ferrous metals to Uzbekistan.

For the medium term, the most important task is the diversification of the structure of foreign trade between the two countries.

It is vital to search for new formats of economic relations, in particular by creating conditions to set up new non-commodity productions, creating value chains in the automotive industry etc. The economic development strategies being implemented by countries are aimed at changing the structure of national economies. The goal is to form new sectors that could play the role of the countries' economic development drivers. It means that under the new conditions the countries will build new cooperation schemes (the creation of value chains in the automotive industry, petro chemistry, textile and pharmaceutical sectors).

There is an understanding of the need to develop new approaches. The agreement signed in September 2016 on the main areas of trade and economic cooperation between Uzbekistan and Kazakhstan is focused on the creation of joint trading houses to sell petrochemical, engineering, electrical and pharmaceutical products. There is a serious potential in establishing joint ventures for processing and exporting fruit and vegetables to third countries.

The Republic of Belarus

As the results of the state visit of the President of the Republic of Belarus A.G. Lukashenko to Uzbekistan in the middle of September 2018 show, Uzbekistan is interested in Belarus for its technological capabilities. These are mechanical engineering, machine-tool construction, pharmaceuticals, the food industry and the agro-industrial complex. Belarus can become a serious partner for Uzbek enterprises in the implementation of modernization and technical re-equipment programs for Uzbekistan's industries. In addition, the following plans were announced:

- Organization of the manufacturing of confectionery products under the license of the Belarusian enterprise “Kommunarka” in Uzbekistan and an increase in the supply of Belarusian sugar.
- Belarus has a well-established pharmaceutical industry. Uzbekistan and Belarus are implementing several projects in this area.
- Efforts to implement fruits and vegetables processing projects have been initiated.
- Cooperation in the field of information and communication technology is underway.
- Uzbek car manufacturers hope to enter the Belarusian market (especially with the cars that will be assembled in Kazakhstan).
- Tashkent and Minsk want to launch agricultural engineering joint ventures.

The interest of Belarus in Uzbekistan is obvious. Uzbekistan is a large market in Central Asia and the most important thing is the possibility of introducing the joint Uzbek-Belarusian goods to the markets of third countries, Afghanistan, Pakistan and others. At the same time, unlike Kazakhstan, the wage rates, one of the main production factors, are lower in Uzbekistan, therefore, it is more profitable to build joint ventures in Uzbekistan and to enter other markets with their products. Other countries in the region, such as Tajikistan, have a small market volume and cannot be potential consumers of Belarusian products.

According to the plans announced by the President of Belarus, within 5 years the trade between the countries can be increased from approximately \$130 million to \$1 billion. According to our estimates, \$500 million seems to be a more realistic target.

Kyrgyzstan

In 2017, during the state visits of the presidents of Uzbekistan and Kyrgyzstan, there was a breakthrough in the area of possible participation of Uzbekistan in the construction of hydropower plants in Kyrgyzstan. It was announced that Uzbekistan did not object to the construction of hydropower plants on the Naryn river and was even ready to co-finance these projects. However, so far there is no clarity about the basic principles of participation or about the financial conditions.

An important step forward was the agreement on the readiness of the Republic of Uzbekistan and the Kyrgyz Republic to implement projects to construct motorways (and later railway) from Uzbekistan to China across Kyrgyzstan.

These projects are based on actual facts. The Transcaucasia railway corridor (Baku-Kars) has already been constructed. Two bridges (road and railway) were put into operation across the Amu Darya on the border of Uzbekistan and Turkmenistan. Turkmenistan is investing heavily in the upgrading of the port of Turkmenbashi in the Caspian Sea. On the whole, the last joint remains, China-Kyrgyzstan-Uzbekistan, in order to start the southern corridor: China-Kyrgyzstan-Uzbekistan-

Turkmenistan-Azerbaijan-Georgia-Turkey. A principal issue with China regarding the width of the railway gauge has been agreed upon.

Nowadays Uzbekistan imports electricity from Kyrgyzstan (purchases were resumed in the summer of 2017). Kyrgyz exports are represented by a small volume of goods of a limited range: potatoes, meat, raw materials for the cement industry. In the opposite direction - from Uzbekistan to Kyrgyzstan - the flow of goods can be incomparably larger. In particular, the issues of increasing the supply of Uzbek household appliances, furniture, and cars are being addressed. Plans are underway to create a number of Uzbek-Kyrgyz car assembly plants in southern Kyrgyzstan.

Armenia

Due to the fact that there are serious limitations in the field of foreign policy relations between Uzbekistan and Armenia (because of the unresolved Karabakh problem and the principle position of Uzbekistan on this matter), the level of economic relations between the two countries remains weak, with a tendency to decline in recent years. There is no reason to expect a sharp increase in trade between the two countries in the short term.

In lieu of a conclusion: the prospects for interaction at the expert level

An In-depth analysis and expert assessments are the basis for making political and economic decisions at all levels.

Today, Uzbekistan does not participate in the integration institutes initiated by Russia (the CSTO and the EAEU). It creates certain limitations to a more active cooperation in various fields, and, in particular, in the field of the expert-analytical interaction between the two countries'.

Therefore, it is necessary to search for new formats of interaction between the expert-analytical communities of the two countries, with an emphasis on the development of bilateral relations.

It would be useful to create a pool of research organizations of the Russian Federation and the Republic of Uzbekistan, including Russian organizations (the Institute of Oriental Studies of Russian Academy of Sciences and others) and Uzbek analytical organizations, which can be both private and government-funded. It will enable to form a permanent expert dialogue platform for expert discussions and the support of the processes of political, economic and humanitarian cooperation between the two countries.

Within the framework of this expert format it would be possible:

- to hold a cycle of round tables on export support issues (pre-export and post-export financing, evaluation of positive and negative experience of institutions and export financing ar-

rangements both in the Russian Federation and Uzbekistan) with the participation of expert researchers, businesses (exporters), business associations, public officials, etc.

- to prepare a joint study assessing the effects of Uzbekistan's entry / non-entry into the EAEU (using economic statistics and econometrics tools) followed by wide-range presentations for target groups (business, government authorities, mass media).