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Executive Summary – Uzbekistan Trade Logistics Study

Introduction

Lying on the ancient trade routes between Asia and Europe, Uzbekistan has been the center of commerce and trade for many centuries. Its territory covers 447,400 sq km, the third largest among the five Central Asian republics it borders - Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Afghanistan. Uzbeks are hard working and successful in business. They form the core of the legendary traders along the ancient Silk Road.

With a young and literate population in excess of 28 million, Uzbekistan enjoys a vibrant and fast growing economy. Agriculture is the most important sector of Uzbekistan's economy, accounting for nearly 29% of GDP. Other major export earners include gold (second largest export), natural gas, minerals and fertilizer.

In 2007, its GDP grew by 9.5%. From 2006 to 2007, its trade surged by 27.4%, driven by a huge 40.7% increase in export.

Despite its enviable geographic position and increasing prosperity, Uzbekistan's Logistics Performance Index (LPI) rank is a disappointing 129th out of the 150 countries surveyed in the 2007 World Bank Report, "Connect to Compete – Trade Logistics in the Global Economy".

LPI measures a country's trade logistics performance using a number of parameters. It profiles the trade logistics of the countries covered and identifies the factors that explain the wide differences in logistics performance among countries. Countries with high LPI scores have lower trade costs and are better connected to the global value chain.

Uzbekistan's 136th "Customs" Rank, (7 notches lower than its composite rank) highlight the poor efficiency and effectiveness of Customs and other border procedures. Its 133rd "International Shipment" rank reflected the challenges encountered in arranging international shipments.

World Bank Logistics Performance Index

Country	Rank	Score
Peoples Republic of China	30	3.32
Kyrgyzstan	103	2.35
Uzbekistan	111	2.29
Uzbekistan	129	2.16
Kazakhstan	133	2.12
Mongolia	136	2.08
Tajikistan	146	1.93
Afghanistan	150	1.21

Challenges

Even though Uzbekistan air and rail transport is among the best in Central Asia, supply chain management services and freight logistics are weak. Its road carrier industry is fairly small and multimodal transportation is underdeveloped.

The new Deputy Managing Director of UZDAEWOO commented that Uzbek supply chains operate on a “push” system instead of the more efficient “pull” system common in countries with mature supply chain practices (e.g. US, Japan).

Logistics and supply chain management education and training is weak in Uzbekistan. The paucity of qualified logistics professionals made it hard for Uzbekistan to achieve rapid advances in supply chain management. Frequently, large Uzbek firms and multinationals have to recruit supply chain managers from abroad.

Air Transportation

The state-owned airline, “O‘zbekiston Havo Yo‘llari” (Uzbekistan Airways) was formed in 1992 out of the Uzbekistan Division of Aeroflot.

Staff with 15,000 employees, Uzbekistan Airways is a huge enterprise that runs the entire air sector, including air traffic control, airport management, and passenger and cargo transportation. Uzbekistan Airways operates scheduled international flights to more than forty cities in USA, Europe, Middle East, Southeast Asia, Central Asia and CIS. It runs a modern fleet that includes Boeing 757-200, Boeing 767-300-ER, A 310-300 and RJ85,

Since Uzbekistan is double landlocked, air plays a particularly important role in cargo transport, transporting about 4% of the international cargo. Uzbekistan Airway’s cargo routes include Europe – Uzbekistan, Istanbul – Uzbekistan – Japan, Bangkok – Uzbekistan – Russia and China -Uzbekistan. Typical cargo includes fruits and vegetables, high value equipment, critical parts as well as consumer electronics.

Tashkent Airport was certified by the International Civil Aviation Organization (ICAO) to be an all weather airport. Several leading airlines have chosen Tashkent as the intermediate stop for long haul intercontinental flights between Europe and Asia.

The Uzbekistan government is building a large airport in Navoi. When finished, Navoi airport will be a super air cargo hub with comprehensive multimodal logistics capabilities (air, road, and rail) and a key passenger hub for serving tourist going to Samarkand, Bukhara and Khiva.

Uzbekistan Airways has built a large route system and airport network. However, high fuel prices are forcing shippers away from air transportation in favor of lower cost ground alternatives. To remain competitive, Uzbekistan Airways should focus on optimizing its operations and improve its cost structure.

Road Transportation

88% of Uzbekistan’s domestic passenger and cargo traffic and 10% of the international traffic are transported over the road. Its 83,000 km of highways (90% paved) are also strategically important to its neighbors in providing transit routes. For instance, its neighbor, Tajikistan relies

on Uzbekistan's roads to provide a year-round linkage between Northern Tajikistan and Southern Tajikistan.

"Uzavtoyul", the State Owned highway construction company has only a modest \$350 million annual budget. Insufficient maintenance in the past has led to the deterioration of roads. Since the country has no toll roads, additional funding sources should be created to pay for highway maintenance and construction.

In recognition of Uzbekistan's critical transit role, on December of 2007, the Asian Development Bank (ADB) announced it will provide Uzbekistan a \$75.3 million loan to upgrade two sections of the A-380 highway, a 1,204 kilometer road that runs from the Kazakh border in the north, toward Afghanistan and Turkmenistan.

Due to high customs duty and excise tax, the estimated cost for acquiring a new European made truck in Uzbekistan (e.g. Volvo, MAN) is about Euro 160,000 per unit. Few Uzbek enterprises can afford the large investment in entering the trucking business. Therefore, the Uzbek trucking industry is underdeveloped. It is estimated the total number of Uzbek trucks is less than 2,000, with most of them consisting of Russian equipment (mostly old Kamaz trucks) that do not meet EURO 3 standards. Consequently, few Uzbek trucks can carry cargo to Western Europe.

Uzbek International Freight Forwarders Association (UIFA) has successfully lobbied the Uzbekistan government to reduce the customs duties to 30% for new trucks and 10% for used trucks. This lowers the investment barrier for entering the trucking business substantially. However, more needs to be done by the government to support this important industry, currently dominated by Turkish, Iranian and Russian carriers.

Rail Transportation

Formed from the majority of the Soviet Central Asian Railway, the state-owned joint stock rail company, "O'zbekiston Temir Yo'llari" (UTY) is one of the largest rail operators in the Central Asian region.

Below are selected statistics about UTY:

- 4400km broad gauge track network, 600km electrified
- Labor force of 33,500
- Transport 20 billion ton-km of cargo
- Handle 86% of international cargo

The railroad has achieved robust traffic growth, with 19% increase in 2007 and mid teen increase in recent years.

UTY's tracks are in good condition, capable of handling 120km/hour trains, with some sections accommodating speed as high as 160km/hour.

In the 2010 – 2015 plans, UTY will electrify high traffic density sections of its network including the following sections:

- Samarkand-Karshi-Tash Guzar-Baisun-Kum Kurgan

- Samarkand-Navoi-Uchkuduk-Urgench-Nukus
- Navoi-Bukhara

The Uzbek government contemplates constructing a 140km rail line linking Tashkent and Andijan that will avoid passage through Tajikistan. Future plans also involve the building of a 5km spur to link its main line to Novoi International Airport.

However, Uzbek rail wagons are old and in poor condition. Despite tight supply, many shippers reject up to half of the wagons offered due to poor condition. Fortunately, Uzbekistan is one of the three CIS countries with wagon construction and renewal capabilities. Pending future funding from multilateral organizations, more wagon manufacturing and repair facilities can be built.

Water Transportation

Uzbekistan is far from the ocean. The closest access point to open sea is 2950km away.

Uzbekistan's volume of water traffic is small and almost all are ferry traffic moving on its two major rivers – the Syr Darya and the Amu Darya. Water traffic on the Amu Darya increases for a brief period in 2001 when large volume of supplies is shipped via Uzbekistan to Afghanistan, but has dropped off in recent years. Looking long term, water transportation will decline as more bridges are built.

Multimodal Transportation

“Uztemiyolkonteyner” - Uzbekistan Railway's terminal operator, runs 13 rail stations with container lifting capability, one of them is the Chukusay container terminal in Tashkent. Other intermodal terminals include the Shoshtrans Terminal and the Azia Terminal in Tashkent.

Unlike U.S. intermodal terminals handling thousands of containers and trailers a day, intermodal terminals in Uzbekistan are generally small, inefficient and handle a very light amount of traffic.

Compare to North America and Western Europe, Uzbekistan is at an early stage in the development of multimodal transportation. U.S. railroads run scheduled, dedicated, double stacked container trains generally over 1,500 meters long. In contrast, container trains in Uzbekistan (and generally in Central Asia) are short and single stacked and frequently intermingled with general wagon traffic. This results in slower service and higher cost to the shipper.

Uzbekistan Railway carries containers in “home grown” flat wagons by removing the box from old box wagons. It also moves containers in whatever wagons can accommodate a container, including rail wagons designed for carrying lumber and tree logs. Inappropriate placement of containers in rail wagons not designed for container carriage can damage the container and its cargo, plus the rail wagon.

Uzbekistan Railway owns very few containers. Almost all of the containers used for transporting goods in and out of Uzbekistan are owned by shippers or by foreign railways, foreign freight forwarders, foreign logistics companies and foreign container leasing companies.

Freight Forwarding & Logistics

Uzbekistan is well served by a diverse group of freight forwarders and logistics companies, including those from Russia, Kazakhstan, Iran, UAE, Germany, Switzerland, Korea and China.

Most of the services offered are traditional forwarding and warehousing services. Some companies are starting to augment their offerings with valued added services, but 3PL, supply chain management services are still at an embryonic stage in Uzbekistan.

Traffic Pattern

Currently, much more cargo flows into Uzbekistan than going out, causing many trucks, containers and rail wagons to return empty. These empty movements are driving up the transportation costs.

Part of this is caused by Uzbekistan's import/export imbalance. But part of this is also a result of Uzbekistan's role as a transit country for its neighbors. Its traffic pattern is affected by the import/export pattern of neighbors that route their goods through Uzbekistan.

Most of Uzbekistan's inbound traffic consists of high value machinery, capital equipment, electronics and consumer goods. Foreign shippers generally control the inbound routing.

Most of Uzbekistan's outbound traffic is raw material (e.g. cotton), with routing generally controlled by the government.

The dispersion of routing control also contributes to the high percentage of empty equipment movements, increasing the shipping cost.

Cotton Movement

Uzbekistan is the fifth largest cotton producer of the world and the second largest cotton exporter after USA. Cotton is Uzbekistan's largest cash crop – accounting for around 16% of the GDP.

After harvest, cotton is sold to the government at low state procurement prices (derived from subtracting government cost from export revenue), ginned, then marketed through government agency or licensed trading firms.

A network of cotton terminals is set up throughout Uzbekistan to store ginned cotton bales. Bales stored in approved cotton terminals (e.g. Akaltin) can be traded before they are shipped out of the country.

Bandar – Abbas became main cotton export port since the completion of the Iranian Meshed-Sarakhs rail line in 1997. This is the shortest route to the sea and the best route for shipping Uzbek cotton to the Indian subcontinent and Southeast Asia.

Cotton destined to China is shipped through both Bandar – Abbas and Alashankou, according to the General Manager of Tianjin Cotton Exchange. A new route through Kara Suu, Osh, Sary Tash, Irkeshtam, and Kashi to China is planned.

Cotton is a highly competitive commodity. It is important for Uzbekistan to constantly search for the most attractive way to ship this important product to market.

Trade Logistics Impediments

Uzbekistan does not have an integrated trade facilitation strategy. There is no institution dedicated to trade facilitation or trade reform.

Trade is subjected to a wide variety of government controls and regulations. Exchange control, in particular, is a major impediment to trade. In addition, all import and export contracts must be filed and approved by the Ministry of Foreign Economic Relations, Investments and Trade.

The banking system in Uzbekistan is not well developed. The Uzbek government regulates the banking industry tightly and discourages foreign investment in that sector.

Uzbekistan's import tariff and excise taxes are high and hamper both regional and global trade. Even imports from countries with a most favored nation status are subjected to customs duties of up to 30%. Automobiles are taxed at a high 90%. With some exceptions, Uzbekistan also imposed a 20% excise tax on imports.

Traders and forwarders reported Uzbek Customs as the most difficult challenge. The following are some examples:

- Non-uniform interpretation of customs law and regulation by different customs posts and different officers.
- Mandated use of customs convoys when import cargo is destined to a point more than 300km from the border. Forwarders reported long wait for a convoy to be assembled, followed by a long road trip zigzagging from customs post to customs post that deviates from the shortest route to final destination.
- Uzbek Customs examines 100% of the import cargo.
- Borders are closed from time to time with no advance notice.
- Operating hours of Uzbek border crossing point are not synchronized with the operating hours of its neighbors, further shortening the actual amount of time people and cargo can cross.

In addition, militia highway checkpoints are ubiquitous in Uzbekistan. There are special highways checkpoints staffed by customs officers, border guards and special police near the borders. These checkpoints slow down traffic movement and add to the uncertainty of transit time.

High Logistics Cost

There are no official calculations of Uzbekistan's logistics cost as a percentage of GDP.

Due to Uzbekistan's long distance from sea access, inadequate infrastructure, non-physical barriers, inefficient supply chain practices, shortage of trained professionals and very high cost of capital, Uzbekistan's logistics costs is considered to be quite high.

Opportunities

The convergence of the Asian and European production networks presents significant opportunities to CAREC countries in bridging both regional production networks to form a Eurasian production network. Potential opportunities include:

- Grow a strong transport industry to carry goods from one regional production network to another (like what Turkey has accomplished)
- Develop a strong logistics industry to meet the needs of both Asian and European production networks
- Provide transit services for people and goods traveling from one region to another
- Supply the inputs required by both regional production networks

Uzbekistan can use its central location in the CAREC region to play a leadership role in promoting the Eurasian Landbridge; similar to the role it played on the “Great Silk Road”.

To exploit these opportunities, Uzbek governments and enterprises must understand the concept of “global value chain” and target carefully chosen niches that are suitable for the region. These opportunities include:

- Exploit Tashkent’s location on the pathway of long distance flight routes and the availability of competitively priced aviation fuel to develop Tashkent as a major intercontinental air hub.
- Develop Tashkent to be the air cargo hub for its five neighbors, especially Tajikistan, Turkmenistan and Afghanistan.
- Provide pilot and mechanic training, aircraft maintenance and repair, engine rebuilding, etc to take advantage of the strong aviation sector.
- Construct refineries, polymer manufacturing plants and fertilizer plants to take advantage of ample supply of crude oil and natural gas.

Uzbek law on free economic areas covers the creation of free economic zones. The concept of free zones, where government income, property and consumption taxes are light and where goods can be stored, packaged, processed and transformed duty free is widely adopted all around the world. The Uzbek government should implement this as a highly effective way to advance the country’s trade logistics.

Uzbekistan has excellent neighbors to benchmark – China in the proper mix of socialism and capitalism, Japan and Korea in manufacturing, Singapore and Hong Kong in trade logistics. Importing their “best practices” and learning how they migrate up the value chain, will assist Uzbekistan greatly in accelerating development.

Uzbekistan can also study how Switzerland transformed itself from a landlocked country to be the crossroad of Europe and a global center of trade and finance.

Key Recommendations

The Uzbekistan Trade Logistics Study proffers a set of recommendations for improving Uzbekistan's trade logistics. Some of the key points are listed below:

1. Adopt comprehensive transport infrastructure planning to:
 - Achieve the highest return on investment
 - Balance the amount of investment in various types of infrastructure
 - Ensure seamless air/truck/rail/sea modal integration
2. Reform transport and logistics curriculum. Recruit world-class faculty to teach in Uzbekistan's universities.
3. Develop special economic zones, multimodal cargo facilities, logistics centers, cold storage facilities and modern border crossing points.
4. Establish a pilot corridor with special economic zones, multimodal cargo facilities, logistics centers, cold storage facilities and modern border crossing points, as a demonstration corridor to showcase the improvements that can be achieved.
5. Simplify customs laws and regulations. Improve transparency of rules and regulations. Promote harmonization of border crossing procedures, forms and data requirements. Reduce regulatory burden on trade.
6. Encourage private sector participation. Enact laws that protect property rights and act to enhance quality of the judicial system.
7. Promote the development of Small & Medium Enterprises, especially those that are in agriculture, supply chain services, transportation and logistics.
8. Develop industries that will sustain Uzbekistan's economy for many future years. Transport, logistics, aviation and agriculture are high potential industries that the government should focus on.
9. Secure foreign investments that come with technology transfers.
10. Compile logistics performance indicators to assess the success of government policies, laws and regulations
11. Work with Kyrgyzstan to construct the China - Kyrgyzstan - Uzbekistan - Railroad as a standard gauge railroad from Kashi to Kara Suu (see details in the trade logistics study).

Concluding Remarks

A route is a fragile chain; the breakdown of just one link will disrupt the entire route.

The selection of trade routes is dynamic and constantly evolving. Merchants, manufacturers continuously monitor freight rates, transit time, service quality and reliability of alternate routes to optimize their choices. Ever cognizant of risks, the merchants are always seeking new routes - the key reason why there are so many routes that form the ancient "Silk Road".

The China – Kazakhstan - Russia route linking Asia and Europe is much simpler than the direction through Uzbekistan. Kazakhstan will soon have two rail connections with China (Alashankou and Horgas), increasing the competitiveness of the Trans Kazakhstan route. Mongolia and Russia are also working diligently with China to improve the attractiveness of the Trans Mongolian Route and the Trans Siberian Route. In the years to come, the trade routes crossing Uzbekistan will face even more intense competition from both existing and emerging transportation routes.

Uzbekistan's transit traffic can easily be interrupted by its own actions and its transit partner's political turmoil. Frequent border closures and movement impediments will only convince shippers to bypass Uzbekistan.

Uzbekistan must be vigilant in defending its competitive advantages and constantly strive to make it the most trade and transit friendly country. Investment in infrastructure is a good start, but the government must lower transit barriers, reform its laws and regulations, improve its transparency and increase the competitiveness of Uzbekistan's logistics industry.