



Navigating Uzbekistan's economic transformation

Is now the time to invest?



Uzbekistan's government is embarking on an ambitious package of structural reforms to open up the country's economy and entice international business. The reforms, which were launched by President Shavkat Mirziyoyev in December 2016, have thus far delivered a suite of policy changes aimed at liberalising the country's currency and capital markets, overhauling the taxation system and improving the transparency of government and its regulatory agencies. But while Uzbekistan is opening up to the global marketplace, foreign investors should be prepared to navigate existing challenges linked to corruption and the dominance of state-owned companies over Uzbekistan's rapidly growing economy.

Uzbekistan's untapped potential

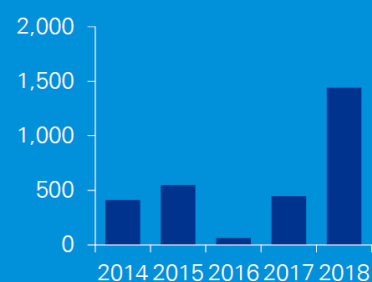
Uzbekistan has vast oil and gas reserves. Earlier this year President Mirziyoyev urged Uzbek officials to take advantage of these largely untapped resources by increasing oil and gas production, which has been steadily dwindling due to ageing infrastructure and a lack of outside investment. The World Energy Council, for instance, cited that Uzbekistan's crude oil output fell by 42% in the space of 10 years from 1990. Mirziyoyev himself said in 2017 that up to 23% of all natural gas extracted in Uzbekistan was lost due to poor supporting infrastructure.

Recognising the need to fast-track upgrades to his country's oil and gas sector, Mirziyoyev embarked on an international charm offensive early in 2018 signing multi-million-dollar deals with energy giants ExxonMobil, Total and US conglomerate Honeywell, among many others. Under the deal with ExxonMobil, which Mirziyoyev carved out on a trip to the United States in May, the Fergana Oil Refinery in Uzbekistan's east will receive a GBP 116 million boost from ExxonMobil and Uzbek state-owned oil and gas company Uzbekneftegaz. The investments will be used to upgrade the refinery's manufacturing facilities that produce motor oil and petroleum-based lubricants. More than 20 other major contracts worth GBP 3.7 billion were signed by the Uzbek delegation on Mirziyoyev's trade mission to the US, opening new paths for investment from energy, consulting, education and aerospace companies.

UK businesses and trade agencies are also making moves towards Uzbekistan following the recent reforms. In May this year, for example, UK Export Finance (UKEF) signed a memorandum of understanding with Uzbekneftegaz to provide GBP 1.25 billion in finance to energy projects in Uzbekistan. The UKEF's commitment to the country's energy sector was affirmed by a visit by the agency's CEO Louis Taylor in September where he pledged that the UK was ready to support Uzbekistan's economic reforms and foreign investment "by any means".

According to statistics published by the Uzbek Ministry of Foreign Economic Relations, Investments and Trade, UK-Uzbek trade for 2016—just after the new reforms were introduced—also increased by 43% in a single year, to GBP 116.7 million.

The World Bank's commitment to Uzbekistan per year (in millions of dollars)



The World Bank and its agencies are backing Uzbekistan's economic reforms, providing USD 1.44 billion in loans in 2018 alone.⁽¹⁾

Source: Global and Russian Energy Outlook to 2040, ERI RAS;
<http://www.worldbank.org/en/country/uzbekistan/overview#2>

Challenges remain for investors

While Mirziyoyev's reforms are having a positive impact on Uzbekistan's economy, numerous post-Soviet governance and civil society issues persist, which if unchecked, will impact future investor confidence.

A 2018 report by the US Bureau of Economic and Business Affairs into Uzbekistan's investment climate notes, for example, that foreign investors looking to enter Uzbekistan's oil and gas sector must gain the approval of Uzbekneftegaz even though it has no legislative mandate for its control over the sector. Foreign businesses lacking legal advice about operating in Uzbekistan, a local partner or contacts close to government, could face several artificial bureaucratic hurdles too, like increased tax red tape if they compete with a state-owned business in the same market.⁽¹⁾

Corruption in public bodies remains a challenge for investors looking to enter Uzbekistan, even though Mirziyoyev has introduced several new reforms to tackle the problem. The most recent 2017 Transparency International Corruption Perceptions Index ranks Uzbekistan 157th out of 180 countries it assessed, citing the misuse of public coffers by government officials as a key reason for its poor rating.⁽²⁾

In acknowledgement of some of these challenges, Uzbekistan's justice minister, Ruslanbek Davletov, has recently sought to assure investors that meaningful changes are underway to tackle corruption and other governance challenges. He said that the government understood that it must meet its economic reforms with meaningful changes so that Uzbeks can see the positive impact of the changes for themselves.⁽³⁾ Sources working with foreign firms operating in Uzbekistan echoed Davletov's comments – that while there is progress to be made, there appears to be a genuine will among Uzbek policy makers to address corruption and the perceived dominance of the country's state-owned businesses.

Competition from established players

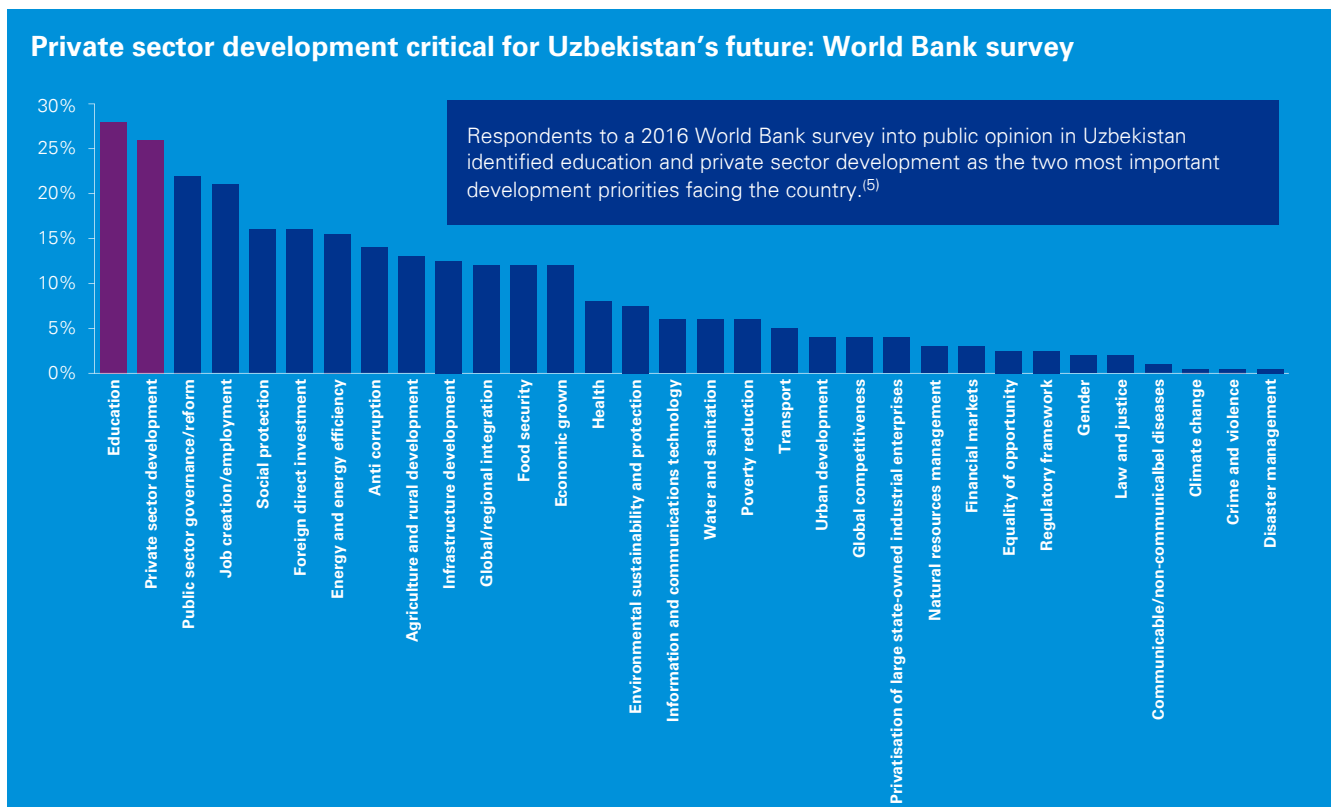
Russian and Chinese companies have been the historical partners of Uzbek state-owned businesses operating in the oil and gas sector, meaning that new players in the country's reformed economy face stiff competition from established competitors.

Prior to Mirziyoyev's visit to France in October 2018, there was speculation in the Uzbek press that there were plans to award a sizeable contract to a French company to construct Uzbekistan's new nuclear power plant. Despite the speculation and Mirziyoyev's personal meeting with French president Emmanuel Macron, the majority of the construction works for the power plant were awarded to Russian state-owned energy company RosAtom.

Uzbekistan's historical favouritism of Russian companies extends to other areas of the country's energy sector too, with Russian oil and gas companies making up the majority of joint venture partners with Uzbekneftegaz. According to Wood Mackenzie, Russia's LUKOIL alone is expected to be responsible for as much as 30% of Uzbekistan's total gas production over the next decade.⁽⁴⁾

Russia has a clear strategic interest in managing the reforms in Uzbekistan while ensuring that Russian companies remain heavily involved in the country's oil and gas sector. Yet there are numerous opportunities and several live examples where foreign firms are reaping the rewards from the modernisation of both the Uzbek economy and its oil and gas industry specifically.

Uzbekistan's path to reform may be long, but recent large-scale investments from abroad highlight a palpable sense of optimism among those international companies that are equipped with the right insight and expertise to navigate Uzbekistan's economic transformation.



Source: Global and Russian Energy Outlook to 2040, ERI RAS

Note: (1) <https://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm#wrapper>

(2) <https://www.transparency.org/country/UZB>; <https://www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm#wrapper>

(3) <https://thediplomat.com/2018/05/uzbekistan-reforms-on-the-right-path/>

(4) <https://www.azernews.az/region/135995.html>

(5) 156 stakeholders in Uzbekistan participated in the World Bank's FY16 Uzbekistan Country Opinion Survey. Survey participants include individuals from the Office of the President and Prime Minister of Uzbekistan; parliamentarians and ministers; civil servants; employees of private sector organisations; the media; trade unions; academia; the judiciary; and other organisations. The full report is available here: <http://microdata.worldbank.org/index.php/catalog/2720/download/38982>

How the Corporate Intelligence team can help ...

KPMG has a specialised Corporate Intelligence team that can use its knowledge and its network of sources in Uzbekistan and Central Asia to give you commercially valuable insight ahead of a proposed entry into the country or a business transaction.



We can help you:

- Identify and assess investment opportunities in Uzbekistan.
- Map out the interests and agendas of stakeholders in Uzbekistan relevant to market entry on a deal.
- Understand, and plan for, any changes in government or policy-making.
- Analyse the competitive landscape in a broad range of sectors in Uzbekistan, to identify potential partners.
- Assess the reputation and track record of a potential partner.
- Identify and mitigate risks in your trade relationship with buyers.

KPMG's presence in Uzbekistan ...

Earlier this year KPMG reopened its office in Tashkent to provide clients in Europe, Russia and the CIS with a full suite of advisory services. In addition to its corporate intelligence and market entry offerings, KPMG also provides fraud and risk management, compliance, forensic technology and market research services in Uzbekistan.

Contact us



Alexandra Maddy
Head of Corporate Intelligence, KPMG UK

T: +44 (0)20 7694 1301

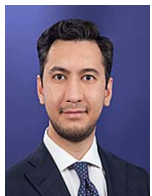
E: alexandra.maddy@kpmg.co.uk



Matthew Walker
Russia & CIS Desk, Corporate Intelligence, KPMG UK

T: +44 (0)20 7311 5299

E: matthew.walker@kpmg.co.uk



Farrukh Abdullakhanov
Director, Risk Consulting, KPMG Russia and CIS

T: +7 964 597 1442

E: fabdullakhanov@kpmg.ru



Ksenia Surkova
Director, Risk Consulting, KPMG Russia and CIS

T: +7 929 939 2045

E: ksurkova@kpmg.ru

kpmg.com/uk



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2018 KPMG LLP, a UK limited liability partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.

Designed by CREATE. | CRT105507A | October 2018