UZBEKISTAN

TRADE SUMMARY

The U.S. goods trade balance with Uzbekistan went from a trade surplus of $142 million in 2004 to a trade deficit of $22 million in 2005. U.S. goods exports in 2005 were $74 million, down 68.0 percent from the previous year. Corresponding U.S. imports from Uzbekistan were $96 million, up 8.7 percent. Uzbekistan is currently the 139th largest export market for U.S. goods.

The stock of U.S. foreign direct investment (FDI) in Uzbekistan in 2004 was not available, $77 million in 2003.

IMPORT POLICIES

The Government of Uzbekistan restricts imports in many ways, including 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).

Highly discriminatory excise taxes exist to protect locally produced goods. From November 1, 2005, the government raised excise taxes on a number of food products as well: from 50 percent to 70 percent on meat and sub products of poultry (in addition to a 30 percent import duty), and from 10 percent to 30 percent on final products made of meat and fish. A Presidential Decree introduced new excise taxes of 20 percent on imported beef and 40 percent on crackers. New excise taxes were also introduced on imported entertainment goods (30 percent), as well as differentiated imported duties on 46 different knitted products. A slight increase was also introduced on imported sugar (20 percent to 30 percent). Combined with unofficial payments that often must be made to border and customs officials to import goods, most imported goods are prohibitively expensive for the majority of Uzbeks.

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 reportedly subject to an excise tax of 90 percent versus a rate of 40 percent to 65 percent for domestic liquors. Additionally, at retail level, imported automobiles have been subjected to duties and taxes totaling approximately 100 percent.

Tariffs are officially (not including unofficial duties) 30 percent for most textile products, including carpets and rugs, home furnishings, and essentially all other fabrics and apparel.

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 new decree enacted in August 2004 imposed further import 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 the 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 2004 – 2005, the Government of Uzbekistan continued to restrict imports by limiting access to hard currency for private importers. On October 14, 2003, the Government of Uzbekistan accepted the International Monetary Fund's Article VIII agreement. This led to dramatic legislative changes in the import registration system and the import regime as a whole. One of these new changes states that companies that are not government-owned do not need advance approval for each import contract. However, the government continues to restrict consumer goods imports in order to prevent hard currency flows and curb the threat of devaluation of the soum (see above). Unfortunately, in recent months the GOU has taken several steps backwards. Currency conversion has slowed significantly. The Central Bank is currently about two months behind in processing imported goods conversion requests and six weeks behind in raw material orders.

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 five 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 for up to a month, which results in devaluation losses for the importer. 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 full of 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 provides 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 regulation transparency at customs border posts, primarily by posting all relevant regulations and decrees where traders can review them.

STANDARDS, TESTING, LABELING AND CERTIFICATION

The system of standardization, accreditation, certification and application of sanitary and phytosanitary (SPS) standards still presents significant barriers to trade. Currently, Uzbekistan applies a mandatory certification requirement to most of its imported and domestically produced products. The National Agency of Standards (Uzstandard) remains in charge of certification, accreditation and state control. The Uzbek Government is in the process of drafting a new law on technical regulation designed to bring Uzbekistan's regime in line with the requirements of the WTO Technical Barriers to Trade (TBT) and SPS Agreements.

The Commonwealth of Independent States has an agreement on mutual recognition of certificates, which is not being fully honored by Uzbekistan. 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.

The Government of Uzbekistan accepts U.S. manufacturers' self-certification of conformity with Uzbek foreign product standards and environmental regulations. Effective June 2003, all foreign products must be labeled in Russian and Uzbek. Industry reports that some domestic entities, including Uzbek Government enterprises, do not have to meet these mandatory-labeling requirements.

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 based on corruption. 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.

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 export subsidies on cotton in the form of heavily subsidized inputs, such as electricity, water and fertilizer, to farmers who then sell their cotton directly to the Uzbek government. This creates an end product that can be sold more cheaply in the international market. Moreover, in December 2002, the Government of Uzbekistan issued regulations allowing cotton farmers to sell half of their actual harvest, most often back 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 regime for the protection of intellectual property. 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.

In 1996, the Government of Uzbekistan undertook a comprehensive revision of its copyright law, but copyright protection in Uzbekistan remains significantly below international standards. In its December 2000 session, the Uzbek parliament made minor changes to the Uzbek copyright law and added trademark protections. The 2000 copyright amendments put in place additional protection for national authors and producers of sound recordings; however, these amendments did not extend protection to all works and recordings. In 2005, Uzbekistan joined the Berne Convention for the Protection of Literary and Artistic Works (Berne Convention), but the Uzbek Government declared an exception to Berne Article 18, which requires that signatory countries extend copyright protection to pre-existing works. Further, Uzbek law does not protect U.S. sound recordings, and, although the Government of Uzbekistan has announced its intention to join the Geneva Phonograms Convention, it has not yet applied to do so.

Enforcement of intellectual property remains weak in Uzbekistan. Pirated audio and videotapes and compact disks are sold openly. In fact, 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

For years, the most significant barrier to foreign services firms entering the Uzbek market has been difficulty in currency conversion. The Uzbek Government's adoption of currency convertibility in October 2003 eased the process of conversion in 2004 and the

first half of 2005. However, during the second half of 2005, conversion procedures began to slow again. According to unofficial estimates, the Central Bank is two months behind on import-related conversion requests and six weeks delayed on raw material-related requests.

Although the Government of Uzbekistan has created an insurance supervisory board, a system of licensing insurance companies does not yet exist. Insurance firms can currently only operate in Uzbekistan on the basis of a governmental decree. Uzbekistan imposes a ten 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 ten 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 of Uzbekistan determines the required size of the charter funds for Uzbek firms on a case-by-case basis.

In 1999, the Uzbek Government issued a decree ordering all Internet Service Providers (ISPs) to be re-registered with the state-owned monopoly UzPAK and to obtain new ISP licenses, forcing all ISPs to provide services only over UzPAK lines. In October 2002, the Uzbek Government rescinded its decision as a part of larger market reforms and removed UzPAK's monopoly powers. The Uzbek Government then reversed this decision first unofficially beginning in March 2003 and then officially in November 2004, giving UzPAK monopoly powers once again. The Uzbek Government has granted exclusive control over all international telecommunications services to Uzbektelekom, the largest national telecommunications operator. All international voice and data transmission services, including Internet and IP-telephony, must be provided over Uzbektelekom's network.

INVESTMENT BARRIERS

According to the Uzbek State Statistics Committee, the volume of foreign investment (including foreign loans covered by Uzbek Government Guarantee) in January-September 2005 decreased 6.4 percent in comparison with the same period in 2004. Foreign investment for the first nine months of 2005 totaled $343.5 million, with investment backed by sovereign guarantee totaling $96.87 million (2.2 times less than for the same period in 2004), and direct investment equaling $246.6 million (60 percent increase).

To be considered "an enterprise with foreign investment" under the new laws implemented in 1998, 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. The Government of Uzbekistan has postponed consideration of proposals to ease these requirements further. U.S.-owned companies in Uzbekistan also face cumbersome regulations and licensing requirements. Profit repatriation remains extremely difficult for foreign-owned companies due to constant government interference.

In the past, businesses had to register with numerous government organizations and obtain licenses from separate entities. However, in 2001, the Government of Uzbekistan introduced legislation to create a "one-stop shop" to make the company registration process easier. These one-stop shops are located in local government offices (Hokimiyats) throughout Uzbekistan and have reportedly made it easier to start a new business. However, even with the new regulations, businesses sometimes must satisfy bureaucratic requirements in multiple government offices.

Uzbekistan's Tax Code, introduced for the first time in 1998, lacks important provisions that are part of the business environment 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 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. Their earnings are taxed in Uzbekistan and then taxed again when remitted to the foreign parent. Another significant problem in the Uzbek Tax Code involves the classification of expenses. Many expenses that are normally deductible for purposes of calculating taxable profits are not deductible under the Uzbek Tax code, thereby increasing the effective tax burden in comparison to other countries. In most countries, expenses such as advertising and business travel are not subject to taxation. In Uzbekistan, however, travel is not deductible and advertising is only deductible based on 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.

Foreign firms in Uzbekistan face high labor costs. Corporate income tax rates, although reduced slightly over the last two years, total 18 percent, which is combined with a mandatory contribution for insurance 32 percent, a rate significantly higher than other similarly developed countries. While most Uzbek companies successfully evade their tax obligations, foreign investors generally adhere to the law. The Government of Uzbekistan imposed minimum salary requirements in 2001 to obligate foreign firms to pay full taxes on their employees. 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 detrimental to individual private investors and the business community at large.

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 tax code and regulatory environment, foreign investors in Uzbekistan often find it necessary to 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 is lengthy and uncertain, 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 of Uzbekistan or an Uzbek-controlled firm is a competitor, they face higher bureaucratic hurdles and currency conversion problems. Often, competitors are not even allowed in such sectors.

Businesses complain that they lack access under Uzbek law to international arbitration. Moreover, 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. policymakers and legislators.

Finally, the regulatory framework for joint ventures in Uzbekistan is also extremely burdensome. Many international corporations complain that the Government of Uzbekistan demands more financial reports than are necessary for shareholders.

OTHER BARRIERS

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 ninety 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 with salary withdrawals for non-existent staff. Western

accounting practices prevent American 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.

Another barrier to investment in Uzbekistan is the perception that Uzbekistan will not in all cases implement its internationally contracted obligations. A 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 ruling.