



FDI Scenario in Uzbekistan: Current Reforms and Future Prospects

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Abstract: Foreign Direct Investment is considered as one of the most common types of capital flows especially in the case of developing countries. FDI has a significant impact on the economic growth of host country and stability of its macroeconomic indicators. The main aim of this paper is to analyze the FDI inflows in Uzbekistan, one of the developing countries of Central Asia, which is stated to receive a limited amount of FDI compared to other CIS countries. The paper describes the general environment in Uzbekistan after achieving its independence. Moreover, current reforms under the new government of Uzbekistan is taken into consideration in discussion part which is aimed to stimulate foreign direct investment. Since there is a limited number of studies undertaken to study FDI in Uzbekistan, the current paper derived most of its content from the research by Theodore Metaxas and Polyxeni Kechagia (2016) which shed light into the attraction of FDI in Uzbekistan. Additionally, this paper provides up-to-date information on new reforms being undertaken in Uzbekistan to attract Foreign Direct Investments.

Keywords: FDI, Central Asia, Developing countries, Determinants of FDI inflows

1. Introduction

It can be noticed that the inflow of FDI towards the economy of developing countries has significantly increased. The review of the literature in this field provides evidence for the fact that majority of Central Asian countries has become a top destination for FDI inflows due to the several strengths they show like the abundance of natural resources as well as increasing number of population size which is essential for ensuring the market size.

This paper focuses on the case of Uzbekistan. Precisely, this report aims to analyze the main determinants of FDI and its contribution to the growth of the country. Moreover, recent reforms undertaken to improve the investment climate by the government of Uzbekistan is also going to be reviewed.

There is a limited number of papers which focused on the determinants of FDI in the case of Uzbekistan (Ployxeni, 2016). This can be explained by the fact that country has not taken enough measures to attract the FDI in comparison to other Central Asian countries such as Kazakhstan, Tajikistan, and Turkmenistan (Ployxeni, 2016). Thus, the main contribution of the paper is that it explains the major reasons which are preventing Uzbekistan from receiving the FDI. Furthermore, several suggestions are going to be provided as to how investment climate should be developed.

2. Literature Review

To have a clear picture of the economic influence of FDI, it is important to consider what are the main reasons for both investors and FDI receivers when they consider the investment projects. The review of the literature differentiates between three main types of investment motivations including resource-seeking, market-seeking, and efficiency seeking (Dunning, 1993). Resource seeking FDI is characterized by the availability of natural resources, cheap labor and infrastructure in the host country (Morck, 2008). When it comes to market seeking FDI, it is explained by the investors willing to expand their businesses to overseas. Most of the market seeking FDI occurs in sectors that are well protected. Efficiency-seeking FDI is essential when a company wants to obtain common governance of the geographically dispersed activities through both markets seeking and resources seeking types of FDI (Ismail, 2015). In order to make efficiency-seeking FDI happen, there should be open cross-border markets that are the main reason for efficiency-seeking FDI.

When it comes to hosting countries, which are receiving FDI, they should have two important motivations. Firstly, host countries receive FDI since they lack domestic resources to serve their local markets. This is mainly the case with poor countries, where the wages are significantly low. Another important motive is the lack of technologies and expertise, which are not available in host countries (Kemme, 2012). Most of the FDI that takes place in Central Asia can be explained by the availability of oil, gas, and metal. FDI trends at a global level suggest that extraction of oil and processing of oil constitute 50% of FDI investments (Yasar, 2007). Thus, the main reason behind the stimuli of FDI to Central Asian countries is related to the increasing level of the price of these natural resources (Spechler, 2009). However, labor-intensive sectors are less likely to receive investment. Although Uzbekistan receives a large proportion of its FDI to textile sector, it is explained by the availability of cotton rather than labor force.

3. FDI in Central Asian Countries

Central Asia is rich in natural resources, and this is the main reason for attracting foreign direct investments in the region. For instance, in Kazakhstan, most of the investment attracting sectors are mining and processing industries, such as retail, real estate, and services (ADB, 2013). Particularly, the government of Kazakhstan is aiming to invest in metallurgy, oil and gas, agriculture, construction materials, textile, tourism and transport and logistics.

In Kyrgyzstan on the other hand, a significant proportion of foreign direct investment goes to food processing industry, trade, retail and financial services (World Bank, 2015). The main sectors that government prioritizes to invest are energy, mining, and agriculture. When it comes to Tajikistan (ADB, 2014), it has attracted most of the FDI in the mining industry. As to Tajikistan, there is no specific sector for investment and Tajikistan encourages the investment into all sectors of the economy (Eurasian Development Bank, 2013)

Mining, tobacco, automotive, oil and gas sectors are considered as the main sectors for FDI in Uzbekistan (UNDP, 2014). Below, there is a list of sectors which are regarded as the prioritized sectors for FDI in Uzbekistan.

- Light industries, including silk;
- Construction materials production;
- Automobile industry;
- Agriculture processing;
- Chemical industry;
- Exploration of mineral deposits;
- Tourism;
- Electro technical industry.

It is worth to mention that one of the major ways through which countries attract foreign direct investment is through creating special economic zones. Special economic zones mainly attract investment by offering them favorable conditions and huge tax exemptions which are less likely to be found in other countries. It has been identified that governments in developing countries often establish special economic zones to implement new economic and investment policies in a limited scope before introducing it to a national level (WTO, 2013). This can be explained by the fact that this allows the governments to predict and control the future policies based on the experience they gain from special economic zones.

There are several papers which analyzed the foreign direct investment inflows to developing countries. Particularly, economic growth of the country is positively associated with the amount of foreign direct investment inflows. However, it is not always true that FDI is positively related to economic growth. The following evidence can explain this. For instance, there is the positive support for the fact that foreign direct investments impact positively on technological capability of the host country, thus, increases local productivity. However, at the same time, it affects negatively on local manufacturers. Therefore, it is of critical importance to take into consideration the state of local companies while designing policy regulations.

Also, it's been said that overseas capital inflows do influence positively the level of productivity inside the host economies of the region. However, this influence decreases as compared to the one deriving from the imports (Arazmuradov, 2015). Consequently, both imports and FDI inflows are taken into consideration in channels of diffusion so that the host nations have control to acquire R&D and human capital accumulation (Krammer, 2010).

Moreover, natural sources have attracted a large quantity of foreign capital inside the area of Asia. Accordingly, Kazakhstan and Turkmenistan managed to draw most of the overseas capital among the members of the Central Asian countries. Further, Doytch and Uctum (2011) argued that the manufacturing enterprise of the area attracts overseas capitals, while it is possible to cause deindustrialization in case that capital is attracted by the services zone. Accordingly, the biggest recipients had lower criminal activity charges, larger marketplace size, and much fewer investment dangers. Brock (1998) supported that the infrastructure and the academic level of the team of workers within the recipient country do not affect the quantity of the received foreign capitals.

4. Discussion

4.1 Current situation of Uzbekistan Investment Market

4.1.1 Political Environment

The government of Uzbekistan has declared 2018 as the year which supports the entrepreneurship, innovative ideas and technologies. As a result, the political environment in Uzbekistan has undergone a number of positive changes. Moreover, the government of Uzbekistan has started to improve the relations with other countries including Russia and Korea in the hope of improving international trade and foreign direct investment. Particularly, it is worth to mention that international trade turnover between Uzbekistan and Russia has increased by 23% in 2017 (Gazeta.uz, 2018).

Moreover, foreign policies have significantly changed in regards to a neighbor country such as Tajikistan and, as a result, both countries came to a mutual agreement. In this regard, Farkhad, hydroelectric power plant will be situated in the territory of Tajikistan and its property will be under the responsibility of Uzbekistan (. Moreover, countries have canceled requirements, where citizens of both countries will be able to stay in the territory of countries within one month. This can be evidence of how Uzbekistan is trying to establish favorable relationships with neighbor countries and improve the investment climate in the country.

Moreover, starting from 2018, several reforms have been introduced to tax policy. Particularly, electronic system of declarations, payments, and taxes have been introduced for the convenience of local and foreign individuals who are doing business in Uzbekistan. At the same time, corporate income and development of social infrastructure taxes have been reduced by 1.4 % and now constitute 14%. This has resulted in the more time demanding due to the new platform for paying and processing taxes. Precisely, hours were reduced from 202 to 181, and a total number of taxes decrease from 58 to 10. Moreover, Government of Uzbekistan has canceled tax benefits on profit for foreign individuals. Furthermore, single tax payment and additional tax payment for foreign legal parties with permanent business in Uzbekistan has also been decreased, which can be regarded as an evidence of favorable investment environment in Uzbekistan (Spot.uz, 2018)

Moreover, Uzbekistan has adopted a program for further reformation and diversification during 2015-2019, which consists of seven strategic steps. The adoption of these strategic reforms allows the country to consider more than 900 new investment projects. These investment projects are in different spheres including oil, food, automobile, and medicine.

4.1.2 Economic Environment

Economic Environment in Uzbekistan can be considered as a stable one since the country has no internal and external debt and this amount does not exceed 18% of GDP. The significant economic reform in Uzbekistan has been carried out on September 5, 2017, with foreign currency liberalizations. This allows the legal and physical individuals to conduct the transaction of foreign currency at the market rate which is offered at commercial banks and exchange offices. This reform has some implications for the further development regarding increasing Uzbek export, improving healthy competition and limiting the cases of corruption. However, at the same time, this has an increased inflation rate. As a result, Uzbekistan has a high rate of inflation in the first half of 2017 with an increase by 14% in the consumer sector, which is considered as the highest one since 2012 (Trading economics, 2018). According to Jamshid Kuchkarov, Minister of Finance, in 2018 the inflation rate is expected to be at the level of 12%, and this will further decrease and stabilize step by step (Gazeta.uz, 2017)

According to Global Economic Prospects report by World Bank Uzbekistan is considered as the second fastest growing economy. (World Bank Group, 2017). This can be explained by the growth of GDP, the total amount of which equal to \$650 and it is expected that this will further increase (Spot.uz, 2018). This implies that standard of living of Uzbek people has improved, which can be evidenced by the increase in population income by 14% (Uznews.uz, 2017).

4.1.3 Technological factors

Internet users in Uzbekistan constitute 13,791, 083 and this has risen to 20 million in 2018. The number of internet users is expected to increase further by 2022 (Indexmundi.com, 2018). In this regard, it is worth to mention that internet is currently available in urban areas of the country, whereas the situation in rural areas requires further investment. The government of Uzbekistan has adopted the decree on measures to enhance the ICT sector. According to this decree, businesses are allowed to export products using online commercial platforms based on a non-contractual basis. Moreover, they are exempted from making a payment to banks for export activities, which will start from July 1, 2018.

Nowadays, e-commerce is developing at a rapid pace. In the case of Uzbekistan, Tashkent is regarded as the only viable market for conducting e-commerce businesses since there is an increasing number of internet users. Moreover, recent reforms undertaken in Uzbekistan in terms of currency liberalization is expected to have a positive contribution for the development of e-commerce infrastructure of the country, which, in turn, will increase foreign direct investment. Particularly, it is worth to mention the increasing number of mobile phone users, which constitute 23 million and use of fiber optic communication lines make up 23 000 kilometers, which can be evidence of improving the technological environment in the country.

5. Conclusions

The recent economic reforms that have been undertaken by the new government of Uzbekistan can provide valid evidence for the creation of the favorable conditions for doing business in Uzbekistan. Particularly, the creation of free economic zones and tax exemptions can be considered as the main motives for foreign investors to choose Uzbekistan as the proper destination for doing business. Furthermore, the review of the Political, Economic and Technological environment supports the favorable investment climate in Uzbekistan.

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