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Export Financing in Uzbekistan: Focus on Manufactured Goods

The top five exports of modern Uzbekistan are cotton-fiber, precious metals, hydrocarbons, non-ferrous metals and a number of manufactured goods. The latter currently make up only 28% of Uzbekistan's overall exports. Moving from exporting primary goods to higher value added products is a key direction in Uzbekistan's external economic policy.

An important dimension of this policy is improving the system of export financing, which includes financing priority export products and export contracts (including export marketing financing), as well as ensuring export delivery insurance.

There is no "cookie-cutter" approach to export financing. Global practice indicates that various measures and tools, from national standard commercial bank credits to complicated financial schemes with government support and guarantees, are used in export financing, based on the conditions of each country.

At the moment, export financing in Uzbekistan involves standard commercial bank credits at the stage of manufacturing products for export. In addition, there are four major tools for financing export contracts: 100% prepayment, letters of credit (L/C), insurance policies and bank guarantees. However, there is a lack of financing tools for higher value added export products. Increasing the export of such products requires: (a) significant financial resources at the manufacturing stage; (b) resolution of a number of problems related to the utilization of available export financing tools; and, (c) more specialized support for the marketing, transportation and delivery of such commodities.

1. Export Financing of Primary Goods

1.1. Export Financing of Cotton Fiber

The export of cotton fiber is carried out by state joint-stock foreign trade companies such as "UzMarkazImpEx", "UzPromMashImpEx" and "UzInterImpEx" that are under the Ministry of Foreign Economic Relations, Investments and Trade (MFERIT).

They procure cotton fiber not only for export but also to sell it to joint ventures (JVs) with foreign investments operating in Uzbekistan. The JVs purchase cotton

fiber at a 15% discount on the world price[1] and can only use them for manufacturing. They are not allowed to re-sell it.

All foreign currency proceeds received by foreign trade companies, either from exporting cotton fiber or from selling it to JVs, have to be fully (100%)[2] exchanged at the Central Bank which deposits the soum equivalent in their respective accounts.

The method of export financing for deliveries of Uzbek cotton fiber has remained unchanged for a number of years: pre-payment from a buyer for a certain part of the contracted volume and opening a letter of credit for the remaining part. However, the high pre-payment requirement for export contracts leads to a negotiating down of the price. As a result of these discounts, the buyers of cotton fiber (international trade companies) secure large loans in order to make the requested prepayment.

The buyers make the prepayment on the condition of obtaining guarantees from the major banks in Uzbekistan (National Bank for Foreign Economic Activity and "Asaka" Bank) which play the role of insurer in the case of an incomplete delivery of cotton fiber by the Uzbek exporters. Effectively, banks are offered export financing of cotton fiber through the issuance of payment guarantees in favor of buyers of cotton from Uzbekistan upon instruction by the foreign trade companies of MFERIT. Since these guarantees act as collateral on the loans received, foreign banks are able to minimize their risks.

So far, this existing export financing scheme has been acceptable to all sides:

- for the government – because cotton fiber is a strategic commodity, which to a great extent, helps replenish the currency reserves of the state;
- for foreign trade companies – because they have great experience in trading cotton fiber and they operate within the framework of a regulated process of registered export contracts, price setting and permitted discounts;
- for participating banks – since they do not need to attract significant credit resources for direct export financing.

Moreover, attracting credit resources directly via MFERIT's foreign trade companies, and not by the buyers of cotton fiber, will necessitate major amendments to the legislation since banks' credit resources cannot be used for the mandatory exchange of export proceeds.

1.2. Export Financing of Other Primary Goods

Financing the exports of other primary goods (gold and other precious metals, hydrocarbons and non-ferrous metals) is carried out within the framework of contracts concluded by economic entities either under the condition of a 100% prepayment or of letters of credit, otherwise within the framework of inter-governmental treaties and production sharing agreements.

2. Financing of Manufactured Goods

Uzbekistan faces the challenge of entering highly competitive international markets. Thus increasing the share of exports of higher value-added products is a key issue. So today, the elaboration of export financing tools is a critical development issue.

The financing of automobile exports can be considered as a good start. It was organized according to the Instruction of the President of the Republic of Uzbekistan

[1] The agreed prices for cotton fiber sold to JVs are set on the basis of world prices as indicated in the rates of Index "A" and its Uzbek component published in the 'Cotton Outlook' on the date of shipment. The methodology for calculating the agreed price for cotton fiber is currently defined by the Resolution of the President of the Republic of Uzbekistan № 456 "On regulating the sales and payment mechanism for cotton fiber" dated August 29, 2006.

[2] In compliance with the "Procedure for mandatory sale of proceeds in foreign currency by economic entities" approved by the Resolution of the Cabinet of Ministers №245 dated June 29, 2000.

№1962 "On measures for expanding investment and economic cooperation with the Russian Federation" dated May 25, 2004. In compliance with this, on September, 2004 the National Bank for Foreign Economic Activity of Uzbekistan (NBU) and "Asaka" Bank opened a $100 million credit line to the Russian Joint Stock Commercial Bank "Asia-Invest Bank"[3] to support export financing of manufactured goods and services from Uzbekistan.

Box 1: Trade financing tools of the "Asia-Invest Bank" credit line:

- Confirmation of irrevocable documentary L\C;
- Confirmation of bank guarantees and\or issuance of a "Stand-by" type reserve L\C;
- Participation of "Asia-Invest Bank" in syndicated crediting jointly with other Uzbek, Russian or foreign commercial banks;
- Provision of credit resources for "Asia-Invest Bank" for their further re-financing of Russian companies, including those selling goods on Russia's domestic market;
- Provision of Uzbek banks' guarantees to foreign banks for credit resources attracted by the "Asia-Invest Bank".

About 80% of loans issued for the purchase of "UzDaewooAuto" automobiles, which are in high demand on the Russian market, are part of the "Asia-Invest Bank" credit portfolio. The automobiles are sold by regional dealers who purchase them in Uzbekistan with 100% pre-payment, financed through loans from "Asia-Invest Bank" and other Russian banks.

Increasing the share of high-tech output along with the elaboration of relevant financing tools raises a number of macroeconomic issues:

- The need to focus on new technologies for manufacturing high value-added products;
- Elaboration of competition/cooperation methods between Uzbek and transnational companies and identification of the level to which Uzbekistan should raise its R&D potential in order to promote the manufacturing of competitive products[4], or join international production chains;
- Further financial market liberalization by providing more tangible support to the private sector engaged in the manufacturing of higher value-added products.

3. Problems in Financing of Manufactured Goods Production

1. The lack of working capital is one of the most significant factors constraining production of export goods.

As of July 1, 1995 commercial banks can offer credits to enterprises and organizations only in soum[5] in compliance with point 6 of the Decree of the President №1193 "On measures for the further expansion of internal convertibility of the national currency of the Republic of Uzbekistan" dated June 27, 1995. For a number of export-oriented enterprises this is a major impediment since their manufacturing process requires that they import parts purchased with foreign currency. This creates considerable transaction costs for such enterprises. In order to make payments under import contracts, they have to convert the loans they receive in soums into US dollars.

2. Many export-oriented enterprises have significant volumes of trade liabilities on investment loans[6]. Nearly all major banks' investments into light

[3] Joint Stock Commercial Bank "Asia-Invest Bank" is a Russian Bank founded by NBU, "Asaka" Bank and a number of Uzbek enterprises

[4] For example, raising the level of technology in industry was a key feature in China's industrial policy during the 1980-1990s. The government was directly involved through the import of machinery, equipment and technology, and indirectly by increasing expenditures on science and education. The average annual rate of growth of expenditures on science (in terms of permanent prices) totaled 15% in 1991-1997, outpacing the average annual growth of GDP which stood at 13%. Source: Molchanov D.I., "Industrial Policy in China", Institute of Complex Strategic Research, 2002.

[5] In exceptional cases, banks may currently issue short-term loans in foreign currency only to light industry enterprises for up to 180 days in compliance with the Resolution № 141 of the Cabinet of Ministers dated March 25, 2004.

[6] Investment loans with a duration of 5 years with no more than 18 months grace period for repayment of the principal for setting up new facilities, modernization, reconstruction and technical requipment of operating facilities. According

industry export enterprises are loans provided for investment projects, forming an integral part of the enterprises' assets that determine the debt receivables. All profits received from their activities are used to pay back this debt, thus defining the enterprises' level of profitability.

According to the current legislation, access to short-term bank loans is impossible for unprofitable enterprises. Hence, even when there is collateral or security, i.e. a L/C or bank guarantee, they cannot receive a loan to replenish the operating capital required to meet deliveries promised under the export agreements already signed.

3. Tools of trade financing such as factoring service for exporters are practically absent from banking practice. Analysis indicates that the major reasons for the low demand are: legislative restrictions; lack of circulating capital required to manufacture products for enterprises (because factoring service is provided through the redemption of accounts receivable for an already shipped product), as well as exporters' prudence manifested in deferring payments on export contracts.

The ban on rendering factoring services to unprofitable enterprises is specified in point 1.6. of the Central Bank's Provision "On conducting factoring transactions" (registered by the Ministry of Justice under № 953 dated August 3, 2000). In this regard, the enterprises (including in light industry), which suffer due to exchange rate depreciation under foreign currency loans and previous losses, as well as from overdue liabilities on previous loans, cannot use the bank services on factoring transactions.

4. The mechanism for the re-imbursement of some taxes (most frequently VAT) was widely used as an export financing tool in many countries. Elaborating an effective mechanism for VAT reimbursement is important for exporters since it provides them with financial resources (up to 20% of turnover), which could be used as a source of credit for the operating capital as well as for the manufacturing of export products.

One of the proposed solutions is the improvement of the VAT repayment mechanism to trading companies. The majority of companies are interested in the procurement and subsequent export of export-designated production because they could use part of the currency proceeds left over after the mandatory sale to pay for import transactions, which are needed for solvency. But this is problematic, since trading companies are not VAT-payers according to legislation and thus the VAT is not reimbursed to the enterprises, from which they buy the exported product.

The introduction of VAT for trading companies can lead to an increase in the tax burden and ultimately to bankruptcy. However, comparative estimates of the level of tax payments under the current taxation system (I) and with the introduction of VAT (II)(Box2) demonstrate that, ultimately, it does not make a difference which option the trading company chooses. Nevertheless, the VAT payment regime significantly increases the motivation of the manufacturing enterprise. The latter, receiving VAT from a trading company for repayment, noticeably improves its financial position, especially the circulating capital. This then directly contributes to the expansion of exports.

5. Enterprises with a negative VAT difference due to the export of their production cannot credit products to their account when importing raw and auxiliary materials for their own needs and are consequently compelled to pay additional VAT. For a certain period, this leads to a reduction in the amount of circulating capital available.

6. As of July 1, 2001 small enterprises and micro-firms were granted exemption from the mandatory sale of proceeds in foreign currency[7]. They are also

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to point 1 of the Decree of the President №1659 "On additional measures for promoting the development and investment activity of enterprises with foreign investments" dated December 13, 1996, such investment loans may be granted in foreign currency.

[7] Resolution of the Cabinet of Ministers № 263 "On measures for the further liberalization of the currency market" dated June 22, 2001.

Box 2. Comparative analysis of the level of tax deductions (conditional example)	
Level of tax deductions under the current taxation system (I)	**Level of tax deductions with the introduction of VAT (II)**
According to the current taxation procedure trade companies pay the following types of taxes for wholesale sales: 20 % of gross income; 1 % of turnover to the Road Fund; 1 % of turnover to the	
Calculation: A trading company has received 1 mln. soums for an imported product at its invoice cost, which is an indicator of the prime cost for a trading company. A 20% value added tax is charged for this import, which brings up the prime cost of this product to 1.2 mln. soums. The company sells this product for 1.3 mln. soums (trade turnover) receiving a gross income of 100 thousand soums (1.3 mln. soums – 1.2 mln. soums). **This trade company is bound to face the following payments:** 20% of gross income = 20.0 thousand soums; 1% of trade turnover to the Road Fund = 13.0 thousand soums; 1% of trade turnover to the School Fund = 13.0 thousand soums; 0.7 % of trade turnover to the Pension Fund = 9.1 thousand soums; Total payments to the budget: 55.1 thousand soums. **Total amount of tax deductions:** Import VAT paid out to Customs (200 thousand soums) + 55.1 thousand soums into the budget = **255.1 thousand soums.**	**Calculation:** A trade company has received 1 mln. soums for an imported product at its invoice cost and sold it at the invoice cost of 1.3 mln. soums. In this case the VAT from sales is included into the sales price and represents 216.6 thousand soums (1.3 mln. soums/ 1.2). Trade turnover minus VAT (net revenue) represents 1.83 mln. soums (1.3 mln. soums – 216.7 thousand soums). Gross income represents 83.3 thousand soums (1.083 mln. soums – 1.0 mln. soums). **This trade company is bound to face the following payments:** 20% of gross income = 16.7 thousand soums; 1% of trade turnover to the Road Fund = 10.8 thousand soums; 1% of trade turnover to the School Fund = 10.8 thousand soums; 0.7 % of trade turnover to the Pension Fund = 7,6 thousand soums; Total payments to the budget: 45. 9 thousand soums. **Total amount of tax deductions:** VAT (216.6 thousand soums, of which 200 thousand soums are paid at the Customs) + 45.9 thousand soums to the budget = **262.5 thousand soums.**
The difference between the two options is a mere 7.4 thousand soums.	

allowed to export goods of their own production for foreign currency in cash by depositing their currency proceeds into their bank accounts.

At the same time, private entrepreneurs who, for example, export semi-finished goods or consumer commodities are deprived of this opportunity. They have to act in accordance with the general rule (mandatory sale of 50% of currency proceeds) when conducting export operations. This is one of the causes of the low export potential of private entrepreneurship in Uzbekistan.

Box 3: Exception: light industry enterprises

This is particularly important for light industry enterprises, for which a special mechanism was created in accordance with point 5 of the Resolution № 141 of the Cabinet of Ministers of the Republic of Uzbekistan dated March 25, 2004, under which they have the right to procure raw materials and semi-finished products with payment in foreign currency, while paying a zero VAT rate. However, relevant amendments have not been introduced into the "Provisions on refunding the negative difference on VAT obtained as a result of the application of a zero rate to economic entities" registered with the Ministry of Justice under № 1460 on March 22, 2005.

For example, refunding a negative difference for a spinning enterprise, which had delivered yarn to an enterprise manufacturing finished items, needs to present a contract for commodity delivery with payment in foreign currency and a copy of the customs declaration, which are not necessary in the event of delivery within the country. It is actually more profitable for a spinning company to export its yarn, leaving Uzbek manufacturers with no raw materials. When the product is sold on the domestic market in the national currency including the VAT, the manufacturing company suffers from the diversion of the VAT with the corresponding reduction of the circulating capital during the production and shipment of the good. At the same time, the spinning company loses its property tax privileges as it does not fulfill the condition to export at least 80 percent of its production[8].

[8] The Resolution of the President of the Republic of Uzbekistan № 330 "On measures for the improvement of financial conditions of textile industry enterprises and improvement of the mechanism for selling cotton fiber to them" dated April 21, 2006 sets up a property tax exemption for the period May 1, 2006 - January 1, 2009 for enterprises exporting 80% of their manufactured products for hard currency.

Table 1. Export Potential of Entrepreneurship in Uzbekistan

	Quantity						Share of GDP			Share in total Export		
	2004		2005		2006		2004	2005	2006	2004	2005	2006
	th. units	th. persons	th. units	th. persons	th. units	th. persons	%			%		
Total number registered:	237,5	6038,3	310,0	6679,0	n/a	7258,6	35,6	38,2	42,1	7,3	6,0	10,7
Small enterprises	18,6	359,2	18,4	303,0	n/a	1848,0	2,7	6,5	5,4	4,6	3,2	n/a
Micro-firms	218,9	989,9	290,3	1083,9	n/a		15,9	15,0	18,1	1,2	0,9	n/a
Private entrepreneurs	4689,2		5292,1		5410,6		17,0	16,7	18,6	1,5	1,9	n/a

Sources: 1) "On the Results of Socio-Economic Development in 2005 and Major priorities for deepening economic reforms in 2006", Uzbek Agency, 14.02.2006. 2) The Economy of Uzbekistan, Information-Analytical Review for the year 2005. 3) The Uzbekistan Economy, CEEP, №8, March 2005. 4) 2006 Statistical Review of Uzbekistan, State Committee of Statistics.

4. Insurance of Export Operations and Commercial Bank Loans

The insurance of export credits and investments is regulated by the Resolution of the Cabinet of Ministers №167 "On measures for ensuring insurance security of national exporters" dated April 21, 1998, which defines the procedure for providing capital, commodity and service exporters with insurance coverage.

According to the Decree of the President № 1871 "On additional measures for the stimulation of commodities exports" dated October 10, 1997, economic entities are granted the right to export commodities under the condition of availability of an export contract insurance policy protecting against political and commercial risks (without prepayment and L/C).

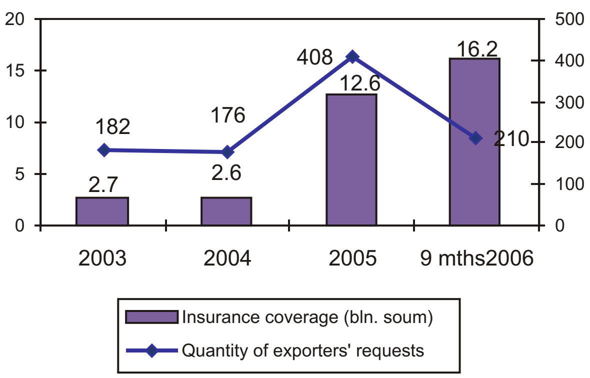

Fig. 1. Dynamics of export insurance in 2003-2006 (according to 'UzbekInvest' company)

In spite of this, the volume of export contract insurance in Uzbekistan remains low, explained by the absence of a number of important prerequisites: in the first place, a relevant legislative basis and availability of significant capital and insurer's reserve funds. Secondly, the availability of necessary "know-how", proven insurance methods, developed insurance policy conditions and tariff policy. Thirdly, there is a need for reliable reinsurance protection on the international insurance market. Fourthly, export credit insurance is impossible without a relevant infrastructure made up of an export-credit agency (ECA), credit-information bureau, debt collection companies, specialized legal advisors and other intermediaries. So far, the majority of insurance companies in the country do not comply with these requirements.

On the local market insurance services as a form of protection for various aspects of foreign economic activity is mainly provided by the National Company

Box 4: ECA as a form of state assistance
One of the forms of state assistance in export development is the insurance of export deals with foreign partners, which is set up by export-credit agencies (ECA). The major objective of ECAs is insurance against default (non-payment) on export contracts. ECAs manage risks against fraud and bankruptcy, protect exporters and their banks against losses and facilitate an easier process for the issuance of loans for export deals by banks. Thanks to ECA support, exporters have the opportunity to provide their buyers with commercial (trade) loans under more reliable conditions, and this, in turn, provides them with the opportunity to freely compete on the market and expand export opportunities. Currently ECAs provide support for up to 10%-20 % of export operations in many countries.
Nevertheless, not all countries have a system of export insurance. This is because there is too low a volume of exports for establishing their own ECAs.

for Export-Import Insurance "UzbekInvest"[9]. Currently, according to the Decree of the President № 1710 "On setting up the National company for export-import insurance" dated February 13, 1997, the company is entrusted with the performance of the ECA functions[10].

5. Barriers in the Development of Export Insurance

1. Exporters do not use the privileges provided for in the legislative acts; they still keep exporting their output mainly under the conditions of prepayment or L/C. The reasons for this are the:

- convenience and reliability of trade transactions under conditions of prepayment or L/C;
- exporters' shortage of circulating capital because it is more expedient for them to trade on conditions of prepayment, which finances the costs of materials for the production of export output;
- threat of fines which, in the case of late payment of currency on a contract, penalizes the exporter at the amount of 100% of the volume of overdue currency[11]. Moreover, according to the legislation the payment of insurance indemnification on export contract losses is not considered as revenue from currency proceeds.

2. Another problem is the absence of banks practicing pre-export financing of circulating capital on export contracts, which provide for the deferment of payment under the insurance policy from political and commercial risks. Banks accept as collateral only mortgaged property, a guarantee of a legal entity or an insurance policy on loan non-payment by a borrower. Banks also do not have sufficient experience in crediting foreign borrowers and buyers of Uzbek exports because of restrictions on the expatriation of foreign currency and the absence of a mechanism for crediting foreign borrowers both in the legislation of the country and in the banks' credit policy. As a result, the exporting enterprises, in particular small enterprises, are faced with a lack of circulating assets necessary for the production and realization of export output.

3. The study of foreign ECA experiences indicates that export risk insurance is realized using both their own and government resources. Moreover, political and commercial risks are re-insured with the government. Despite the presence of insurance companies on the market, there is no individual ECA enjoying full governmental support and carrying out insuring export operations at the request of, at the expense of, and under the guarantee of the government.

4. There is a lack of a specialized institution collating information on foreign and Uzbek enterprises, such as a credit information bureau.

[9] Risks under export insurance are higher than under other insurance operations. The access of many economic entities to this type of transaction is limited because of higher costs. This is why, as a rule, government insurance companies offer these services as they have access to government resources.

[10] The "UzbekInvest" Company has become a full-fledged participant in the ECA sector of Central and Eastern Europe being a member of the Prague Club, International Union of Export Credit and Investment Insurers (Bern Union). Participation in its activities provides the opportunity to master the practice of conducting export insurance from leading foreign ECAs, such as AIG, COFACE, ATRADIUS and ECGD.

[11] Resolution of the Cabinet of Ministers of the Republic of Uzbekistan №245 "On measures for the further development and strengthening off-exchange currency market" dated June 29, 2000.

The National Institute of Credit Information (NICI) under the Central Bank of the Republic of Uzbekistan and the Inter-Bank credit bureau are set up on an affiliate basis under the Banking Association of Uzbekistan and operate currently in compliance with the Resolution of the Cabinet of Ministers №197 "On measures shaping the system of accounting information on borrowers' credit history" dated April 23, 2004. Only commercial banks have access to information available from those institutions. Thus, there is no alternative system of information exchange on the market on a commercial basis and with acceptable prices and that is accessible for all participants and customers of the financial market.

6. Improvement of Payment and Accounting Relations with the CIS Countries

More than 40 percent of Uzbekistan's trade turnover is with CIS countries. Within this just two countries (Russia and Kazakhstan) account for 70% of exports and about 80% of imports. Moreover, Russia plays a unique and increasingly significant role in Uzbekistan's external trade turnover. These two countries will obviously remain the preferred trade partners of Uzbekistan, especially in the context of accelerated regional cooperation within the framework of the Euro-Asian Economic Cooperation.

Table 2. Structure of Uzbekistan's external trade turnover in 2006

Exports	$ million	%	Imports	$ million	%
Total:	**6,384.5**	**100.0**	**Total:**	**4,396.2**	**100.0**
Among them, CIS countries	2,685.0	42.1	Among them, CIS countries	1,971.1	44.8
CIS Countries					
CIS countries total:	**2,685.0**	**100.0**	**CIS countries total:**	**1,971.1**	**100.0**
Among them:			Among them:		
Kazakhstan	304.7	11.3	Kazakhstan	413.9	20.9
Tajikistan	169.9	6.3	Tajikistan	16.0	0.8
Russia	1,661.7	61.9	Russia	1,166.4	59.2
Other CIS countries:	548.7	20.5	Other CIS countries:	374.8	19.1

Source: Bulletin of Foreign Trade Statistics of the State Statistics Committee of the Republic of Uzbekistan, Tashkent, 2007.

Currently, the settlement currency in external trade transactions is mainly the US dollar, although it may also be conducted in other "hard" currencies (British Pound Sterling, Swiss Franc, Japanese Yen and Euro). Mutual settlements between CIS countries can only be made in "hard" currencies, except in the case of Russia, when the Russian ruble can be used. However, in practice setting up mutual accounts with Russia is conducted in US dollars in 80% of cases and just 20% of the time in Russian rubles.

At the initial stage of reform the guarantee of external trade turnover in freely convertible currency was justified, since there had been a number of problems associated with the breakdown of economic links and the presence of a great number of systemic risks. These included a structural weakness of the CIS countries' economies, customs barriers, lack of international payment resources, the "dollarization" of economies, a growing number of "non-payments", the existence of multiple exchange rates, and the functioning of "black markets" against the background of high inflation rates. These problems led to a continuous fall in the value of national currencies in CIS countries, which justified the carrying out of external trade in "hard" foreign currency.

However, now that the CIS countries' balance of payments and their national currencies have stabilized, especially those of Russia and Kazakhstan, and given the weakening of the US dollar as a world currency, the maintenance of such practices entails a loss of potential income for domestic manufacturers. Moreover, trade in "hard" currency tangibly increases the participants' transaction costs in foreign trade operations, which are associated with the exchange of currencies for the purpose of depositing export proceeds in their accounts and making payments for import deliveries. Thus, making transactions exclusively in foreign currency starts to restrict Uzbekistan's export opportunities.

Box 5: Foreign currency used in foreign trade transactions
The exclusive use of the US dollar in accounting and payments (especially in cross-border deals) has the following consequences:
- Increasing the vulnerability of countries in the region to external financial shocks (especially with the continued weakening of the US dollar);
- Growing transaction costs for FEA participants related to currency exchange for the purpose of depositing export proceeds in their accounts and making payments for import deliveries (monetary and temporary conversion costs manifested in the complexities of contract registration at an authorized bank and frequent changes in the nomenclature of import commodities);
- Non-stimulation of the expansion of integrated relations among the countries in the region;
- Restricting the increases in exports of small enterprises, private entrepreneurs and other economic entities, which do not carry out operations in foreign currency (consumer commodities such as vegetables, fruit, building materials, clothes).

The requirement that settlement payments and the hand-over of proceeds be undertaken in foreign currency has made exporting and importing enterprises unwilling to use "soft" currencies in settling their mutual accounts, which leads to an insignificant volume of "soft" currencies in commodity turnover. According to survey results[12] 83% of export proceeds of small and private businesses in Uzbekistan were received in US dollars, just 12% in Uzbek soums and only 2% in Russian rubles.

The continued settlement of accounts in hard currency restricts the development of trade among the countries in the region. As such, improvements in payment and settlement relations when transferring a portion of external trade turnover to accounts in national currencies would considerably boost Uzbekistan's exports to CIS countries (particularly with Russia and Kazakhstan) and reduce specific transaction costs (taking into account the considerable weight of those countries in Uzbekistan's external trade turnover). In addition, this will lead to decreased demand for US dollars on the domestic currency exchange market; it will reduce the size of the parallel currency market, and speed up deals with foreign companies. The net impact will be a reduction in the economy's susceptibility to external financial shocks and an improvement in the investment climate.

7. Conclusions and Recommendations

The process of foreign trade liberalization, the dynamics of the situation in the world commodity and financial markets, and the reorientation of Uzbek exports to higher value-added products require a significant change in export regulation and financing. Uzbekistan has to manufacture and promote quality goods and services to compete in highly competitive markers, and so there is a need to bring the available export financing tools up to international standards.

Shortage of capital, especially operating capital, is the most significant factor that affects private sector enterprises that manufacture for export. The indebtedness under investment loans of enterprises is a serious impediment as it

[12] The results of surveying small and private businesses on the issue of export activities, conducted on the basis of the IFC report called "Business environment in Uzbekistan through the eyes of representatives of small and private enterprises based on the results of 2004", SECO, Tashkent, 2005.

precludes access to short-term bank loans for replenishing operating capital, and rules out a number of new crediting facilities (such as factoring).

The expansion of export crediting mechanisms necessitates the liberalization of the approach towards unprofitable enterprises, which can be achieved by restructuring the current credit liabilities on investment projects.

Introduction of a mechanism of mutual offsetting of VAT in exporting and importing, as well as VAT refunding will create additional resources for financing the operating capital, thus expanding the opportunities for trade companies to be involved in exports.

The methods and tools for export contract financing are also in need of further improvement. In particular, the requirement for 100% prepayment prevents potential importers from buying Uzbek goods, and consequently Uzbek manufacturers from venturing out into new sales markets. Payment in the form of a L/C, however attractive it may seem, has certain drawbacks since it is rather problematic to find and endorse a L/C of a first-class foreign bank. Moreover, a serious disadvantage when using the above-mentioned tools is that Uzbek exporters cannot receive the full amount of export proceeds.

Exporters, particularly among small and private businesses, do not use export contract insurance coverage on a wide scale because of the absence of a number of prerequisites, and because of the manufacturers' obvious unwillingness to incur additional expenses.

Expanding the volume of export insurance requires adoption of a separate law “On Export Insurance”, which would specifically identify an agency (ECA) authorized to offer insurance protection for national exporters at the instruction and under the guarantee of the government and stipulate the insurance procedure on account of the state budget. Solutions may also include other types of mutual offsetting, among them: delay of payment, L/C from non-first-class banks, as well as cancellation of penalties for overdue payments of currency proceeds for exporters with export insurance policy. The possibility of expanding export privileges and preferential treatment on condition of providing trade loans to foreign partners in the case of enterprises exporting raw materials and to trade with intermediary organizations is also proposed.

The continued settling of accounts exclusively in hard currency is starting to impede the expansion of Uzbekistan's export/import opportunities and is leading to a decline in trade between the countries of CIS and Central Asia. Hence, improvement of the payment settlement relations, particularly the transfer of part of the external trade turnover to payment transactions in national currencies, may significantly increase Uzbekistan's export/import flows (particularly with Russia and Kazakhstan). It seems specifically expedient to authorize the surrender of currency proceeds in Russian rubles and a number of organizational measures associated with it. Thus, importers of commodities from Russia will have the opportunity to pay for imported goods in Russian rubles (this requires an Intergovernmental Agreement which, in fact, has already been signed between Russia and Uzbekistan). The risks of Uzbek banks in this case would be minimized considering that starting from July 1, 2006 the Bank of Russia had annulled all currency restrictions on the circulation of the Russian ruble. The same authorization can be applied in the future for the Kazakh tenge. This requires an Intergovernmental Agreement with Kazakhstan on payment transactions in national currencies.

It is also necessary to revise the list of commodities sold only in hard currency, leaving only raw materials, which are mainly traded in the world commodity exchanges. Currently this list of commodities, which can be exported through Uzbek commodity exchanges exclusively with foreign currency payment, is far broader (54 items)[13] and includes goods which are not widely available on

[13] Resolution of the Cabinet of Ministers of the Republic of Uzbekistan № 174 “On measures for the enhancement of the efficiency of stock exchanges and fairs” dated April 15, 1999.

international commodity exchanges, but may well be in demand in other countries in the region. It then seems to make little sense to sell such goods for hard currency when there are potential buyers from CIS countries.

Permitting the export of a number of commodities other than raw materials using the currencies of CIS countries could significantly reduce transaction costs of import-export operations and increase Uzbek manufacturers' exports. Moreover, it would make sense to expand the practice of exporting locally manufactured goods for soums, which could become an important factor in ensuring the stability of the national currency.

Increasing the proportion of higher value added commodities as a share of overall exports along with improving the tools for financing exports highlights a number of macro-economic issues such as the level of preparedness of banks and other financial institutions to finance this activity in conditions of insufficient capitalization and the readiness of the real sector enterprises to manufacture such products. The main issue here is the strategy and priorities of Uzbekistan's industrial policy, which are currently not formulated clearly enough. Another issue, which stems directly from the previous ones, is raising the potential of R&D activities for the purpose of developing world class products.

Solving these issues requires government resources and the creation of specialized institutions. Some countries, which carried out similar shifts in their export structures (including Japan, Korea, Turkey, China, and the countries of Central and Eastern Europe), set up ExIm Banks and Export-Credit Agencies (ECA). It must be said that an important condition for these structures to be effective is the prior liberalization of industrial and trade policies.

When considering the possibility of establishing an ExIm Bank in Uzbekistan it is necessary to take into account the creation of the Fund for Reconstruction and Development[14] in the spring of 2006 with a statutory capital amounting to 1 billion US dollars for financing and co-financing major investment projects included in the state investment program of the Republic of Uzbekistan.

Increasing the export of commodities other than raw materials also requires that niches in the world commodity market be identified where Uzbekistan could achieve a sustainable presence, i.e. there is a need to study the prospects of Uzbekistan's trade partners in more detail. CIS and European countries are currently Uzbekistan's principal trade partners. At the same time, the rapid economic growth (and thereby expanding markets) of Asian countries suggest that the greatest potential is in exporting higher value commodities to Asia.

[14] Decree of the President of the Republic of Uzbekistan № 3751 "On establishment of the Fund of reconstruction and development" dated May 11, 2006.