UZBEKISTAN

TRADE SUMMARY

The U.S. goods trade deficit with Uzbekistan was $97 million in 2006, an increase of $76 million from $22 million in 2005. U.S. goods exports in 2006 were $54 million, down 26.9 percent from the previous year. Corresponding U.S. imports from Uzbekistan were $151 million, up 58.4 percent. Uzbekistan is currently the 148th largest export market for U.S. goods.

The stock of U.S. foreign direct investment in Uzbekistan in 2005 was $114 million (latest data available), up from $107 million in 2004.

The U.S.-Uzbekistan Bilateral Trade Agreement, which entered into force in 1994, provides for normal trade relations (NTR) between the United States and Uzbekistan and governs other aspects of the bilateral trade relationship. The U.S. Government, however, has not acted to bring this agreement into force, and is unlikely to do so until the investment climate in Uzbekistan significantly improves. In 2004, the Uzbeks signed the regional Trade Investment Framework Agreement (TIFA) with the U.S. Trade Representative's Office and its four Central Asian neighbors. Uzbekistan is still negotiating terms of accession to the World Trade Organization (WTO).

IMPORT POLICIES

The government of Uzbekistan restricts imports in many ways, including through high import duties, licensing requirements for importers and wholesale traders, restricted access for sellers of imported items to retail space, and limited access to hard currency and the local currency (the soum).

Uzbekistan's trade policy is based on import substitution. The multiple exchange rate system and the highly over-regulated trade regime have led to both import and export declines since 1996, although imports have declined more than exports, as the government squeezed imports to maintain hard currency reserves. Draconian tariffs, sporadic border closures and crossing "fees" decrease imports of both consumer products and capital equipment.

Highly discriminatory excise taxes exist to protect locally-produced goods. Unofficial payments to customs officials are a normal part of trans-border trade. Imports are prohibitively expensive for the majority of Uzbeks, due to duties on products such as cars, electronics, appliances, foodstuffs and textiles. The government claims the duties are a temporary measure to prevent a surge in imports while it gradually eliminates barriers to trade, such as hard currency quotas, as part of the economic reform process.

Excise tax, charged as a percentage of the declared customs value, must be paid on certain products, such as cigarettes, vodka, ice-cream, oil and gas condensate, fuels, cars and carpets. Excise tax rates vary depending on the type of imported good and may deviate significantly. In 2005, the government raised excise taxes between 30 percent and 70 percent on a number of meat products. On December 18, 2006, new excise taxes were introduced for basic consumer items, varying from 5 percent to 200 percent depending on local production of like goods. In 2006, excise taxes accounted for approximately 12.6 percent of the total Uzbek budget revenue. The U.S. Embassy estimates the average increase in excise taxes for 2007 is 15 percent.

According to reports from foreign investors, "unofficial duties" combined with other tariffs and taxes can cost as much as 100 percent to 150 percent of the amount of the actual value of the product, making the product unaffordable for virtually everyone in the country. For example, imported liquor is subject to an excise tax of 70 percent to 85 percent (depending on type) versus 40 percent to 65 percent for domestic liquors. Additionally, at the retail level, imported automobiles have been subjected to duties and taxes totaling approximately 100 percent. Tariffs are officially 30 percent for most textile products, home furnishings and essentially all other fabrics and apparel, and 90 percent for carpets and rugs.

The government also requires retailers to present certificates of origin and customs receipts for imported products upon the request of tax or customs authorities. The Uzbek government often confiscates goods found without such certificates. A decree enacted in August 2004 imposed further bureaucratic restrictions on traders. In addition to demanding that all individual traders be registered with the local authorities and the Ministry for Foreign Economic Relations, Investment and Trade, traders will have to prove that they have a commercial bank account and imported the goods themselves from the originating country. Surveys of foreign companies consistently conclude that restrictions on access to local currency in order to transact business and pay employees is one of the worst of the many serious obstacles to doing business in Uzbekistan.

In 2005 and 2006 the Uzbekistan government continued to restrict imports by limiting access to hard currency for private importers. Uzbekistan introduced currency convertibility in October 2003. Although the government committed itself to the provisions of IMF's Article VIII on currency convertibility, multiple restrictions remain in place. All legal entities, including those with foreign investments, must have the Central Bank's permission to deal in foreign currency.

The government continues to restrict consumer goods imports in order to prevent hard currency flows and curb the threat of devaluation of the soum. In both 2005 and 2006, private businesses reported regular conversion delays of three months from August through December.

Although clearance of import contracts with the state-controlled clearing company is no longer needed for customs registration, the regulation requiring the registration has not been abolished. The State Customs Committee still turns down about 5 percent of contracts submitted for registration, purportedly due to mistakes in documents. The companies entitled to convert local currency under import contracts encounter problems with arbitrary requests for documentation by banks. While the required documents are outlined in the instructions issued by the relevant bank, these instructions are often amended without any prior notice. As a result, documents are often rejected on disputable grounds and conversion can be delayed, which results in devaluation losses for the importer. Businesses must deposit the funds to be converted with the Central Bank for the entire duration of the Committee's review of the request. Bank dealers have reported cases in which the Central Bank did not approve applications for conversion for some of their clients who needed large sums of hard currency.

In addition to official barriers, the customs clearance process is overburdened with unofficial bureaucratic obstacles leading to significant processing delays of two to three months, even for U.S.-Uzbek joint ventures. Problems include the arbitrary seizure of goods, as well as frequent official and unofficial changes in customs procedures without prior notification. Excessive documentation also makes the Uzbek importing process costly and time consuming. The lack of proper equipment and legislative regulations creates an environment in which the customs official on duty can arbitrarily apply his or her own case-by-case search and seizure procedures. In 2004, the government of Uzbekistan made an effort to increase the transparency of regulations used at customs border posts, primarily by posting all relevant regulations and decrees where traders can review them.

Surveys of foreign companies consistently conclude that trade/border/customs restrictions are the worst of many serious obstacles to doing business in Uzbekistan. Despite the fact that there is a law legalizing duty-free imports for foreign investors, it is mandatory to have a legally binding agreement with the government that waives customs fees and other duties when importing goods for investment purposes.

STANDARDS, TESTING, LABELING AND CERTIFICATION

The system of standardization, accreditation, certification and application of sanitary and phytosanitary (SPS) standards presents significant barriers to trade. Uzbekistan accepts U.S. manufacturers' self-certification of conformity with Uzbek foreign product standards and environmental regulations. All foreign products must be labeled in Russian and Uzbek. Domestic entities, including government enterprises, must also meet these mandatory-labeling requirements. The National Agency of Standards (Uzstandard) is in charge of certification and accreditation. The government is still in the process of drafting a new law on technical regulations.

In August 2004, Uzbekistan's Parliament ratified a decision to join the International Union on Plants Variety Protection, which has been in force since November 11, 2004.

GOVERNMENT PROCUREMENT

There is no systematic approach to government procurement in Uzbekistan. Instead, procurement decisions are generally made on a decentralized and *ad hoc* basis. Often, the procurement practices of the central government are similar to those of many countries, incorporating tenders, bid documents, bids and a formal contract award. A law enacted in 2002 created more transparency in the procurement process by mandating that all government procurement over $100,000 be completed on a tender basis. However, many tenders are announced with short deadlines and are awarded to companies in a non-transparent manner. Uzbekistan is in the process of modifying its trade regime to become a member of the WTO, and it is not yet a signatory of the WTO Agreement on Government Procurement. However, government entities are more frequently announcing tenders in local newspapers and magazines.

The most serious barrier to trade with respect to government procurement is in the field of contract obligations. There are numerous cases in which the Uzbek government is not complying with contract obligations in relation to procuring equipment, equipment pricing and payment guarantees. Further, there are several cases in which a U.S. company provided product for a government tender and then was not paid.

EXPORT SUBSIDIES

The government of Uzbekistan provides agricultural subsidies on cotton in the form of heavily subsidized inputs, such as electricity, water and fertilizer, to farmers who can then sell their cotton directly to the government. This creates an end product that can be sold more cheaply in the international market. Moreover, in December 2002, the government issued regulations allowing cotton farmers to sell half of their actual harvest, most often to the government, at more favorable prices than those allowed in the state order system. It is unclear, however, how well the new regulation is being enforced by the end consumer, which in 90 percent of cases is still the Uzbek government.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Significant deficiencies remain in Uzbekistan's intellectual property protection regime. Due to these deficiencies, there is an ongoing review of Uzbekistan's status as a beneficiary country under the U.S. Generalized System of Preferences (GSP) Program. Uzbekistan has been on the Special 301 Watch List since 2000.

The government adopted the "Law on Copyright and Related Rights" in 2006. The law provides comprehensive definitions of terms, addresses collective rights management and compulsory licensing to the producers of phonograms, authors, performers and subjects of related rights. In 2005, Uzbekistan joined the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention), but the government declared an exception to Article 18, which requires that signatory countries extend copyright protection to pre-existing works.

It is a challenge to purchase legal recordings in Uzbekistan. Current border enforcement is weak. As a result, illegal recordings freely cross into Uzbekistan for sale. Additional personnel and training courses are needed for more effective border enforcement. Uzbekistan does not provide for either civil or criminal *ex parte* search procedures needed for effective anti-piracy enforcement.

SERVICES BARRIERS

The government has created an insurance supervisory board and a licensing system for insurance companies. Uzbekistan imposes a 10 percent withholding tax on reinsurance premiums for policies with reinsurers from countries that do not have a double taxation treaty with Uzbekistan. As the United States and Uzbekistan do not have such a treaty, U.S. reinsurers must add the 10 percent charge to their premiums.

Uzbek law grants state-owned companies a monopoly over certain forms of mandatory state insurance (i.e., mandatory insurance paid for out of the state budget). Foreign banks may not operate in Uzbekistan except in a subsidiary status, which makes the banks subject to Uzbek laws, including the requirement of a charter capitalization fund of $20 million. This is a common requirement in other Commonwealth of Independent States (CIS) countries as well. The $20 million fund requirement does not apply to Uzbek firms. The government determines the required size of the charter funds for Uzbek firms on a case-by-case basis.

The government has granted exclusive control over all international telecommunications services to the Uzbektelekom Company, the largest national telecommunications operator owned by the state. All international voice and data transmission services, including Internet and IP-telephony, must be provided over Uzbektelekom's network. All national data transmission services must be provided by UZNET, a branch of Uzbektelecom.

INVESTMENT BARRIERS

According to official statistics, foreign investment for the first nine months of 2006 totaled $545.9 million. However, the Uzbeks classify foreign loans for goods and services as foreign investment. Uzbekistan says it plans to attract $1.22 billion dollars of foreign investment in 2007.

Under two laws implemented in 1998, to be considered "an enterprise with foreign investment" a firm must be at least 30 percent foreign-owned and have initial foreign equity of $150,000; otherwise, a firm is treated as a domestic enterprise. Normally this equity is "hidden" through assets such as equipment or

technical expertise. Although reduced from previous levels, these ownership and capital requirements are still high enough to discourage foreign investment by small companies. U.S.-owned companies in Uzbekistan also face cumbersome regulations and licensing requirements. Profit repatriation remains extremely difficult for foreign-owned companies due to frequent government interference and restrictions on currency conversion.

In the past, businesses wishing to initiate operations in Uzbekistan were required to register and obtain licenses from several different government entities. In 2001, the government introduced legislation to create a "one-stop shop" to make the registration process easier. These one-stop shops, which are located in local government offices (hokimiyats) throughout Uzbekistan, have reportedly made it easier to start a new business. But even with the new regulations, businesses often must satisfy bureaucratic requirements in multiple government offices.

Uzbekistan's Tax Code, introduced for the first time in 1998, lacks provisions that are key parts of the tax regime in most countries. For example, unless a company receives permission through a special presidential decree, Uzbekistan allows no credit for VAT on capital imports, including plant, machinery, and buildings. This practice puts firms operating in Uzbekistan at a competitive disadvantage compared to those in countries that do allow such credits. In addition, earnings of foreign-owned enterprises are subject to double taxation.

Another significant problem in the Uzbek Tax Code relates to the classification of expenses. Many expenses that are normally deductible for purposes of calculating taxable profits are not deductible under the Tax Code, thereby increasing the effective tax burden in comparison to other countries. In most countries, for example, expenses such as advertising and business travel are not subject to taxation. In Uzbekistan, however, travel is not deductible and the deductibility of advertising is linked to an archaic and onerous formula. In 2005, the government initiated a major revision of the tax code. The changes, however, have yet to be officially announced or implemented. The government continues to work with local tax experts and the United Nations Development Program to complete its revision of the tax code.

Foreign firms in Uzbekistan face higher than average labor costs. The corporate income tax rate has been lowered to 10 percent over the past two years, but firms must also make a mandatory contribution for insurance of 24 percent. While most Uzbek companies evade their tax obligations, foreign investors generally adhere to the law. U.S. companies have also complained that Uzbek laws are not interpreted or applied in a consistent manner. On many occasions, local officials have interpreted laws in a manner that is harmful to individual private investors or to the business community more broadly. Companies are particularly concerned about the lack of consistency and fairness in the application of the Foreign Investment Law, which contains a number of specific protections for foreign investors.

Due to the burdensome, unstable tax and regulatory environment, foreign investors in Uzbekistan often seek special tax and regulatory abatements in the form of Cabinet of Ministers decrees, which must be signed by the President in order to be approved. Such decrees have been helpful to foreign investors in certain strategic industries (e.g., mining, oil and gas, and large manufacturing). The process of requesting tax or regulatory abatements is lengthy and unpredictable, however, and lacks the necessary transparency required to attract significant investment over the longer term. Despite the protections that such decrees are meant to provide, investors working under Cabinet of Ministers decrees still face significant regulatory and bureaucratic impediments.

Persons doing business in Uzbekistan note that if they are engaged in a sector in which either the government or an Uzbek-controlled firm is a competitor, they face higher bureaucratic hurdles and currency conversion problems. Potential competitors are often not allowed to invest in such sectors. The

regulatory framework for joint ventures in Uzbekistan is extremely burdensome. Many international corporations complain that the government demands more financial reports than are necessary from shareholders.

The judiciary in Uzbekistan is not independent. In the event of disputes, courts usually favor firms that are controlled or owned by the state. Disputes involving foreign-owned businesses are common and have proven difficult to resolve even with high-level intervention from senior U.S. officials.

Investors cannot count on the government to honor an international arbitration award in favor of a foreign plaintiff. A late 2006 government court reinterpretation of Uzbek arbitration regulations states that unless both Uzbek and foreign partners agree in writing to conduct a specific arbitration, the government will not honor an arbitral award. Contractual provisions for international arbitration are insufficient. If international arbitration is permitted, awards can be challenged in domestic courts. The Ministry of Justice is responsible for the resolution of all international commercial disputes, but the Ministry's power is limited and frequently co-opted by more influential powers within the government. A number of foreign companies have not received full payment even after being awarded monetary damages in international arbitration. Others have pursued claims and won in the Uzbek courts, only to have the government refuse to enforce the award. There are several cases, however, in which international arbitration awards have been successfully enforced.

Another barrier to investment is the perception that Uzbekistan will not consistently implement its international obligations. One long-standing case involves a decision in favor of an international grain company by the Grain and Feed Trade Association in London, the arbiter agreed to by Uzbekistan when the contract was signed. Uzbekistan has indicated that it will not honor the arbitral award.

OTHER BARRIERS

Much of the Soviet-era economic system remains today, needlessly complicating simple transactions and costing businesses time and money to overcome. Uzbekistan's extensive trade barriers encourage consumers to buy domestically-produced goods. High duties, taxes and tariffs price the majority of imported consumer goods out of reach for the average Uzbek who earns $50-80/month. Corruption at all levels of government creates non-transparent, often kleptocratic, tender processes. Local enforcement of international and domestic rule of law is unreliable; special decrees for business tax benefits can be, and are, capriciously revoked. With so many overlapping, and somewhat intangible trade barriers, it is difficult to gauge the specific monetary impact a barrier has on the U.S.-Uzbek trade balance. The removal, or softening, of one barrier would likely cause another's augmentation, if not the creation of an entirely new barrier. The overall poor political climate between the United States and Uzbekistan has also been a formidable barrier to trade.

American investors unanimously complain that they do not control their corporate bank accounts in Uzbekistan. The main problem involves restrictions on businesses' access to, and use of, cash in their accounts. Every routine banking operation requires official permission. As a result, businesses expend an enormous amount of senior staff time on simple transactions. A March 24, 2000, decree improved this situation by allowing many farms, restaurants, cafes and other small and medium enterprises with foreign investment ($150,000 or more in foreign capital) to access their own funds in commercial bank accounts, so long as those funds were received and deposited within the previous 90 days.

Most other businesses may hold cash for only a small number of permitted purposes, such as paying salaries and travel expenses. All other money must be held in the bank. Cash receipts must be deposited on the day in which they are received. Even small purchases, such as office supplies, must be paid for

using a bank transfer. Uzbek companies handle this problem by making salary withdrawals for non-existent staff. Western accounting practices prevent U.S. companies from using these deceptive practices, and instead, companies are required to wait for as long as a week or more for a wire transfer to arrive before purchases of any kind can be made.

Local and international entrepreneurs face payoff-seeking officials due to pervasive corruption, exacerbated by low salaries for officials and an opaque, cumbersome, and internally contradictory legal regime that makes it difficult for business owners to comply with Uzbek regulations. It is reported that local, regional, and national officials, police officers, as well as tax, customs, fire, health, safety, and labor inspectors are all susceptible to bribery and other corrupt practices.