

**THE TRANSITION FROM RAW MATERIAL INTO HIGH VALUE ADDED
PRODUCTION: PROBLEMS, CHALLENGES AND PERSPECTIVES IN CASE
OF TEXTILE INDUSTRY IN UZBEKISTAN**

By

Urunov Azizbek Allaberganovich

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

MASTER OF PUBLIC POLICY

2012

**THE TRANSITION FROM RAW MATERIAL INTO HIGH VALUE ADDED
PRODUCTION: PROBLEMS, CHALLENGES AND PERSPECTIVES IN CASE
OF TEXTILE INDUSTRY IN UZBEKISTAN**

By

Urunov Azizbek Allaberganovich

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

MASTER OF PUBLIC POLICY

2012

Professor Yoo Jungho

**THE TRANSITION FROM RAW MATERIAL INTO HIGH VALUE ADDED
PRODUCTION: PROBLEMS, CHALLENGES AND PERSPECTIVES IN CASE
OF TEXTILE INDUSTRY IN UZBEKISTAN**

By

Urunov Azizbek Allaberganovich

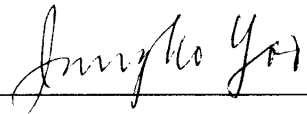
THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

MASTER OF PUBLIC POLICY

Committee in charge:

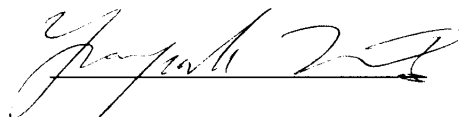
Professor Yoo, Jungho, Supervisor



Professor Lee, Seung-Joo



Professor Kang, Younguck



Approval as of May, 2012

Abstract

Market economy has always promoted specialization on particular sector, industry and production where the most efficiency can be achieved so that all participants could be better off.

In this work, it is assumed that Uzbekistan is highly competent and has comparative advantage in the development of textile industry based on the factors that make up the manufacture of textiles. Every input necessary for textile production is analyzed, and impediments that are constraining the potential of the sector development are investigated. Through thorough consideration of major direct and indirect factors for processing cotton fiber into ready-made goods in order to make high value for the economy, it can be concluded that Uzbekistan possesses great potential for successful clothing industry providing the maintenance of proper opportunities, business climate and utmost measures.

Copyright by

Urunov Azizbek Allaberganovich

2012

Dedicated to my lovely parents: Urunov Allabergan and Kutlimuratova Shakarjon

Acknowledgements

Above all, gratitude for almighty Allah for blessing me with all the opportunities that brought me where I am, and my parents for every support, care and love I have got from them which always serve as extra strength, confidence in my efforts.

Special praise and gratefulness go for Areum Jo who contributed enormously in every endeavor I have taken to make this work. I want to thank her for every support and care; for being worried even more than me so that I can accomplish my obligation before KDI school to have my Master's on public policy.

Also, I would like to express my sincere appreciation for following people for their respective contribution in making this solid work: to professor Yoo, Jungho for sparing precious time to go through series of drafts, thoughtful suggestions; to KDI school outstanding professors, staff and faculty members for making my stay at school fruitful, enjoyable from academic and professional perspectives; to my friends and all KDI students for living, studying and sharing experiences in Korea as one united family.

I avail myself of an opportunity to thank my family, siblings and relatives who have always stood up to contribute for setting my own path.

In addition, I am honored and pleased to express Ministry of economy, executives, coworkers of my high consideration for their trust and backing so that I could represent myself and my warm-hearted people at KDI school.

I highly appreciate everybody's contribution, support and care.

Table of Contents

Introduction	1
2.1. Current conditions of cotton production in Uzbekistan.....	3
2.2. Foreign trade of cotton production and textile goods.	5
2.3. The potential of processing raw cotton into value added product.	8
3.1. The role of investments in processing cotton into finished goods: condition and challenges.....	14
3.2. Other factors that could constraint the high value added production in textile industry. .	18
Conclusion	24
References.....	28

List of Tables

<i>Table 1</i> – World Cotton fiber production and consumption	8
<i>Table 2</i> – Major textile producers, their export	10
<i>Table 3</i> – Ease of doing business	21

List of figures

<i>Figure 1</i> – The dynamics of cotton fiber exports	6
<i>Figure 2</i> – Cotton fiber share in the total exports	7

Introduction

Uzbekistan's recent economic course is directed to gradual transition from raw material into high value added production coming out from its economic potential. Thus, as one of the biggest producers of cotton production and its export in the world, it gives great incentive for the country to make significant reforms in this industry that can be key solution for practicing even more efficient ways of economic performance.

While autarky is absurd, and as a result of internationalization and globalization, countries are becoming more and more interdependent in all spheres: economically, politically, socially, culturally and so on, it is really important to emphasize on what they are good at as long as a country cooperates with other countries in order to be successful and competent. In this sense, every country tries to utilize their comparative advantage as much as possible which will result overall high efficiency in economic performance.

To this extent, Uzbekistan has great potential to add up for its economic success acquired during the years of independence by gradual transitioning into high value added production utilizing its opportunities in which the country has comparative advantages not only providing domestic market with those goods and services, but also contributing to the world economy with high quality – lower price goods production intention.

In this regard, the recent reforms and structural changes in cotton production and its further processing can be one of these key factors for more efficient utilization of endowed resources, yet still leaving some issues to be carried out to deal with existing problems and arising challenges.

The **significance of this work** is that Uzbekistan has a good potential to be successful in utilizing what the country is well-endowed, i.e. further processing of raw materials into high value added production in textile industry.

The **main purpose of the thesis** work is to seek for the solutions for the challenges and problems constraining Uzbekistan from processing fully the annual domestic output of the cotton-fiber to enhance high value added production industry.

To achieve this aim, it is important to analyze:

- Current conditions of cotton industry;
- Recently undertaken reforms and structural changes fulfilled;
- What are the still remaining problems and challenges that should be taken into account?

In my thesis, I will be using the sources from internal documents of relevant government agencies and organizations of the Republic of Uzbekistan as well as thesis-related World Bank reports and topic-related research papers.

Thesis work consists of an introduction, two body parts, and a conclusion.

The introduction is dedicated to the urgency and topicality, aims and tasks, structure of the thesis work.

The first part of the body will be devoted to cotton production and its role in the national economy of Uzbekistan, the latest reforms and structural changes the country has taken to succeed in this industry as well as its potential in high value added production.

The second part of the body will discuss the problems and challenges constraining the industry for working on its full potential.

And, finally, the conclusion part will present proposals and recommendations to ease those barriers for the progress of light and textile industry.

2.1. Current conditions of cotton production in Uzbekistan.

Uzbekistan is the world's seventh largest cotton producer among the 90 cotton-growing countries, producing around 1 million tons of cotton fiber each year that stands for 6% of the World cotton production (USDA, 2011). In Uzbekistan's GDP, cotton production accounts for 13%, employing 30% of rural people (Rudenko, Lamers, and Grote, 2009).

The history of cotton production goes back until 5-6 centuries in Central Asia and coming to the end of 19-century because of the civil war in the US, the cotton import into the Tsarist Russia was cut down significantly. As a result, in seeking alternatives, Russia wanted to succeed cotton production into Central Asia because of the proper climate and geographic location (Rudenko, 2008). Consequently, since then, Central Asia began to serve as the supplier of cotton resources for Tsarist Russia's textile industry. That tradition descended for the USSR period as well. But, the requirements for the volume of cotton production were very tough. As the USSR wanted cotton independence, it forced Uzbekistan to yield 6 million tons of cotton each year which was practically impossible at that time. Another drawback of the Soviet policy was that Uzbekistan served only as a cotton supplier, but most textile factories were located in other socialistic republics within the USSR that made it inefficient (Djanibekov, Rudenko, Lamers, Bobojonov, 2010, p. 2). Specialization in this sector in Uzbekistan, beginning from raw material production till further processing into finished goods might have enabled much efficient production overall. But, the opposite was the policy of the centralized Soviet government.

Another inherited problem from the Soviet Union was one of the worst ecological disasters in the world. As, Soviet government's main concern was about maximizing cotton output in Central Asia, mainly in Uzbekistan, most water resources were directed for the growing of cotton which consequently left the Aral sea without water beginning from 1960s.

The production of cotton at the expense of ecological issues was the big mistake of the Soviet government, as current consequences of that time Soviet policy are leaving great environmental disaster not only in Uzbekistan, but the whole Central Asian region.

As Uzbekistan acquired the independence in 1991, it began quick national economic reforms. The proper and timely reforms were life necessary to avoid and defer social, economic as well as sovereignty related problems. As inherited from the Soviet era, in 1991 agriculture sector had more than 33% share in the GDP, yet industrial sector comprised 27% (Djanibekov et al., 2010, p. 3). In seeking ways to deal with all Soviet-inherited problems as well as to further enhance national sovereignty, to maintain freedom and proper rights of its nation, Uzbekistan began first steps in transformation from the centrally planned into the market economy. The “Uzbek model” was chosen to pursue the aimed goals mentioned above. The model implied gradual steps designed to mitigate the impact of the dramatic changes related with the collapse of the USSR and further liberalize the national economy for the sake of its nation and their well-being.

The production of cotton was one of the leading economic activities in Uzbekistan, but as mentioned above, there was a dilemma between already caused environmental disaster and deferring current economic as well as social problems. Yet, production of cotton could give an urge for other sectors of economy. In this sense, the income from cotton production could enable to give birth and reestablish industrial sector in which Uzbekistan had great potential with its well-endowed natural and human resources.

As a result, alongside with huge agricultural output, giving an accelerated progress for industrial sector was the main priority by gradual liberalizing economy, supporting entrepreneurship, realizing privatization.

By establishing sustainable industrial sector, one of the major aims was to shrink cotton arable areas to save water resources at least to preserve the current condition of the Aral Sea, preventing from even worse consequences for the people living around and from further salination of the Aral Sea region. However, reduction of arable lands for cotton does not imply the decline in the production, but it is aimed for enhancing the efficiency in the production of the “white gold”¹.

Other concerns about cotton production were to find out ways to reach early ripening and highly productive grades of cotton.

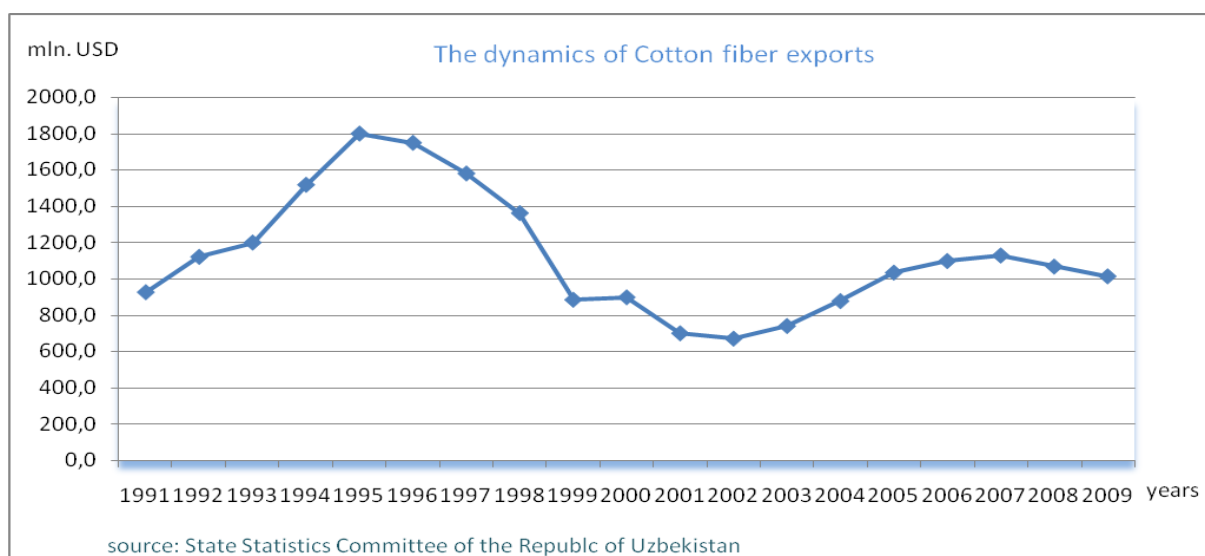
At present, cotton production still remains one of the main economic activities in Uzbekistan, despite the fact that Uzbekistan has progressed successfully in sustaining industrial, services sectors in the national economy. Among those successful achievements, we can count automobile industry, heavy-machinery, metallurgy, foodstuffs and others. But, as about 64% of total population lives in rural areas (Policy brief, No.5, 2006, p. 1), agriculture and cotton production will stay one of the major occupancies of the population as well as major sector of the national economy.

2.2. Foreign trade of cotton production and textile goods.

Approximately, Uzbekistan produces 1 million tons of cotton fiber each year, and the relationship between domestic consumption and export of cotton fiber is 30/70 (USDA). So, 70% of total cotton fiber production goes for export and it comprises 8.8% (see Figure 2) of total export of the Republic.

¹ “White gold” is a term referred to cotton

Figure 1



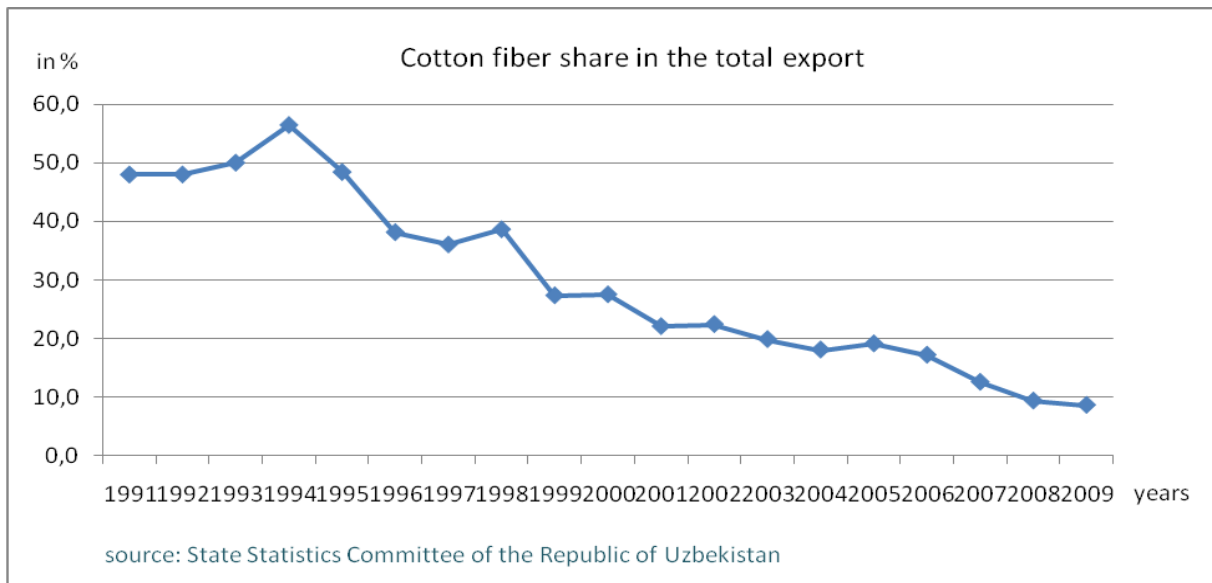
If we look at the dynamics of export of cotton fiber above in the graph, it is clear that the higher income from cotton fiber comes to the years of independence when the economy of Uzbekistan was facing deep reforms and structural changes.

Yet, it is due to note that the fluctuations in the income from exports of cotton fiber also depended on the world price for cotton. That's why it was really important and is still main concern not to depend on one commodity export as world trade in each commodity groups faces ups and downs in prices. Thus, living by hoping for the rise of the country specified good's price is always risky and not sustainable.

The share of cotton fiber in the total export of the republic changed dramatically, so what does it imply:

- national economy has been diversified, other industries progressed significantly;
- domestic consumption of cotton fiber increased, as a result higher value added production developed domestically;
- cotton growing declined in Uzbekistan; other cultures began to be grown.

Figure 2



Indeed, there is the contribution of each factors listed above, however, main reason for the dramatic decline of cotton fiber share in exports is that some other industries like - automobile and heavy industry, services sector, energy sector - took great development in the national economy of Uzbekistan.

Yet, it is important to consider that domestic consumption increase of cotton fiber was not that great, as in 1993 domestic consumption of cotton fiber was only 13% (Dogonkin, *Cotton outlook special feature*, 2005, p. 75), but coming to 2011, it is still around 30% which shows that there should have been much greater progress in this direction. Because, Uzbekistan possesses great potential of not only cotton production, but also further processing domestically which enable the country to become one of the main textile manufacturers in the world trade.

2.3. The potential of processing raw cotton into value added product.

Table 1

World Cotton fiber production and consumption											
<i>in thousands of metric tons</i>											
Production											
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
China	5313.6	5487.8	5182.9	6598.4	6184.7	7730.8	8057.5	7992.2	6968.6	6642.0	7295.3
India	2678.6	2308.4	3048.8	4137.6	4148.5	4747.4	5226.5	4921.6	5008.7	5531.4	5879.8
United states	4421.4	3747.6	3975.4	5063.4	5202.5	4701.2	4182.7	2790.7	2654.2	3942.5	3413.3
Pakistan	1804.4	1736.1	1708.4	2425.5	2145.0	2090.6	1872.8	1894.6	2090.6	1916.4	2177.7
Brazil	766.3	847.1	1309.9	1284.8	1023.5	1524.4	1602.8	1193.4	1186.8	1959.9	1959.9
Australia	727.4	365.9	370.2	653.3	609.8	294.0	139.4	326.7	386.5	914.6	1088.9
Uzbekistan	1067.1	1001.7	892.9	1132.4	1208.6	1165.1	1165.1	1001.7	849.3	892.9	914.6
Turkey	865.6	910.1	892.9	903.7	773.1	827.5	675.1	420.3	381.1	457.3	675.1
Consumption											
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
China	5531.4	6304.4	6740.0	8111.9	9473.0	10453.0	10561.8	9091.9	10888.5	10017.4	9799.7
India	2890.9	2896.3	2939.9	3223.0	3636.8	3941.6	4050.5	3865.4	4301.0	4507.8	4246.5
Pakistan	1856.5	2052.5	2096.0	2292.0	2509.8	2618.7	2618.7	2455.4	2357.4	2183.1	2248.5
Turkey	1339.3	1372.0	1306.6	1546.2	1502.6	1568.8	1326.2	1091.7	1245.6	1202.1	1136.8
Brazil	803.4	780.7	841.7	905.9	936.8	963.2	969.1	882.0	925.5	903.7	903.7
United states	1715.2	1620.0	1410.5	1480.6	1235.0	1140.7	1091.7	711.7	771.1	889.4	780.5
Bangladesh	261.5	338.0	392.4	480.2	545.5	699.0	764.4	829.7	851.5	807.9	742.6
Uzbekistan	250.4	239.5	239.5	190.5	174.2	196.0	217.8	217.8	239.5	272.2	272.2

Source: United States Department of Agriculture (accurately converted from lb.bales into metric tons)

What does this table imply? No doubt, developing countries are consuming the cotton fiber more and more every year because of the cheaper production inputs while in the developed countries like the US and EU, textile production is no more sustainable because the textile is labor intensive. Therefore importing textiles from developing countries makes these countries better off than producing domestically. As a result, earlier textile producers from developed countries are moving to developing countries to sustain their business or transferring to other businesses.

As textile and light industry is labor intensive, the shift of production is coming to those countries where labor force is relatively cheap and raw materials are easy-accessed. In this

regard, countries like China and India are doing well because these countries produce and consume the cotton fiber in large volumes. In addition, labor force is also relatively cheap in them.

However, countries like, Indonesia, Thailand, Vietnam and Bangladesh don't produce cotton at all or produce in small amounts. Despite that fact, these countries have succeeded significantly in the textile production. The countries mostly import cotton fiber and further process it domestically, later exporting with high value added.

In case of Uzbekistan, one of the world's biggest cotton fiber producers, further process of cotton produced domestically comprises only around three tenth currently, and according to the table above, in 2011 it accounted only 272.2 out of 914.6 thousand metric tons of cotton fiber. That shows the gap between production and consumption gives much more potential for further enhancing the textile industry and by this way value adding for the national economy.

Besides that, there are some other factors that give advantage for the production of textiles:

- According to the estimates (Policy brief, No.5, 2006, p. 5), cost of labor in Uzbekistan is relatively cheap comparing to other developing countries;

- availability of cotton fiber, close to production units, makes it less costly for textile producers avoiding high transportation costs like in Bangladesh and other South-east Asian countries;

- Labor force is good-skilled;

- Other production inputs, like electricity and natural gas, water resources cost less: natural gas costs 0.03\$ for each cubic meter in Uzbekistan; range from 0.21 to 0.23\$ in Turkey, France and the US, 0.28\$ in China (Policy brief, No.5, 2006, p. 5);

- Cost of electricity per kWh in Uzbekistan equals to 0.03\$, while it ranges between 0.03 and 0.09 in other competing countries with Uzbekistan (Policy brief, No.5, 2006, p. 6).

All these above-mentioned factors might enable the textile industry to boost up in Uzbekistan, and in its turn, textile industry can provide with high quality clothing the whole Central Asian region with a population more than 55 million and CIS with more than 250 million people, yet entering into the EU market can serve as an additional option.

Table 2

Major textile producers, their export					
year end of 2008					
	Production of cotton fiber in millions of metric tons	Consumption of cotton fiber in millions of metric tons	Textile exports in bln. US \$	World cotton fiber price per kg in US \$	Price* per kg processed cotton fiber in US \$
China	8.0	9.1	185.2	1.5	20.4
United states	2.8	0.7	16.2	1.5	23.1
India	4.9	3.9	22.4	1.5	5.7
Pakistan	1.9	2.5	10.9	1.5	4.4
Turkey	0.4	1.1	23.6	1.5	21.5
Bangladesh	0.0	0.8	12.1	1.5	15.1
World approximate average				1.5	15.1
Price* – refers to the value made from the exports of further processed cotton fiber into half-ready or ready-made products					
Source: United States Department of Agriculture (accurately converted from lb.bales into metric tons)					

The table above shows that each kg of processed cotton makes different value added in different countries, for example in China, value added is $20.4 - 1.5 * 1.2$ (approximate average transportation and other costs comprise 20%) = 18.6\$. However, China produces 75% of its cotton fiber consumption domestically which refers that transportation cost is much less than the world average. Moreover, not all cotton processed domestically goes for export.

Therefore, it can be referred for all textile producing countries that value added is even higher than that calculated above.

Despite that even if we take world average processed cotton fiber price from the *Table 2*, which is the arithmetic average of major textile producers – 15.1\$ and calculate how much value added can be achieved in Uzbekistan from the world average, we get – $15.1 \cdot 1.5 \cdot 1.2 = 13.3\$$. As currently in Uzbekistan, only around 30% of cotton fiber is processed which is 272 000 tons, so 272 000 tons multiplied by 13.3\$ gives 3.62 billion dollars of value which is around 10% of the GDP of Uzbekistan. But unfortunately, current textile manufacture gives a value less than a billion dollar which shows how inefficient the textile industry is working at the moment and the potential to increase as many as four times in value.

The inefficiency in textiles is related with inefficient and outdated machineries busy in all cycles of production, beginning from the first stages of raw cotton processing until the manufacture of finished goods.

Particularly, ginning outturn, i.e. a ratio of fiber to raw cotton is only 32% in Uzbekistan while in most other major cotton producers, that indicator is around 39% (Djanibekov et al., 2010, p. 11). The reason for lagging behind is the outdated ginneries, and further modernization could result in more yields of cotton fibers and more value for the economy as a whole.

Besides, in the near future emphasizing on processing cotton fiber as much as possible domestically could boost the economy, deferring the problems of unemployment, increasing exports, mitigating dependence on world cotton fiber prices and so on.

If it is managed to achieve to process 100% of all cotton fiber domestically, then it will give a value of 1 000 000 tons on average multiplied 13.3\$ which is 13.3 billion dollars each year composing around 30% of the GDP of Uzbekistan.

Yet, alongside with 30 % of GDP, such an achievement contributes highly for preventing from unemployment problem as well as state budget also benefits from additional tax income from textile producers. That means, overall income of the population will improve and that will further be an urge for the emergence of other businesses.

In the table above, per kg price of processed cotton is different in the chosen countries. And that can be explained by following factors:

- in the states like the US and Turkey, high price factor might be proven due to high-technology application in textile production, whereas labor and other production inputs cost more comparing to other textile producers;

- in China, alongside with high-technology usage, economies of scale and lower production inputs: labor, and others result textile success;

- though Bangladesh imports cotton for further textile manufacture, which incurs the country more costs for production inputs, the Bangladeshi textile business is still competent in the world market, turning 1,5\$ cost – 1 kilogram raw cotton plus transportation expenses into 15,1\$ finished good due to specialization, cheap labor, tailoring for World brands (H&M and others);

- significantly lower cotton processed price indicators in India and Pakistan can possibly be explained by inefficiency in technology introduction in the textile sector as we know these countries have quite cheap labor and they produce cotton themselves. Yet, electricity problem is quite severe in Pakistan, especially in northern regions.

Nevertheless, Uzbekistan has almost all the advantages, excluding high technology shortage, raw material availability, cheap labor and other production inputs, textile has not made dramatical successes in the past years. If we look back to the *Table 1* above, taking into

account fluctuations, domestic consumption of cotton has gone up only for 13.7% for the last ten years (years 2002-2011) while in developing countries like India, that indicator grew for 46.6%; in China – 55.4%.

3.1. The role of investments in processing cotton into finished goods: condition and challenges.

As we know Uzbekistan inherited outdated textile producing machinery from the USSR, yet like mentioned above, the country was mainly specialized in yielding raw cotton and further process of it into cotton fiber. And mostly, that cotton fiber went to other socialistic republics of the USSR for further processing and making ready clothing.

After acquiring the independence, one of the major tasks was to organize textile productions locally to process domestic cotton into ready-made garments rather than selling it as a raw material – cotton fiber. But, at that time Government was concerned about sovereignty and social related problems as well as gradual economic reforms to avoid shocking-therapy.

In this sense, the state managed to construct its own model of economic development which comprised the realization of the most necessary issues and reforms. The organization of modern and competitive textile industry was among those important concerns.

It is due to acknowledge that attracting foreign investments for organizing highly competitive textile industry has been priority as Uzbekistan has had all the ingredients for the successful textile sector except up-to-date machinery to produce high quality clothing which demanded huge capital introduction.

In this matter, from the years of independence, Uzbekistan has tried to create favored investment conditions through maintaining legal guarantees and incentives for foreign capital inflows, and executing measures to encourage the activity of enterprises with foreign investments.

The legislation on investment activities is among the most advanced ones amidst the countries of the ‘Commonwealth of Independent States’². The main regulations of the international investment rights are included in it, particularly, the regulation on the guarantees of foreign investor’s rights, provision of privileges to investors and others.

According to the legislation, there are no restrictions on the type of investment and foreign investors can establish enterprises in any form of ownership which is considered legal on the territory of Uzbekistan.

Also, the government guarantees and protects the rights of foreign investors, operating in Uzbekistan. If in future, the legislation worsens investment conditions, within ten-year period from the moment of investment, foreign investors are to follow the legislation effective on the date of investment. Besides, foreign investor has the right to apply the regulations of the new legislation provided that improves investment conditions.

In addition, it is worth to note that the legislation sets up the regime which provides equally favorable investment conditions for foreign investors and for legal and individual entities of Uzbekistan. This regime is the highlight of the non-discrimination principle in Uzbekistan.

Alongside with upper mentioned conditions, the legislation precisely foresees incentives and preferences for foreign investments. The tax benefits are provided as follows.

1. Taxable profit of legal entities decreases on the amount of:

- funds, allocated for the expansion of main production in the form of new construction, reconstruction of buildings used for the manufacturing needs, as well as for loan repayment,

² Commonwealth of 11 former USSR republics – Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan

received for these activities, deducting amortization accrued for this taxable period, yet not more than 30 percent of the taxable profit;

- funds, allocated for the modernization, technical and technological re-equipment, purchase of new technological equipment, loan repayment, granted for these activities, compensation of the leasing cost, deducting amortization accrued for this taxable period.

Also, for the enterprises-exporters, if the share of export of goods and services, excluding raw materials, is:

- from 15% to 30% in total sales – the fixed income tax rate is decreased by 30%;
- from 30% and over in total sales – the fixed income tax rate is decreased by 50%.

Alongside with them, upon exports of goods and services, excluding precious metals, no value added tax is imposed on those goods and services (Tax Code, 2007).

Besides that, newly established enterprises are also exempted from Property Tax within two-year period from the moment of state registration. This privilege does not cover the enterprises, launched at available production facilities and capital assets of liquidated enterprises, their structural sub-divisions as well as legal entities established under such enterprises if they work on the equipment, leased from those enterprises.

Several industries, including textile, are exempted from profit tax, property tax levied on legal entities, tax on utilities and development of social infrastructure, unified tax payment, obligatory deductions into the Republican Road Fund in conditions if the share of foreign investors in the authorized capital is not less than 50%, investment is carried in hard currency or new modern technological equipment, reinvested income.

The period of above stated tax exemptions depends on the volume of the investment as:

- from \$300, 000 up to \$3 million – for three-year period;
- from \$3 million up to \$10 million – for five-year period;
- over \$10 million – for seven-year period.

In addition, for local producers 15% discount is given upon their purchase of cotton fiber for further processing, yet those local producers have to buy cotton fiber in a hard currency (resolution of the President No. 456, 2006).

Currently, in textile industry, production capacities are mainly focused on spinning. Pay back period for spinning and weaving manufacture is 5-6 years whereas for sewing production it is about three years. Special Program of this sector development is worked out and targets up to 50% increase of cotton fiber processed into fabrics and ready-made garments. It is planned to attract over \$700 million of investment with this target (Invest in Uzbekistan, 2010).

We can see that Government is much more interested in the development of this sector than private businesses which might make a lot of money in it. However, with the program above, the processing ratio comes only around 45% which means another 55% of cotton fiber is going for exports as a raw material, leaving a gap of making great value in the textile sector.

Taking into account all the guarantees, preferences and incentives, why is this sector still not so attractive? And most the money attracted to the sector is mainly focused on spinning?

In seeking answers for the questions, we come up against the problems of conversion of national currency into hard currency for domestic producers in Uzbekistan alongside with other barriers.

A foreign investor comes with an incentive to make money out in a business. Therefore, when the investor comes and starts to operate a business, he wants to be free in dealing with his money made as an income from the business. He might be interested in taking back to his country of residence what he earned or invest his capital on other businesses and abroad. In this sense, problems of conversion make him rethink about the decision whether to invest or not.

The reasons why most investments are coming to spinning production can also be explained with the problem of conversion.

We know that in order to produce garments and other ready-made products in textile industry, the producer faces the lack of foreign currency so that it could import other production inputs such as chemical fiber added to make a ready shirt. And the most important is that local producer is purchasing cotton fiber in a hard currency which even more exasperates the problems related with foreign currency necessity.

Therefore, nowadays many textile investors are coming to organize spinning so that they could take back yarns, fabrics as exports into their factories abroad further making ready-made clothes or those products are highly demanded in foreign markets.

By organizing spinning production, they satisfy their necessity for hard currency for further purchase of cotton fiber and other components. At the same time, they are enjoying all the tax preferences, price discounts granted for legal entities.

3.2. Other factors that could constraint the high value added production in textile industry.

The openness of an economy, transparency and ease of doing business are one of the major factors that can enable further economic development of countries. The investment attractiveness of a particular country greatly depends on above mentioned factors as well.

In this sense, it is due to note the annual report prepared by IFC³ of the World Bank to investigate regulations which mitigate or by contrast compound business activities across the 183 countries of the World.

The last report by IFC is *Doing Business 2012* in which data is current of as June 1, 2011 (Preface, V). The report analyzes the ease of business in the countries on following

³ International Finance Corporation – a World Bank Group member

criteria as starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency. Every criterion takes into account procedures involved, time spent, costs incurred and other peculiar procedures.

According to the report, Uzbekistan has ranked as 166th among 183 economies (Executive summary, p. 6) which means doing business is quite complicated and makes the country worse-off in attracting foreign partners to have mutually beneficial businesses.

Following in careful analyzing each criterion for Uzbekistan (*Doing business 2012*, p. 135), we get:

- starting a business requires 6 procedures and minimum capital as 27.2% of income per capita, consumes 14 days time lag, costs 6.4% of income per capita, ranking 96th;

- dealing with construction permits demands 25 procedures, 243 days, and costs 57% of income per capita, ranking 145th;

- getting electricity takes 9 procedures, 117 days, and costs 17.8 times as many as income per capita, ranking 170th;

- registering property obliges to go through 12 procedures and 78 days time lag, and costs 0.9% of property value, ranking 136th;

- in getting a credit, strength of legal rights index is 2 (range 0-10), depth of credit information index is 3 (range 0-6), public registry coverage is 5% and private bureau coverage is 3.6% of adults, ranking 159th;

- in protecting investors, extent of disclosure index is 4 (range 0-10), extent of director liability index is 1 (range 0-10), ease of shareholder suits index is 7 (range 0-10) and strength of investor protection index is 4 (range 0-10), totally ranking 133rd;

- in paying taxes, number of payments per year is 41, time spent for paying taxes are 205 hours a year and total tax rate aggregates to 97.5% of profit, ranking 157th;

- in trading across borders, it demands 10 documents, takes 71 days and costs \$3,150 a container to export, in its turn, it requires 11 documents, takes 92 days and costs \$4.650 to import, ranking 183rd;

- enforcing contracts obliges 46 procedures, 195 days time lag, and costs 22.2% of claim, ranking 43rd;

- resolving insolvency takes 4 years, costs 10% of estate and recovery rate equals to 23.7 cents on the dollar, ranking 117th.

Since the year of 2011 was declared “Year of individual entrepreneurship and small business” by Uzbekistan’s President on December 8, 2010 at the meeting dedicated to the 18th anniversary of the Constitution of the Republic of Uzbekistan and special State Program was approved by the President (The resolution of the President No. RP-1474, 2011), many more measures has been accomplished with the aim to further liberalize the economy, to enhance business activities, to provide maximum favorable conditions, to perfect legal base for the development of individual entrepreneurship and small business in Uzbekistan.

In particular, the State Program envisages following measures to ease business environment:

- the adoption of the laws on “Protection of private property and guarantees of rights proprietors”; “guarantees of freedom of entrepreneurship activities” (new edition) that provides simplification of starting a business; “permission procedures on entrepreneurship activities” that foresees reduction of number of permission procedures at least by 30%;

- the adoption of other norms and standards, such as cut-back of tax investigations of legal entities; introduction of online naming of legal entities, “one window”⁴ state registration and reduction of state registration costs by twice which simplify starting business procedures and expenditures; simplification of connection of legal bodies into electricity networks,

⁴ Registration documents are submitted into one government agency – a local administration

particularly the number of documents required cut back from 79 into 13 and documents considering time cut up to 3 days.

Table 3

Ease of doing business				
Criteria:	Bangladesh	China	India	Uzbekistan
Overall ranking	122	91	132	166
Starting a business:	86	151	166	96
procedures (number)	7	14	12	6
time (days)	19	38	29	14
cost (% of income per capita)	30.6	3.5	46.8	6.4
minimum capital (% of income per capita)	0.0	100.4	149.6	27.2
Dealing with construction permits:	82	179	181	145
procedures (number)	11	33	34	25
time (days)	201	311	227	243
cost (% of income per capita)	154.5	444.1	1631.4	57.0
Getting electricity:	182	115	98	170
procedures (number)	7	5	7	9
time (days)	372	145	67	117
cost (% of income per capita)	3526.1	640.9	216.2	1783.3
Registering property:	173	40	97	136
procedures (number)	8	4	5	12
time (days)	245	29	44	78
cost (% of property value)	6.6	3.6	7.3	0.9
Getting credit:	78	67	40	159
strength of legal rights index (0-10)	7	6	8	2
depth of credit information index (0-6)	2	4	4	3
public registry coverage (% of adults)	0.6	82.5	0.0	5.0
private bureau coverage (% of adults)	0.0	0.0	15.1	3.6
Protecting investors:	24	97	46	133
extent of disclosure index (0-10)	6	10	7	4
extent of director liability index (0-10)	7	1	4	1
ease of shareholder suits index (0-10)	7	4	7	7
strength of investor protection index (0-10)	6.7	5.0	6.0	5.0
Paying taxes:	100	122	147	157
payments (number per year)	21	7	33	41
time (hours per year)	302	398	254	205
total tax rate (% of profit)	35	63.5	61.8	97.5
Trading across borders:	115	60	109	183
documents to export (number)	6	8	8	10
time to export (days)	25	21	16	71
cost to export (\$ per container)	965	500	1095	3150
documents to import (number)	8	5	9	11
time to import (days)	31	24	20	92
cost to import (\$ per container)	1370	545	1070	4650
Enforcing contracts:	180	16	182	43
procedures (number)	41	34	46	42
time (days)	1442	406	1420	195
cost (% of claim)	63.3	11.1	39.6	22.2
Resolving insolvency:	107	75	128	117
time (years)	4.0	1.7	7.0	4.0
cost (% of estate)	8	22	9	10
recovery rate (cents on the dollar)	25.8	36.1	20.1	23.7

source: World Bank, *Doing Business 2012*, Country tables, pp. 81, 88, 101, 135

Besides that, in order to enhance crediting legal entities for investment and production purposes, the increase was foreseen by at least 30% in the volume of the annual credits of banks operating in Uzbekistan in the State Program. As a result, more than 1,500 new business entities have been created which were financed by their own resources, bank credits and foreign investments. Among those 1500 legal entities, the new enterprises on textile industry compose more than 320.

In spite of that overall ratio of cotton processing has not changed much comparing to 2010.

The implementation of the measures above was intended for the year of 2011 and due to that the latest changes for the sake of business entities might not be reflected in the report of IFC – *Doing business 2012* as its data is current as of June 1, 2011.

At the same time, it is clear that the measures will serve for the sake of enhancing business activities in the economy in the coming years as well as making better off existing legal entities.

With the analyses of IFC report, we have a choice to compare the indicators with major textile producers, like China, India and Bangladesh.

From the table above it is clear that Uzbekistan has advantages on particular criteria, such as starting a business and dealing with construction permits are much easier in Uzbekistan than in China and India while protecting investors and trading across borders are much enhanced in China and India rather than in Uzbekistan. It is clear that the latter indicators make foreign investors much attractive.

The reason, why the costs of import and export per container are much higher than other countries, can be explained by the fact that Uzbekistan is “double land-locked”⁵ country and major transporting means are rail, road and air. However double land-lockedness can not reflect to further processing of cotton into finished goods as currently it is practiced to export yarns and fabrics which prove no bother for the export of ready-made garments.

Despite the fact that textile producers, like Bangladesh, China, India do not have much differing business terms, i.e. Uzbekistan has advantages in some criteria while those countries have in others, the success of textile business has been different in them. Successes of abovementioned countries can be explained by the capacities of economies, markets and important components for foreign investors – protecting investors and trading across borders criteria.

Therefore, further improving business conditions and opportunities, simplifying procedures can serve well for the textile’s success.

⁵ A landlocked country surrounded by other land-locked countries that it takes at least two countries to cross to get to the sea.

Conclusion

When a country is rich in some resources or raw materials, as a rule, it is accepted that the country manages successfully with the endowed opportunities. However, in practice we frequently come across with opposite examples.

We are aware that using comparative advantages conformably lead to performing well and being better off. And almost every country has its own comparative advantage and niche in the world market.

In case of Uzbekistan, I have considered the factors that can enable to organize highly competitive textile industry. Consequently, my consideration led me further to make an idea that production inputs advantage can not itself lead to achieve success in the production as it is generally assumed.

In an economy, many factors besides production inputs interact and meet to define the progress in a certain good's production.

To the extent of Uzbekistan, raw cotton production has been a major occupation of the people. This tendency won't change significantly since most people are rural. Climatic and geographic conditions also allow for growing high quality sorts of cotton that are demanded well in the textile. Taking them into account, it is clear to infer that Uzbekistan must follow the way to further enhance textile industry.

With the availability and cheapness of most textile production inputs, we could easily guess the textile flourishes in Uzbekistan. However in practice, though it has passed more than twenty years since reforming in the sector, desired advance has not been reached referring to the fact that further measures should be undertaken.

First, the efficiency in the sector must be enhanced by abolishing outdated machineries and further modernizing the sector.

Obviously, these efforts require huge capital investing. Internal investing can not be enough to realize technology modernization process. Therefore, attracting foreign investors stays on the focus.

In this matter, further liberalizing currency conversion improves and increases foreign investment inflow to the country.

Besides that, free conversion can enable existing domestic producers to modernize their technologies, production line and also encourage them to further process cotton into ready-made garments by importing production needed ingredients.

Government ought to reconsider the system of purchasing cotton fiber. Enabling domestic producers to buy cotton fiber in the national currency will further improve the conditions for domestic cotton processing.

Moreover, existing yarn and fabric exporters will have incentive to later convert yarns and fabrics into finished goods as their necessity for hard currency to purchase cotton fiber decreases to zero.

Excessive tax and other preferences should be cancelled out, particularly, 15% discount on purchasing cotton fiber as we have considered earlier. Since even without this benefit, the producers are better off comparing to other textile producers. The reason is that domestic producers do not have to incur transportation costs and cotton quality is very high. In comparison, most textile producing countries incur transportation costs for cotton fiber. For instance, China imports 2.5 million metric tons of cotton fiber which is 25.6% of its domestic consumption (see *Table 1*).

The taxation in the textile industry should be perfected in order to leave more incentive for textile manufacturers to further process cotton. The principle is that the more cotton processed, the more preferences granted.

The purchase of cotton in the national currency and taxation perfection will decrease the stimulus of most textile producers to export minor processed yarns and fabrics.

Next measures that are as important as previously proposed ones are to enhance business activities in Uzbekistan.

Easing doing business activities will serve as the major source of even more attracting foreign investments.

The legal base for protecting foreign investors fully corresponds to world standards. However, improving institutional protection of foreign investors' rights, their properties will take the economy into the better stage of development.

Further simplifying permission procedures, in particular, easing trading across borders procedures, cutting down documents and accelerating time lag to import and export will enhance the textile industry and total business activities in Uzbekistan.

Furthermore, the government had better pay more attention to bring doing business activities to the most efficient level applying for the experiences of advanced countries like Singapore, New Zealand, Denmark, Norway and others.

It is obvious that clothes' designing plays a significant role in establishing competitive textile industry.

To this matter and in order to promote national textile industry, the attraction of World brands such as H&M, Zara, Gap and tailoring for them set a good basement for further developing the manufacture of finished products as well as designing.

Also, Government could allocate preferences for textile manufacturers as long as the enterprises practice to educate skilled designers in famous and advanced designing schools worldwide.

While raw cotton remains as a major agriculture output, establishing powerful and competitive textile industry is prominent and important. Therefore, taking necessary measures to annul impediments and give essential incentives for further progress of textiles is a precise choice to go for.

References

Djanibekov, N., Rudenko, I., J. Lamers and Bobojonov, I., 2010. Pros and Cons of Cotton Production in Uzbekistan. Case Study #7-9 of the program: *Food policy for developing countries: the role of government in the global food system*, 2010.

Dogonkin, A., 2005. Textile Industry of Uzbekistan: Today and Tomorrow. *Cotton Outlook Special Feature*, pp.74-78, 2005.

Law of the Republic of Uzbekistan *On foreign investments*, 1998.

Law of the Republic of Uzbekistan *On investment activities*, 1998.

Law of the Republic of Uzbekistan *On guarantees and means of protection of foreign investor's rights*, 1998.

Ministry for Foreign Economic Relations, Investments and Trade of the Republic of Uzbekistan. *Invest in Uzbekistan*, 2010.

Resolution of the President of the Republic of Uzbekistan, no. RP-456, 2006

Resolution of the President of the Republic of Uzbekistan, no. RP-1474, 2011

Rudenko, I., J. Lamers, and U. Grote, 2009. Can Uzbek farmers get more for their cotton? *European Journal of Development Research* 21 (2): pp. 283–96.

Rudenko, I. 2008. Value chains for rural and regional development: The case of cotton, wheat, fruit, and vegetable value chains in the lower reaches of the Amu Darya River, Uzbekistan. Ph.D. diss., Hanover University, Germany.

UNDP. *Textile Industry in Uzbekistan: Problems and Prospects*. Policy Brief No.5, 2006.

United States Department of Agriculture, USDA, 2011, retrieved from <http://www.indexmundi.com/agriculture/?commodity=cotton&graph=production>.

WorldBank. *Doing business 2012*, annual report of IFC, 2011, retrieved from <http://www.doingbusiness.org/~media/FPDKM/Doing%20Business/Documents/Annual-Reports/English/DB12-FullReport.pdf>.