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# UZBEK-RUSSIAN ECONOMIC RELATIONS AND THE IMPACT OF THE RUSSIAN ECONOMIC PERFORMANCE ON UZBEKISTAN'S GROWTH AND FOREIGN TRADE

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## *I n t r o d u c t i o n*

The Russian and Uzbek economies were parts of the single economy for a period of over 100 years. These years resulted in establishment of a complex of deep economic, scientific, cultural, and military links between the two countries. There are well worked out technological and supplier-buyer relations between enterprises and, in some cases, the whole branches of the economies of Russia and Uzbekistan. This paper argues that, despite a significant decline in Uzbek-Russian economic relations after the break-up of the Soviet Union, Uzbekistan's economic development, to a large extent, is still dependent on the Russian economic performance. The number of trade and economic links decreased during the years of independence, but the majority of ties in the complex web of

bilateral economic relations were not eradicated. Good macroeconomic performance in Russia influences positively the Uzbek economy. This was especially noticeable in 2001. In conditions of global economic slowdown and a slump in world market prices for Uzbekistan's main commodities in 2001, the sustainable import demand in Russia and CIS saved the Uzbek economy from severe economic crisis. Part I of the paper highlights the major stages in the history of economic relations between the two countries in the years after the collapse of the U.S.S.R. Part II is devoted to analyzing the current status of economic relations. The next part will look at the prospects of the Russian-Uzbek economic and political relations in the near future. And finally, Part IV draws conclusions.

## **I. Uzbek-Russian Economic Relations after the Collapse of the U.S.S.R.**

Since achieving independence Uzbekistan's relations with Russia have gone through different stages, which could be divided into three. In the first stage, which began after the dissolution of the U.S.S.R. in 1991 and lasted roughly till 1995, Russia disengaged from Uzbekistan and the other former Soviet Republics. The economic relations with the former Soviet Republics were not considered to be advantageous by Russia because they were not based on market terms but on terms of concessions and barter.<sup>1</sup> Besides that Moscow found itself busy with domestic upheaval accompanying the initial phase of economic and political reforms. The switch to world prices in trade with Uzbekistan immediately resulted in

<sup>1</sup> See: N. Abbas, "Uzbekistan Splitting Ways with Moscow," *Marco Polo Magazine*, No. 2, 1999.

a decline in the Uzbek-Russian trade volume. Whereas the share of Russia among the CIS countries in foreign trade of Uzbekistan accounted for 53.1% of exports and 52.9% of imports in 1992, it was reduced to 38.6% and 36.3%, respectively, in 1995.<sup>2</sup> Uzbekistan established trade relations with developed Western countries—U.S., Germany, Japan, France, Italy and others, and reoriented its foreign trade and economic relations to these countries. In fact, Uzbekistan's foreign trade with non-CIS countries increased at the greatest rate compared to other Central Asian countries.<sup>3</sup> Further erosion of bilateral relations happened when Russia demanded that Uzbekistan deposit a sizeable part of its gold reserves in the Russian Central Bank in order to stay in the ruble zone. This demand was unacceptable for Uzbekistan. The Government of Uzbekistan opted out of the ruble zone and introduced its own national currency in 1993.

From 1994 to 2000 Russia undertook efforts to reestablish its influence in Central Asia in political and military areas. Uzbekistan also found it necessary to restore old links with Russia. Russian-Uzbek rapprochement was especially illustrative in the case of civil war in Tajikistan, where the Uzbek Army fought alongside the Russian Army for the sake of peace in the country and both Uzbekistan and Russia played a major role in ending the war in Tajikistan. The military cooperation between Uzbekistan and Russia was solidified by the common zeal to fight against Islamic fundamentalism as the most dangerous threat to both countries' southern borders. This also paved the way for significant improvement in bilateral economic relations, which resulted in the signing of trade and economic treaties with Russia. However, the notable strengthening of economic cooperation did not elevate the status of bilateral economic relations to its pre-independence levels.

Since Putin came to power in 2000, Russia started to accentuate on economic aspects of cooperation in building its relations with Uzbekistan. Initially, this was done with purely economic agenda in order to exploit benefits of cooperation, and later to counterbalance the rising U.S. presence and influence in the region. Russia is trying to use the reliance of Uzbekistan's infrastructure on Russia as a means to gain a firm foothold and avoid further crumbling of its geopolitical role in this part of the world. During the informal meeting of the presidents of 11 CIS countries in Shymbulak on 1 March, 2002, Kazakhstan, the Russian president Putin took the initiative and opened discussions on the possibility of cooperation in the gas sector between Russia, Kazakhstan, Uzbekistan, and Turkmenistan. He proposed to create the alliance of these countries in production and delivery of gas to Western markets.

## II. Analysis of the Economic Role of Russia for Uzbekistan's Foreign Trade and Economy

The significance of the Russian economy for Uzbek economic development is clear even after more than 13 years since the break-up of the U.S.S.R. The Russian-Central Asian trade was estimated at \$7 billion in 2000. This makes up only about 5% of Russia's total foreign trade.<sup>4</sup> However, Russia historically relies mainly on Uzbek cotton for its textile industry. Indeed, Uzbekistan supplies roughly 90% of Russia's cotton imports.<sup>5</sup> In addition to cotton, Uzbekistan exports cars, textiles, and food products to Russia and imports industrial equipment, timber, and other construction materials. *Nexia* brand of cars produced by joint venture UzDaewooAuto, in terms of sale volumes, top the list of the most popular foreign made cars sold in Russia in 2001. Russians bought about 10,000 *Nexias* produced in Uzbekistan in 2001. *Nexia*'s sales performance edged *Skoda Octavia* and *Skoda Fabia*—8,500 cars.<sup>6</sup> In addition to

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<sup>2</sup> See: E.M. Ivanov, "The New Reality in Uzbekistan and the Economic Position of Russia," *Marco Polo Magazine*, No. 3, 1999.

<sup>3</sup> See: N. Abbas, op. cit.

<sup>4</sup> See: *Russia Rethinks its Central Asia Strategy*, March 20, 2001 [www.eurasianet.org].

<sup>5</sup> See: E.M. Ivanov, "Contemporary Russian-Central Asian Countries Economic Relations," *Marco Polo Magazine*, No. 1, 1999.

<sup>6</sup> See: *Narodnoe Slovo* newspaper, March 2001.

officially recorded trade, a great part of the trade turnover between the countries goes unrecorded. Russia remained Uzbekistan's key trading partner as regards informal trade as well.<sup>7</sup> Thousands of small "shuttle" traders deliver thousands of tons of Uzbek fruits and vegetables to Russia in lorries, trains, and planes.

To expand its economic role in Uzbekistan Russia is also actively participating in privatization process and the development of the oil and gas extraction. There is a greater willingness to accomplish the expansion of economic ties on bilateral basis rather than within the CIS framework. For example, the Uzbek State Property Committee and the Russian Fund for Social Protection of Military Servants signed an agreement on the sale of 51% of shares of the Uzbek Joint Stock Company Photon. The Russian partner will invest \$2.88 million in kind by supplying Photon with technological equipment and has assumed obligations to keep the major production profile of the enterprise—production of the element base for electronics. The State Property Committee is also holding negotiations with another Russian company on selling 39% of shares of State Joint Stock Company (SJSC) Uzkabel. The SJSC Uzkabel is the largest enterprise in the country, specializing in production of cable. Meanwhile, the Russian oil and gas companies LUKoil and Itera are planning to start developing three gas fields in Uzbekistan in the near future.

The importance of the Russian import demand for Uzbek economic performance could be further illustrated in the example of the Russian economic crisis of 1998. According to *Uzbekistan Economic Trends*, an abrupt decrease in demand for Uzbek exports in Russia as a result of the crisis forced Uzbek exporters to direct part of their exports to non-CIS countries.<sup>8</sup> However, such a sudden shift was not going to be without losses. As a consequence, *Uzbekistan Economic Trends* estimated that the commodities for the amount of over \$100 million remained as "excess supply" that Russian demand/market could not absorb. Because of an increase in transportation and insurance costs, Uzbekistan lost an additional \$15-20 million. Moreover, the crisis led to a decline of prices (in dollar terms) for Uzbek exports by 16.4%—the loss of export proceeds in hard currency equal to about \$44 million. It is estimated that in total the Russian crisis cost Uzbekistan about \$150-160 million in lost export revenue. As a matter of fact the Russian crisis had a contagious negative impact on the whole of the CIS. The crisis diminished import demand in not only Russia, but also in other CIS countries—economic partners of Uzbekistan. In the second half of 1998, Uzbek exports to the CIS (except Russia) decreased by 16.3% and imports by 16% year to year basis.<sup>9</sup> IMF staff calculations indicate that the gap between projections prepared before crisis's outbreak and actual export revenues widened during the crisis. The shortfalls in Uzbekistan's export revenues reached 23% and 30% of the pre-crisis projections in 1998 and 1999, respectively.<sup>10</sup>

In 2001, Russia's macroeconomic performance was very good. GDP grew by 5.2%, bringing cumulative growth since the crisis of August 1998 to over 20%.<sup>11</sup> On the other hand, from 1999 to 2001 the Uzbek-Russian trade increased by 38%.<sup>12</sup> The signing of long-term trade agreements in 2000 further facilitated the bilateral trade. According to the Russian Center for International and Scientific Cooperation, Uzbek-Russian trade grew by 20% in 2001 annually to reach \$1.2 billion, which accounts for 18-20% of Uzbekistan's total trade. The statistics for geographical composition of foreign trade in Uzbekistan indicate that Russia's share in Uzbekistan's foreign trade fell during the crisis and expanded after it (see Table 1). The reverse is true regarding the share of the rest of the world—it increased during the crisis and decreased after it. This could mean that Russia is a trading partner of choice for Uzbekistan and during the crisis Uzbekistan simply had to reorient its exports to other markets.<sup>13</sup> As soon as economic situation improved in Russia, Uzbekistan eagerly resumed its trade

<sup>7</sup> See: C. Pastor, T. Damjanovic, The Russian Financial Crisis and its Consequences for Central Asia, IMF Working Paper WP/01/169, 2001.

<sup>8</sup> See: *Uzbekistan Economic Trends* for 1998, 1999, 2000, 2001.

<sup>9</sup> See: *Uzbekistan Economic Trends Quarterly*, October-December 2000.

<sup>10</sup> C. Pastor, T. Damjanovic, op. cit.

<sup>11</sup> See: World Bank Moscow Office, *Russian Economic Report*, January 2002.

<sup>12</sup> See: *Uzbekistan Economic Trends*, 1999, 2000, 2001; Russian Center for International and Scientific Cooperation.

<sup>13</sup> This was possible to do within such a short period of time because the major part of exports to Russia is cotton—a commodity, which is in demand in the world commodity markets.

relations with it. However, as the tables below indicate, the overall foreign trade turnover, balance of payments situation, and exports driven growth in Uzbekistan to a significant extent depend on the price fluctuations and production volumes of Uzbekistan's main commodities (cotton and gold).

Table 1

**Uzbekistan-Russia: Selected Macroeconomic Data, 1994-2001**  
(US\$ million, unless otherwise stated)

	1994	1995	1996	1997	1998	1999	2000	2001
Foreign trade turnover	5,299	6,602	9,311	8,911	6,817	6,347	6,212	6,401
Exports of goods & services	2,690	3,720	4,590	4,388	3,528	3,236	3,264	3,265
Imports of goods & services	2,609	2,892	4,721	4,523	3,289	3,110	2,947	3,137
Trade balance	81	828	-131	-135	239	125	317	128
Cotton crop (1,000 tons)	3,938	3,934	3,350	3,641	3,206	3,600	3,002	3,300*
Cotton fiber exports	1,508	1,584	1,539	1,390	1,198	833	897	
Gold extraction (tons)	65	63	60	62	70	80		
Gold exports	375	611	906	738	788	810	809	
Russia's share in Uzbekistan's foreign trade			16.4	18.1	14.9	13.4	16.6	19.9
GDP growth in Uzbekistan	-4.2	-0.9	1.6	2.5	4.3	4.4	4.0	4.5
GDP growth in Russia	-12.7	-4.1	-3.4	0.9	-4.9	5.4	8.3	5.2

\* Estimate.

Sources: IMF; *The Economist Intelligence Unit*, Uzbekistan Country Reports and Updates, 2001 and 2002; Ministry of Macroeconomics and Statistics of Uzbekistan, *The Basic Indicators of Social and Economic Development of the Republic of Uzbekistan in 2001*, Tashkent, 2002; *Uzbekistan Economic Trends*, 1998, 1999, 2000, 2001.

Table 2

**Cotton and Gold Prices in Dollar Terms**  
(% changes from the previous period)

	1994	1995	1996	1997	1998	1999	2000	2001
Cotton	23.8	259	-16.5	-7.0	-4.8	19.7	+14.2	-18.7
Gold	6.8	0.0	0.8	-14.7	-11.2	-5.2	0.07	-2.9

Sources: *Uzbekistan Economic Trends*; World Bank.

Russian macroeconomic situation and, as a consequence of it, the state of Uzbek-Russian trade, is another important factor that determines the volume of export revenues<sup>14</sup> and economic performance of Uzbekistan (see Tables 1 and 2).

### III. Prospects

Uzbekistan and Russia could both benefit from the regional alliance of gas producers as both countries are important gas producers and transit countries. Some observers estimate that the revenues from exporting Central Asian gas through Russia should considerably exceed the size of the American financial aid offered to Central Asian nations as a reward for their loyalty. It is not ruled out that China, with its huge energy market, may also join in the project in the future.<sup>15</sup> Russia would definitely play a leading role as the main link in the transit route and the largest investor.<sup>16</sup> If the project materializes, this would allow Uzbekistan to diversify away from its poor and insolvent customers—Kyrgyzstan and Tajikistan—and gain access to European markets, Turkey and Russia. Many analysts believe that potential proceeds from the sale of gas in more lucrative markets are offered in exchange for some degree of political collaboration.<sup>17</sup> The opening of the export route would give Russia an important instrument of exercising political control over the former Soviet republics of Central Asia, including Uzbekistan. If Uzbekistan takes on a pro-American policy, Russia will be able to exert pressure on Uzbekistan by creating difficulties or even by cutting access to export infrastructure.

In another development, an international forum on the Aral Sea jointly organized by the Russian Center for International and Scientific Cooperation and International Ecology and Health Fund Ecosan, made efforts to revive a plan conceived during the Soviet period to construct canals from Siberian rivers to Central Asia in order to alleviate the Aral Sea crisis. It is well known that Russia possesses excessive water resources, whereas Uzbekistan and other Central Asian countries face an extreme water shortage problem. These problems hit Uzbek agriculture and economy seriously. The project, if implemented, would undoubtedly help solve many economic, ecological, and social problems in Uzbekistan associated with water shortage.

According to Christof Ruehl, Chief Economist with the World Bank's Russian office, the Russian economy started to anchor itself outside the natural resources sector during the first half of 2003.<sup>18</sup> This means that the Russian economic growth has become more broad based and less vulnerable to changes in the oil prices—Russia's main export item. Although growth is still driven by the oil price, the diversification of the economic base and increased economic stability seem to be the prevailing economic trend. This could be good news for Uzbekistan. The sustained and broad based economic growth and import demand in Russia could further expand the horizons of Uzbek-Russian economic cooperation and favorably stimulate the Uzbek economy.

### IV. Conclusions

The era of dominance of centrifugal forces that followed the break-up of the Soviet Union led to disintegration of the majority of the connections among enterprises and branches of the economies of Russia and Uzbekistan. However, the sense of simple economic expediency, geographical proximity, cultural bonds, and foreign policy agenda made it necessary to restore and develop further economic relations between the countries. Despite notable increase in the share of the rest of the world in Uzbekistan's for-

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<sup>14</sup> According to *Uzbekistan Economic Trends*, Uzbekistan ran trade surplus with Russia in 1999 and 2000.

<sup>15</sup> See: M. Yermukhanov, "CIS Leaders Meet at a Summit in Kazakhstan," *Central Asia Caucasus Analyst*, 13 March, 2002.

<sup>16</sup> All the existing pipelines from Central Asia to Europe pass through the Russian territory.

<sup>17</sup> See: M. Yermukhanov, *op. cit.*

<sup>18</sup> Interview with Christof Ruehl, chief economist, World Bank Moscow Office. Moscow, 25 November, 2003 (Prime-Tass).

eign trade, Russia's share is still big enough to significantly influence the Uzbek economy. The potential for Uzbek-Russian cooperation is especially promising in oil and gas, agriculture, textile, machine building, construction and aircraft production. Attitude of Russia toward Central Asia—the region Russian politicians have portrayed since the end of the 19th century as the country's soft underbelly—is also changing in light of geopolitical shifts in the region after 11 September events. Some Russian observers compare the geopolitical significance of the establishment of the U.S. bases in Uzbekistan and Kyrgyzstan with the unification of Germany. In light of these developments, Russian policymakers devote closer attention to their Central Asian policy and Russia is becoming more assertive in Central Asia, including Uzbekistan.

In general good macroeconomic performance in Russia, in combination with the increased prices for Uzbekistan's main commodities as a consequence of the economic recovery in the US and EU, better weather conditions for Uzbekistan's main branch of economy—agriculture—would compose a “coveted” combination of positive external economic factors for Uzbekistan. It is unlikely that all these favorable conditions occur simultaneously in a given period of time. However, the expected sustained economic growth in Russia will help the Uzbek economy stay afloat by creating the demand for Uzbek products.

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