

# UZBEKISTAN´S LONG WAY TO THE WORLD TRADE ORGANIZATION

Jamshid Normatov

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## About the Author

**Jamshid Normatov** is a research fellow at the University of World Economy and Diplomacy in Tashkent, Uzbekistan. He studied International Relations at Tashkent Oriental Institute in Uzbekistan and completed a postgraduate program in European studies with majors in Management and International Economics at the University of Saarland in Germany. He has worked as a lecturer of economics at the University of World Economy and Diplomacy, and at the Westminster International University Tashkent. His research interests include: international economics, economics of development and transition, and financial services regulation.

## Imprint

**Publishers:** Prof. Dr Mathias Jopp, Head of International Programmes, IEP  
PD Dr Matthias Waechter, Director General, CIFE

**Editors:** Dr Susann Heinecke, Programme Manager EUCACIS, CIFE  
Janny Schulz, Programme Manager EUCACIS, IEP  
Aisulu Akhmetzhan, Intern, IEP

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## Abstract

Uzbekistan has been negotiating WTO accession since 1994. The accession process of the country was not progressing because initial liberalization reforms were later replaced by protectionist policies in foreign trade. The change of leadership in Uzbekistan in 2016 renewed hopes for positive development in the WTO accession. President Merziyoyev announced comprehensive economic and political reforms to modernize the country. However, economic reforms are likely to face resistance from interest groups profiting from government support and protectionism. Taking different possible trends into account, this article argues that the accession to the WTO is an essential step for the Uzbek government to be able to proceed with reforms and to build a robust market economy.

## 1. Introduction

Uzbekistan applied for membership in the World Trade Organization (WTO) in 1994, the year the Agreement on establishing the World Trade Organization was signed. The WTO effectively regulates 98 percent of global trade and includes 164 member states as of 2016. Currently, over 20 countries are negotiating their accession into the WTO, including Uzbekistan. Uzbekistan's WTO accession is still ongoing and is among the longest accession negotiations in the WTO history. The reason is not the WTO's unwillingness to accept Uzbekistan. On the contrary, the protraction has to do with Uzbekistan's choice not to proceed with the accession. The government's willingness to join the WTO had waned over time as the government was uncertain about the benefits of WTO membership. However, recent policy developments in Uzbekistan, particularly after the new president came to power in 2016, raise hope for Uzbekistan's political and economic openness globally. In the light of these changes, the country's WTO accession is expected to progress.

This paper aims to review the accession process of Uzbekistan into the WTO. It provides an analysis on factors affecting this process and includes recommendations to policy makers.

## 2. History of Uzbekistan's WTO accession

### Leaping forward and stepping back (1994-2016)

Uzbekistan was among the first WTO applicants among the Former Soviet Union (FSU) states. However, after four consultations with working groups of the WTO (last meeting in 2005), Uzbekistan's accession did not progress.<sup>1</sup> Currently, Uzbekistan along with Azerbaijan, Belarus and Turkmenistan are the only FSU countries that are not members of the WTO (Table 1).

**Table 1.** WTO accession status of the post-Soviet states

Country	Application	Status/Membership
Armenia	1993	2003
Azerbaijan	1997	Negotiations
Belarus	1993	Negotiations
Georgia	1996	2000
Kazakhstan	1996	2015
Kyrgyzstan	1996	1998
Moldova	1993	2001
Russia	1993	2012
Tajikistan	2001	2013
Turkmenistan	-	not started
Ukraine	1993	2008
<b>Uzbekistan</b>	<b>1994</b>	<b>Negotiations</b>

Source: WTO (2017).

The slow pace of negotiations was a result of changing policy priorities on foreign trade in Uzbekistan. After some initial liberalization reforms in 1994/1995, the government decided to opt for protectionist trade policies. This was a response to the deterioration of terms of trade (fall in prices for the country's major exports). The government reduced imports through foreign exchange controls and launched an import substitution program in 1996<sup>2</sup>. The government pursued the restriction

<sup>1</sup> WTO Accession status: Uzbekistan." World Trade Organization, 2018, [https://www.wto.org/english/thewto\\_e/acc\\_e/a1\\_ouzbekistan\\_e.htm](https://www.wto.org/english/thewto_e/acc_e/a1_ouzbekistan_e.htm)

<sup>2</sup> Christopher B. Rosenberg & Maarten de Zeeuw, "Welfare Effects of Uzbekistan's Foreign Exchange Regime," IMF Staff Papers 48, no. 1 (2001): 160–78.

of “unnecessary” imports (such as consumer products) by limiting access to currency conversion and stimulated “desired” imports (such as machinery, socially important goods etc.) by granting currency conversion at an overvalued official exchange rate of the Uzbek *sum*. This policy was later referred to as the “Uzbek model of development.”<sup>3</sup> The subsequent economic crisis in the FSU states and Asia in 1998 reinforced the government’s attitude to stick to protectionism. Under these new circumstances, the accession to the WTO was no longer a priority for the Uzbek government.

The hope for trade liberalization was resurrected in 2003 when the government removed the currency exchange restrictions and took steps towards liberalization. Reforms resulted in significant growth in trade and the economy as a whole. However, the global economic crisis in 2007/2008 affected Uzbekistan severely. In response to the crisis, the government returned to trade protectionism by restricting foreign exchange to exclusively government-approved exchangers.

Effects of protectionist policies were two-directional. Some experts hailed Uzbekistan’s response to the global crisis citing its success as the country was least affected by the crisis<sup>4</sup>. Uzbekistan was listed among the countries with the highest growth rate during the global crisis. On the other hand, strong governmental control over the economy, particularly over foreign trade, created conditions for the rise of corruption leading to poor governance and economic inefficiency<sup>5</sup>.

The government effectively monopolized foreign trade under its import substitution program. Companies under this program had privileged access to currency conversion. The

huge gap between the legal official rate and the unofficial market rate created incentives for corruption as these companies could make excess profits by selling converted foreign currency at an artificially high exchange rate on the black market instead of using it for imports. Meanwhile, most private businesses had limited and irregular access to currency conversion, thus remaining constrained in their participation in foreign trade. As a result, protectionism resulted in reduced business activity and economic inefficiency<sup>6</sup>.

### **Change of leadership and reform expectations (since 2016)**

The year 2016 was an important milestone in the history of Uzbekistan. After the first president Islam Karimov passed away unexpectedly, the new president Shavkat Mirziyoyev made a promising debut with regard to policymaking and economy. The government announced wide-scale economic reforms, including in the area of foreign trade. Moreover, it started to focus on external cooperation, which is widely regarded as a shift away from protectionism. Mirziyoyev proclaimed regional cooperation as the priority for Uzbekistan and has already paid numerous visits to neighboring countries. Domestically, the new government removed foreign exchange restrictions creating an equal opportunity for all importers – whether state-owned or private – in September 2017. In addition, the government eased restrictions for exporters. These changes have already resulted in an increase of Uzbekistan’s foreign trade turnover by estimated 20% in 2017.

There is a consensus in the expert community that these measures are steps in the right direction and economic reforms would result in welfare benefits.

### **3. WTO Accession for Uzbekistan: what is at stake?**

#### **Making market reforms irreversible**

The accession to the WTO is a political process which requires intensive negotiations between

3 Richard Pomfret, “The Uzbek Model of Economic Development, 1991-99,” *Economics of Transition*, (2000).

4 Vladimir Popov, “An Economic Miracle in the Post-Soviet Space: How Uzbekistan Managed to Achieve What No Other Post-Soviet State Has,” *PONARS Eurasia*, (2013): 1-22.

5 Daniel Kaufmann & Aart Kraav, “Worldwide Governance Indicators (WGI) Project,” *World Bank*, (2018).

6 Edward Gemayel & David a Grigorian, “How Tight Is Too Tight? A Look at Welfare Implications of Distortionary Policies in Uzbekistan,” *European Journal of Comparative Economics*, (2006):1-32.

the WTO and the acceding country. The acceding country is required to open up its economy for international competition and agrees on granting free access to its markets, although accession terms might differ from case to case. Once a country is a member of the WTO, further restrictions of trade are not allowed, otherwise the country may face consequences from trading partners – in practice, liberalization is irreversible.

Experiences of newly acceded WTO members show that economic benefits from their WTO accession can be felt especially in the long run. However, there are immediate political benefits from accession as it helps the government of the acceding country to improve its legislation and protect itself against interest groups by referring to obligations under WTO law. Indeed, accession helps the government to stay firm on market principles and to build a stable trade and investment climate<sup>7</sup>. Uzbekistan has already had periods of liberalization attempts which were followed by protectionism. Therefore, the new leadership of Uzbekistan must make sure that the proclaimed

determination to pursue liberalization reforms turns into practical action soon. The accession to the WTO is crucial to ensure that reform process is successful and cannot be reversed at a later point.

### Opening up markets for competition

Currently, Uzbekistan's foreign trade is more closed in terms of average import tariffs than is the case with other South Caucasian and Central Asian states (see Table 2). Uzbekistan applies duties ranging 0 - 30% on imports. Zero or lower duties are applied for primary or intermediate goods and higher rates on final products. Certain products that compete with domestically produced goods are subject to additional import-specific excise duties. The applied duties (import tariff and specific excise duty combined) on automobiles, for example, exceed 100% of the import value of the car. The figures below that show average tariff rates do not tell the whole story since they do not take non-tariff barriers to trade into account. As mentioned above, Uzbekistan practiced foreign currency exchange restrictions to reduce the volumes of imports in the past (1996-2003,

**Table 2.** Uzbekistan's customs duties in comparison

<b>Country</b>	<b>Import tariff rate range(min-max) %</b>	<b>Average tariff rate, all products %</b>	<b>Average applied tariff rate, all products %</b>
Armenia	0-100	7.8	6.36
Azerbaijan	0-15	8.52	8.52
Belarus	0-100	7.8	6.02
Georgia	0-30	1.47	0.43
Kazakhstan	0-100	7.8	6.91
Kyrgyzstan	0-100	7.8	5.33
Moldova	0-75	5.6	5.41
Russia	0-100	7.8	5.33
Tajikistan	0-15	6.14	6.14
Turkmenistan	10-100	5.43	n/a
Ukraine	0-60	10	4.08
<b>Uzbekistan</b>	<b>0-30</b>	<b>14.2</b>	<b>13.66</b>

Source: World Bank

<sup>7</sup> Zdenek Drabek and Marc Bacchetta, "Effects of WTO Accession on Policymaking in Sovereign States: Lessons from Transition Countries," in *Is the World Trade Organization Attractive Enough for Emerging Economies?: Critical Essays on the Multilateral Trading System*, (2009).

2007-2016). The import restrictions resulted in higher domestic prices and negatively affected the markets making some businesses turn to the gray economy. Restrictions on currency exchanges also kept investors away from the country as foreign producers had to worry about the possibilities of the repatriation of their profits. Poor governance indicators in the area of the rule of law and corruption also contributed to relative low levels of Foreign Direct Investments (FDI) to Uzbekistan. In fact, the FDI per capita in Uzbekistan was the lowest among all countries in the region (Table 3).

**Table 3.** Uzbekistan's FDI per capita in comparison

Country	1997-2006	2007-2016
Armenia	60	172
Azerbaijan	282	423
Belarus	25	210
Georgia	81	311
Kazakhstan	193	672
Kyrgyzstan	14	82
Moldova	33	86
Russia	67	303
Tajikistan	12	29
Turkmenistan	56	580
Ukraine	43	119
<b>Uzbekistan</b>	<b>5</b>	<b>24</b>

Source: Author's calculations based on World Bank Data (In current \$US).

The WTO accession would probably require lowering the import duties to levels comparable with the regional average. Uzbekistan is likely to try to keep exemptions and transition periods for specific industries. However, overall reduction of tariffs can be expected.

### Opportunities and Risks

Uzbekistan might face certain risks resulting from the WTO accession as trade liberalization is likely to create winners and losers. Consumers will benefit from increased choice, improved quality of goods and decreased prices. Furthermore, the country may benefit from liberalization in the service sector. Granting market access to services in the financial and construction sectors, for example,

could increase FDI to the country and, thus, create new jobs and growth opportunities.

On the other hand, producers competing with increased imports will be on the losing side so that weak industries will be forced to leave the market. This might create losses for the domestic industry in the short run; the country might nevertheless be better off in the longer run as it will specialize towards areas of competitive advantages.

Almost all domestic industries, especially the heavily protected ones, are among the industries which would face increased competition. The automobile, chemical and textile industries as well as the agricultural sector are among those likely to be affected. Social consequences in terms of higher unemployment will lead to additional financial burdens. Here, increased state investment or strengthened unemployment schemes could be a solution.

Moreover, Uzbekistan will have to face adjustment costs upon WTO accession, which will require large investments in institutions involved in foreign trade. Ensuring transparency and rule of law, protection of property rights as well as improving the quality of governance institutions will be a challenge.

In addition, the WTO accession might face resistance on the side interest groups to be affected by increased foreign competition. In this case, the government will have to test its commitments for reforms and will have to find solutions to negotiate with protectionist interest groups.

The risks and opportunities need to be assessed with adequate methodologies and techniques. The economic assessment of the WTO accession for specific sectors will require quality statistical data. However, the quality of statistical data on Uzbekistan is often questioned by the experts.<sup>8</sup> Foreign trade time series data by sectors is not available at all, which certainly complicates the impact assessment.

<sup>8</sup> Asad Alam and Arup Banerji, "Uzbekistan and Kazakhstan: a Tale of Two Transition Paths?," World Bank, (2000).

#### 4. Conclusion and recommendations

Uzbekistan's way to the WTO has been long due to the slow pace of market reforms. The country chose protectionism in response to external shocks. Protectionist policy, although having some merits during the economic crisis, created higher costs on the whole as it did not allow for deep market reforms. Foreign trade remained restricted and the country's attractiveness for FDI was low in comparison to the rest of the region. However, there is optimism for reforms progressing with the leadership change.

WTO accession is likely to produce higher gains for Uzbekistan than it did for other FSU states. Uzbekistan is more closed economically and ranks lowest in terms of per capita FDI inflows among the countries in the region. Lowering import duties will give more choice for consumers and investment flows are likely to increase due to an improved legal and institutional framework. Most importantly, WTO accession will allow for further market reforms making it difficult, if not impossible, for the country to step back.

Given the history of economic reforms in Uzbekistan (reform efforts followed by protectionism), the risk of a reversal of the reforms cannot be excluded. Therefore, the following recommendations are proposed:

- WTO accession negotiations need to be accelerated;
- Import duties need to be lowered to allow for competition in domestic markets;
- Legislation on foreign trade and investment needs to be improved in line with international standards;
- External actors need to strongly support trade policy reforms of Uzbekistan providing technical and financial assistance as required;
- Assistance to trade policy reforms and WTO accession of Uzbekistan needs to be reflected in policy documents of

external actors (e.g. the EU strategy towards Central Asia).

WTO accession is important for Uzbekistan in order to advance its market reforms and make them irreversible. Once a WTO member, Uzbekistan with an open, transparent and growing economy will be more attractive as well as welcoming to international businesses.