

The Impact Of Foreign Direct Investment On Economic Growth In Uzbekistan

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Abstract: *The article in Uzbekistan is devoted to the role of foreign direct investment (FDI) in stimulating economic growth. Our article on the growth of direct investment and their impact on income levels and the quality of the institutional environment. In particular, we consider the long-term and interrelated effects of growth on a country's income level and direct investment of Uzbekistan on growth in many developing countries.*

Keywords: Foreign direct investment, growth, investment, economic growth, strategy, indicator.

Introduction

It should be noted that President of Uzbekistan Shavkat Mirziyoyev by his decree has approved the action strategy on priority areas of the country's development for 2017-2021. The action strategy will be implemented in five stages, and each stage provides for approval of a separate annual state program on the strategy's implementation in Uzbekistan, according to the decree. There is five key legal and institutional reforms: state governance, rule of law and legal reforms, liberalization of the economy, social sphere, security, religious tolerance and interethnic harmony, foreign policy. To approve the developed on the basis of a comprehensive study of topical and exciting people and business issues, the analysis of the current legislation, law enforcement practices and the best international practices, as well as a broad public discussion Strategy actions in five priority areas of the Republic of Uzbekistan in 2017-2021 years in accordance with Annex development and economic liberalization aimed at further strengthening the macroeconomic stability and the maintenance of high economic growth, increasing its competitiveness, modernization and intensive development of agriculture, continuation of institutional and structural reforms to reduce the state presence in the economy, further strengthening the protection of rights and priority role of private property, stimulating the development of small business and private entrepreneurship, comprehensive and balanced socio-economic development of regions, regions and municipalities, active attraction of foreign investments¹ in the sectors of the economy and regions of the country by improving the investment climate development. According to the report of the United Nations Conference on Trade and Development (UNCTAD), the world foreign direct investment volume has been declining for the third year in a row, reaching the lowest level that was observed immediately after the global financial crisis. Including, in 2019, due to all sources of financing, the volume of investment in Uzbekistan development amounted to 220.7² trillion soums, exceeding the approved annual forecast indicators by 2 times, including the volume of investments in fixed assets amounted to 189.9 trillion soums, with a growth rate to the same indicator in 2018 – 1.3 times. 1.3 compared to the same figure.

Literature review

The economic growth depends on sustained growth of productive capacity, consisting in investment and saving. The low levels in investment and saving imply low economic growth. Being a source of economic growth, the need of FDI inflows has increased in the last years. Over the last decades, investment was the object of scientific research and a vector of social development for prominent political figures. One of the leading economists **A.Sh. Bekmurodov**³ is a foreigner He spoke about the characteristics of investments, their role in the economy and the investment climate: "Most countries in the world have a certain level of ability to attract foreign direct investment. Creating a favorable and competitive investment environment for it by carrying out a competitive struggle. "Foreign direct investment is not only an important source of additional capital for each country in the face of limited domestic financial resources, but also a reliable source of innovation, new techniques and technologies, knowledge, training and competencies needed to ensure the competitiveness of the country's economy." **Economists A.Vahobov, Muminov N.G. Sh.Khajibakiev**⁴, say the following about the investment climate: "Investment climate is a set of economic, political, legal

¹ Decree of the President of the Republic of Uzbekistan PF-4947 of February 7, 2017

² <https://invest.gov.uz/mediacenter/news/results-of-investment-activity-of-the-republic-of-uzbekistan-for-2019/>

³ Bekmurodov A. Sh. (2018) "In search of an innovative model of economic growth of Uzbekistan ...". Tashkent: "XXI ASR". 215b.

⁴ Vahobov A.V, Khajibakiev Sh.H., Muminov N.G. (2010) Foreign investments. Tashkent: "Finance". 346-b.

and social factors that predetermine the level of risk of foreign capital investments and their effective use in the country. In 2014, a report “Catalyzing a global market in impact investment”, initiated by the Prime Minister of the United Kingdom *David Cameron*, was published. Among empirical studies on FDI, *Wallis* (1968) had looked at increase in inflows of FDI from the US to the EU and assessed the importance of FDI in enhancing economic growth⁵. Studies have found a positive relationship between openness and FDI flows (*Chakrabarti*, 2001). Following *Chakrabarti*⁶ (2001), the trade volume is determined by the sum of exports and imports divided by nominal GDP as a proxy for trade openness and must be positively correlated with direct investment. The greater the degree of trade openness, the more it is directed towards external market that would be more open to foreign capital. The effect of exchange rates on FDI has been examined with respect to changes in the bilateral level of the exchange rate between countries and also in the volatility of exchange rates (*Blonigen*, 2005). Throughout the years, a lot of empirical research works have investigated the relationship between FDI and economic growth. Although there is many empirical researches have been conducted, the influence of FDI on economic growth is still inconclusive; some studies described the impact positively while others described it as negative.

Data and econometric model

This study intends to estimate the determinants of FDI flows to Uzbekistan using time series data. The dependent variable is the FDI net inflows to Uzbekistan. The study uses seven explanatory variables. In order to characterize the determinant of FDI flows to Uzbekistan, we set up the following empirical mode:

$$\ln FDI_t = \alpha_t + \beta_1 \ln TO_t + \beta_2 \ln INFL_t + \beta_3 \ln ER_t + \beta_4 \ln PCGDP_t + \beta_5 \ln NR_t + \beta_6 \ln INFR_t + \beta_7 \ln LIB_t + \varepsilon_t$$

where \ln is the natural log, FDI_t is the dependent variable, the subscript t is the time period, TO is the trade openness, $INFL$ is the rate of inflation, ER is the exchange rate, $PCGDP$ is the per capita gross domestic product, NR is the natural resources, $INFR$ is infrastructure, and Trade openness (TO) by a host country is considered as a major determinant of FDI, and has different effects on FDI.

Analysis and results

Uzbekistan ranked 69th in the World Bank 2020 Doing Business, gaining seven places from the previous year. Restructuring of large state enterprises and joining the WTO would bolster Uzbekistan's plea for FDI, but the country has been slow to advance on said fronts, and corruption is endemic and penetrates all levels of the business, government and social environment; the country ranks 153rd out of 180 countries in Transparency International's Corruption Perceptions Index 2019. A decree of President Shavkat Mirziyoyev in May 2019 foresees the State Anti-Corruption⁷ Program for 2019-2020. At the end of 2018, this indicator decreased by 19% (in 2017, 16%). In the reporting period, about 2.8 thousand social, infrastructural and industrial facilities were commissioned: 145 large industrial facilities, 167 large regional projects, 2.5 thousand social and infrastructural facilities.

A significant increase in investment performance is due to an increase in the inflow and development of foreign investment and loans in the amount of 13.3 billion dollars, of which:

- Foreign direct investment – 9.3 billion dollars (including in fixed assets – 6.6 billion dollars).
- funds of international financial institutions – 4.0 billion dollars (including in fixed assets – 3.2 billion dollars). To actively attract foreign capital, there are currently tax and customs incentives, 21 free economic zones (7 pharmaceutical, 12 industrial, 1 agricultural and 1 tourism), a business ombudsman institution has been introduced, the Tashkent International Arbitration Center has been established, and a draft unified law on investments has been developed and investment activity”, which aims to combine the norms of 3 laws and about 100 by-laws regarding investments. At the same time, the share of utilized foreign direct investment in the total investment volume increased to 37% (for comparison, in 2018 this indicator amounted to 10.5%). According to the report of the United Nations Conference on Trade and Development (UNCTAD), the world foreign direct investment volume has been declining for the third year in a row, reaching the lowest level that was observed immediately after the global financial crisis. At the end of 2018, this indicator decreased by 19% (in 2017, 16%). At the same time, according to the UNCTAD report, positive

⁵ Wallis, K., F, The E. E. C. and United States Foreign Investment: Some Empirical Evidence Re-Examined Economic Journal, 78(311), (1968), 717-719

⁶ Chakrabarti, A. (2001) The Determinants of foreign direct Investment: Sensitivity analyses of cross-country regressions, *Kyklos*, 54(1), 89-113.

⁷ <https://www.gazeta.uz/oz/2019/05/29/corruption/>

trends were observed in developing countries, especially in Asia, where the volume of foreign investment grew by 5%. Moreover, while in Central Asian countries the growth in foreign investment amounted to an average of 8-10%, then in Uzbekistan this indicator compared to the indicators of 2018 (\$ 2.9 billion, of which \$ 1.6 billion in fixed assets .) grew 3.2 times (\$ 9.3 billion, of which \$ 6.6 billion in fixed assets), which provided the Republic with leadership in terms of growth rate among the countries of the region. The main foreign partners in attracting foreign investment to the Republic of China were China, Russia and Germany, while the total number of investing countries in the economy of Uzbekistan exceeded 50, due to which the share of the largest investing countries fell to 34% of the total volume of direct foreign investments and loans. Active growth in attracting foreign direct investment compared with the forecast indicators of 2018 was observed in the electrical industry (growth – 7.5 times), metallurgy (growth – 4.6 times), textile industry (growth – 2.5 times), leather footwear (growth – 2.1 times), oil and gas (growth – 2 times) industries. At the same time, the growth trend of foreign direct investment flows into regional projects has strengthened, the total value of which in 2019 amounted to \$ 4.8 billion (of which \$ 4.2 billion was in fixed assets), an increase of 4 times compared to the same the period of 2018 and 24 times compared with 2017. In the regions, with the participation of foreign capital alone, 167 projects with a total value of \$ 858.5 million were put into commercial operation. In 2020 and subsequent years, work will continue to actively attract foreign direct investment, diversify their areas for implementing projects in priority areas such as electricity, the chemical industry, the production of electrical products, IT technologies, light industry, agriculture and the production of building materials. The emphasis will remain on increasing the number of plants for the deep processing of raw materials with the creation of chains of high added value.

FDI SUSTAINABLE GROWTH⁸

FDI Inward Flow (million USD)	2017	2018	2019
FDI Inward Flow (million USD)	1,797	625	2,286
FDI Stock (million USD)	10,044	8,992	9,504
Number of Greenfield Investments	10	55	45
Value of Greenfield Investments (million USD)	1,384	5,177	4,843

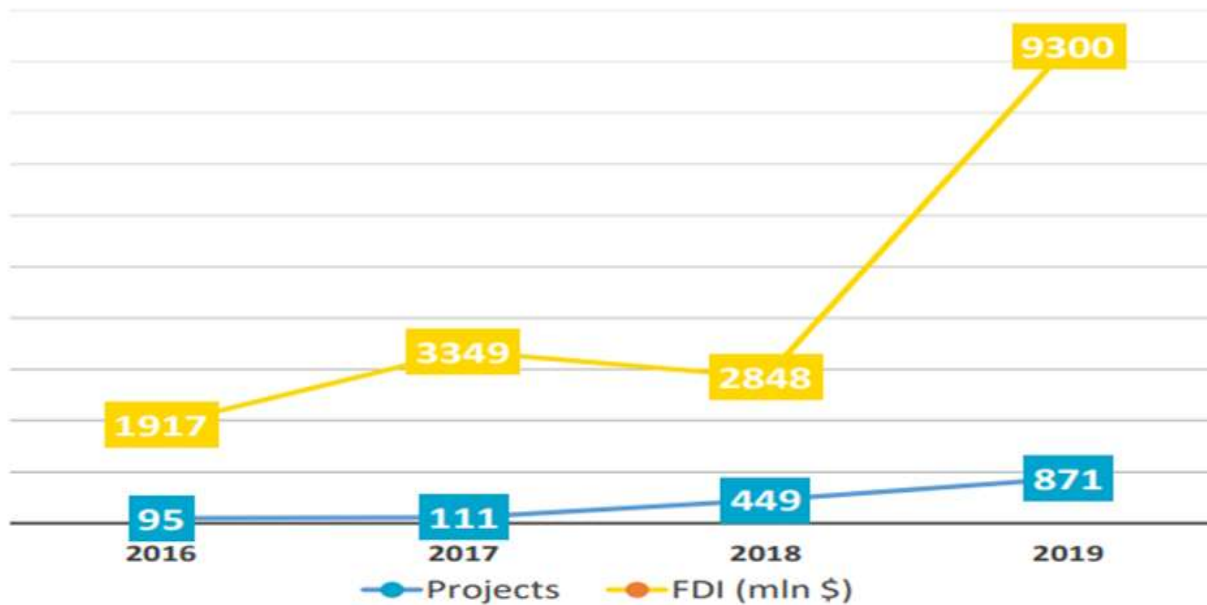
Source: UNCTAD - Latest available data.

According to the UNCTAD's 2020 World Investment Report, FDI inflows increased significantly in 2019 to USD 2,3 billion, compared to USD 625 million in 2018. Total FDI stock stood at USD 9.5 billion in 2019. FDI traditionally arrives from Russia, South Korea, China and Germany, but Canada recently increased its financial presence. Investments focus on the energy sector, including alternative/renewable energy in recent years.

HISTORICAL DATA OF FDI AND CREDITS INFLOW⁹ {NUMBER OF INVESTMENT PROJECTS}

⁸ <https://santandertrade.com/en/portal/establish-overseas/uzbekistan/investing>

⁹ <http://invest.gov.uz/wp-content/uploads/Presentations/presen.pdf>

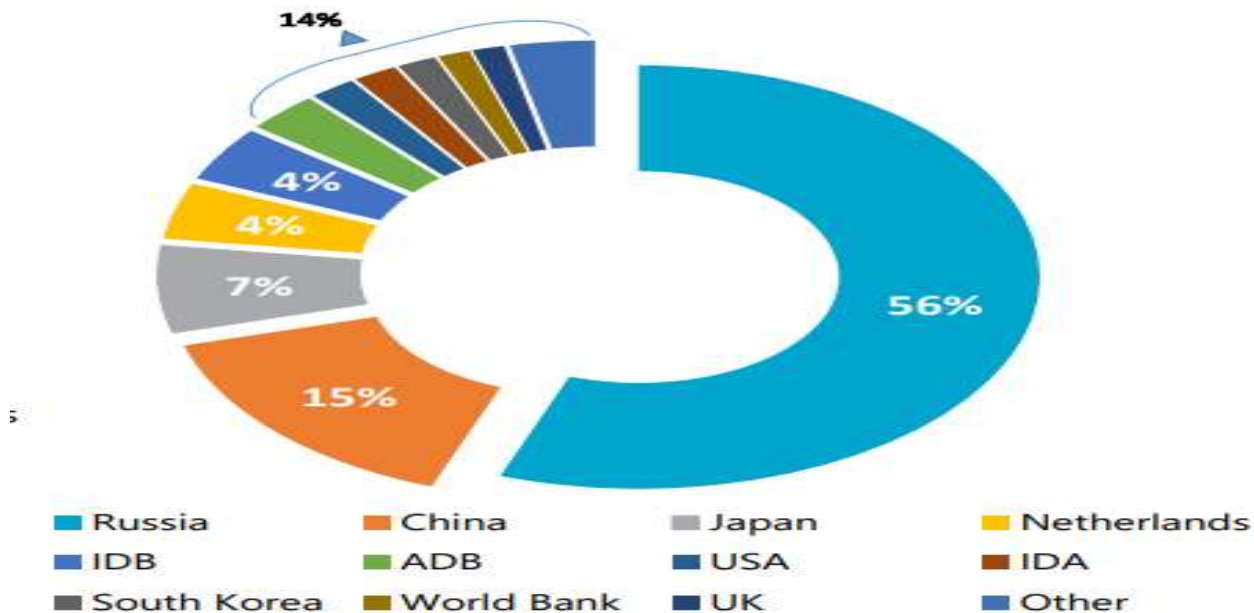


According to the Investment Program, approved by the Decree of the President of the Republic of Uzbekistan dated January 9, 2020 No. PP-4563 in 2020, from all sources of financing, the development of investments in fixed assets is projected in the amount of 233.2 trillion. soums, of which direct foreign – 7.1 billion dollars, foreign investment and loans under the state guarantee – 2.7 billion dollars. In particular, in 2020, it is planned to commission more than 2 thousand social, infrastructural and industrial facilities: 206 large new production facilities, 240 regional production facilities, 1.6 thousand social and infrastructural facilities.

MAIN INVESTING¹⁰ COUNTRIES (2018 Y)

¹⁰ <http://invest.gov.uz/wp-content/uploads/Presentations/presen.pdf>

Main investing countries {2018}



The Republic of Uzbekistan conducts an open, mutually beneficial and constructive foreign policy based on the national interests of the country. Current foreign policy of Uzbekistan is formed taking into account the dynamic changes in the world and the region as well as large-scale reforms within the country. Main turnover partners are China, Korea, Turkey, Germany and CIS countries.

In addition, law of the republic of Uzbekistan on investments and investment activity¹¹, Basic principles of investments and investment activity, The main principles of investments and investment activity are:

- legality;
- publicity and openness;
- freedom to implementation of investment activity;
- justice and equality of subjects of investment activity;
- non-discrimination against investors;
- presumption of investor conscientiousness;

The basic principles of the legislation on investments and investment activity are applied at all stages of the investment process and investment activity.

What to consider if you invest in Uzbekistan Strong Points Uzbekistan's key assets attracting FDI include:

- abundant and diversified natural resources (gas, gold, cotton, hydropower potential);
- low level of debt and comfortable foreign exchange reserves;
- ambitious public investment program;
- important size of the domestic market (population of 33,4 million)
- strategic position between China and Europe ("New Silk Road").

Weak Points the major obstacles to FDI in Uzbekistan are :

- low economic diversification and dependence on commodity prices;
- low competitiveness;
- underdeveloped banking sector;
- state interventionism and difficult general business climate;
- autocratic regime.

¹¹ law of the republic of Uzbekistan on investments and investment activity 25.12.2019

Conclusion

The results of analysis of foreign direct investment economic growth in Uzbekistan shows the lack of transparency, dominant role of government in economy, inefficient judicial mechanisms and diversifications in “strategic” sectors are the obstructions for many potential foreign investors. Currently the government of Uzbekistan is striving against problems of foreign direct investment of country regional development. The objective of this study was to shed light on the determinants of foreign direct investment (FDI) in Uzbekistan. In order to undertake it, we performed on data analysis for the 2016-2019 periods. The study found trade openness, exchange rate, natural resources and infrastructure as the drivers of FDI in Uzbekistan. Macroeconomic variables, such as inflation and per capita gross domestic products, were also found to be contributing to the determinants of FDI flows in Uzbekistan. Finally, the contribution of this paper is that economic liberalization does really matter for FDI inflows in Uzbekistan and policymakers' efforts in liberalizing the economic activities may necessarily translate into significant FDI inflows into the country.

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