



# THE IMPACT OF FOREIGN DIRECT INVESTMENT (FDI) ON UZBEKISTAN'S ECONOMY

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## ABSTRACT

*This article examines the impact of Foreign Direct Investment (FDI) on Uzbekistan's economy, highlighting the significant role FDI plays in the country's economic development. With a focus on recent reforms, investment inflows, and government strategies, the analysis provides a comprehensive overview of how FDI contributes to Uzbekistan's economic landscape, including the challenges and opportunities it presents.*

**KEYWORDS:** *Foreign Direct Investment (FDI), Uzbekistan's economy, Economic reforms, Special Economic Zones (SEZs), Investment inflows*

## INTRODUCTION

Uzbekistan, a nation with a rich tapestry of natural resources, including gas, gold, and cotton, occupies a strategic geographical position that bridges the significant markets of China and Europe. This unique positioning, coupled with its considerable domestic market of over 37 million people, presents a compelling case for Foreign Direct Investment (FDI) as a catalyst for economic transformation. In recent years, the Uzbek government has embarked on an ambitious journey to overhaul its economic landscape, aiming to transition from a predominantly state-controlled economy to a more open, market-oriented model. This shift is designed to attract foreign investment, stimulate economic growth, and diversify the country's economic base.

The significance of FDI in Uzbekistan's economic strategy cannot be overstated. FDI not only brings in capital but also facilitates technology transfer, enhances managerial skills, and integrates the Uzbek economy into global value chains. Recognizing these benefits, the government has implemented a series of reforms aimed at improving the business environment and making the country more attractive to international investors. These reforms include liberalizing the foreign currency market, establishing special economic zones (SEZs) with enticing tax breaks, and launching a large-scale privatization plan targeting key sectors such as banking, energy, telecommunications, and agriculture.

However, the path to attracting and maximizing the benefits of FDI is fraught with challenges. The country's economic diversification efforts are ongoing, and while there has been progress, dependence on commodity exports remains high. Additionally, the business climate is evolving, with efforts to reduce state interventionism and combat corruption taking center stage. These efforts are crucial for building investor confidence and ensuring that FDI contributes effectively to sustainable economic development.

This article aims to explore the multifaceted impact of FDI on Uzbekistan's economy, examining how recent reforms and government strategies have shaped the investment landscape. By analyzing the current state of FDI, its contributions to the economy, and the challenges and opportunities it presents, we can gain insights into the role of foreign investment in Uzbekistan's economic reform and growth trajectory.

## LITERATURE REVIEW

The role of Foreign Direct Investment (FDI) in the economic development of emerging markets has been extensively studied, with a significant focus on its impact on growth, technology transfer, and the enhancement of competitive industries. In the context of Uzbekistan, recent economic reforms and strategic initiatives to attract FDI have sparked interest among scholars and policymakers alike. This section reviews the existing literature on FDI in Uzbekistan, highlighting key findings and contributions from various studies.



One pivotal study by Khamidov (2021) examines the liberalization efforts in Uzbekistan's economy post-2016, emphasizing the government's initiatives to attract FDI through the establishment of special economic zones (SEZs) and the liberalization of the foreign exchange market. Khamidov argues that these reforms have significantly improved the investment climate in Uzbekistan, leading to an increase in FDI inflows, particularly in the energy and telecommunications sectors. The study underscores the importance of continuous reforms and the need for Uzbekistan to enhance its legal and regulatory framework to sustain FDI growth.

Another important contribution is made by Mirzaev et al. (2020), who analyze the impact of FDI on Uzbekistan's economic growth using econometric models. Their findings suggest a positive and significant relationship between FDI inflows and economic growth, indicating that FDI has been a crucial factor in Uzbekistan's recent economic performance. The authors recommend further reforms to improve the business environment, suggesting that such measures could amplify the positive effects of FDI on the economy.

In a report by the United Nations Conference on Trade and Development (UNCTAD, 2022), Uzbekistan is highlighted as a case study in the context of developing countries attracting FDI. The report acknowledges Uzbekistan's strategic efforts to attract FDI through policy reforms and the establishment of SEZs, noting the positive trend in FDI inflows despite global economic uncertainties. The UNCTAD report calls for continued efforts in policy reform and economic diversification to fully leverage the potential of FDI in driving sustainable development.

Furthermore, a study by the World Bank (2021) on the investment climate in Uzbekistan provides an in-depth analysis of the challenges and opportunities for FDI in the country. The World Bank report emphasizes the need for Uzbekistan to address issues related to economic diversification, competitiveness, and the reduction of state interventionism to create a more conducive environment for foreign investors. The report also highlights the importance of combating corruption and improving the transparency of the investment process as key factors in attracting and retaining FDI.

## **ANALYSIS AND RESULTS**

Over the past 6 years, Uzbekistan has undertaken significant reforms that have bolstered its appeal to foreign investors. These reforms include the liberalization of the foreign exchange market and the establishment of seven special economic zones (SEZs), which offer tax incentives to investors. The United Nations Conference on Trade and Development (UNCTAD) reported in its 2022 World Investment Report that despite the global economic downturn triggered by the COVID-19 pandemic, FDI inflows to Uzbekistan rose from \$1.72 billion in 2020 to \$2.04 billion in 2021, with the total FDI stock reaching \$11.27 billion by 2021. Despite being landlocked and facing economic challenges due to pandemic-induced border closures and other restrictions, the adoption of the SEZ law in February 2020 has paved the way for new investments in the energy and telecommunications sectors. In May 2020, the Uzbek government disclosed that it received proposals from 70 companies across 30 countries for green energy projects. Furthermore, the Volkswagen Group from Germany initiated an investment project in the Jizzakh SEZ, and in February 2021, the Russian telecom giant MegaFon announced a \$100 million investment to form a joint venture with Ucell, Uzbekistan's leading mobile phone operator, thus entering the Uzbek telecom market. In a significant move, ACWA Power from Saudi Arabia invested \$2.5 billion in 2020 to develop three major power projects, aiming to enhance the country's energy capacity by 2500MW.

FDI in Uzbekistan has traditionally been sourced from Russia, South Korea, China, and Germany, with recent increased investment from Canada, particularly in the energy sector, including renewable energy sources. The national investment promotion agency assists foreign investors, aligning with the government's strategy to attract FDI into critical sectors like banking, energy, manufacturing, telecommunications, transport, and agriculture as part of a comprehensive privatization plan. Despite its rich natural resources and strategic location, Uzbekistan faces challenges such as the need for state enterprise restructuring and World Trade Organization (WTO) membership. The country's progress has been hampered by widespread corruption. In response, President Shavkat Mirziyoyev established an Anti-Corruption Agency in 2020 to address these issues comprehensively.

Uzbekistan's FDI growth was recorded at 3.8% of its nominal GDP in September 2022, an increase from 2.9% in the preceding quarter, according to CEIC Data, 2023. The country has outlined ambitious plans to implement projects worth \$17.34 billion in 2023, with foreign direct investment projected at \$7.06 billion. The majority of the funds (\$9.24 billion) are earmarked for geology, energy, and industry sectors. For 2024, projects worth \$18.2



billion are planned, with expected foreign direct investments reaching \$7.73 billion, as per the 2022 Presidential decree on Uzbekistan's investment program for 2022-2024.

**Table 1. Trends in Foreign Direct Investment in Uzbekistan**

Metric	2020	2021	2022
FDI Inward Flow (million USD)	1,728	2,276	2,531
FDI Stock (million USD)	10,288	11,547	13,631
Number of Greenfield Investments	22	25	14
Value of Greenfield Investments (million USD)	3,247	1,924	1,221

Source: UNCTAD, Latest available data

Note: Greenfield Investments refer to a form of Foreign Direct Investment (FDI) where a parent company establishes a new venture in a foreign country by constructing new operational facilities from scratch.

**Table 2. Comparative Analysis of Investor Protection**

Index	Uzbekistan	Eastern Europe & Central Asia	United States	Germany
Index of Transaction Transparency	8.0	7.5	7.0	5.0
Index of Manager's Responsibility	3.0	5.0	9.0	5.0
Index of Shareholders' Power	7.0	6.8	9.0	5.0

Source: Doing Business, Latest available data

## DISCUSSION

The data presented in Table 1 illustrates a consistent increase in FDI inward flow and FDI stock in Uzbekistan from 2020 to 2022, indicating a growing confidence among foreign investors in the Uzbek economy. Despite a fluctuation in the number and value of Greenfield investments—peaking in 2020 and then declining—this investment type remains a significant contributor to Uzbekistan's FDI, showcasing its role in establishing new business ventures and expanding the industrial base of the country.

Table 2 reveals Uzbekistan's standing in terms of investor protection compared to other regions and countries. The country scores higher in transaction transparency than the Eastern Europe & Central Asia average and the United States, suggesting a relatively open and clear regulatory environment for transactions. However, it lags in the index of manager's responsibility, indicating potential areas for improvement in corporate governance and accountability. The index of shareholders' power is notably high in Uzbekistan, indicating strong rights and protections for shareholders, although still below the benchmark set by the United States.

## RECOMMENDATIONS

To further enhance the impact of Foreign Direct Investment (FDI) on Uzbekistan's economy and sustain the positive trends observed in recent years, the following recommendations are proposed:

**1. Continue Regulatory Reforms:** Uzbekistan should persist in its efforts to streamline regulatory processes, making it easier for foreign investors to start and operate businesses. This includes simplifying licensing procedures, enhancing the transparency of regulatory requirements, and reducing bureaucratic hurdles that can deter investment.

**2. Strengthen Legal Frameworks for Investment:** Strengthening the legal frameworks that govern FDI is crucial. This involves ensuring the enforcement of contracts, enhancing the protection of investor rights, and establishing clear, consistent rules for the expropriation and nationalization of foreign-owned assets.

**3. Enhance Infrastructure and Connectivity:** Investing in infrastructure, including transportation, telecommunications, and energy, is vital to making Uzbekistan more attractive to foreign investors. Improved infrastructure facilitates business operations, reduces operational costs, and enhances the country's integration into global supply chains.

**4. Focus on Human Capital Development:** Developing a skilled workforce is essential to attract high-value FDI. This can be achieved through investments in education and vocational training programs that align with the needs of foreign investors, particularly in sectors targeted for growth and diversification.

**5. Promote Sectoral Diversification:** While recent investments have focused on energy and telecommunications, Uzbekistan should also promote FDI in sectors like agriculture, manufacturing, and services.



Diversification can help mitigate the risks associated with over-reliance on a few sectors and create more balanced economic growth.

**6. Enhance International Partnerships:** Expanding bilateral and multilateral agreements can provide a more stable and predictable environment for foreign investors. Uzbekistan should seek to negotiate investment treaties that include provisions for the protection of investments and mechanisms for dispute resolution.

**7. Improve the Business Environment:** Continuous efforts to improve the overall business climate, including fighting corruption, ensuring political stability, and promoting good governance, are essential. These efforts will not only attract more FDI but also contribute to the sustainable development of the economy.

## CONCLUSION

Foreign Direct Investment (FDI) has played a pivotal role in Uzbekistan's economic development, contributing to growth, diversification, and the integration of the country into the global economy. The government's reform initiatives have started to yield positive results, as evidenced by the increasing inflows of FDI and the expansion of investments into various sectors of the economy. However, to sustain and build on this momentum, Uzbekistan faces the challenge of further improving its investment climate through regulatory reforms, infrastructure development, human capital enhancement, and the promotion of sectoral diversification.

The recommendations provided aim to address these challenges, offering a roadmap for Uzbekistan to attract more high-quality FDI that can contribute to sustainable economic growth. By continuing to reform and open up its economy, Uzbekistan can solidify its position as an attractive destination for foreign investors, thereby ensuring long-term economic prosperity and development. The way of economic transformation is complex and requires sustained effort, but with strategic planning and execution, Uzbekistan can achieve its goals and realize its full potential on the global stage.

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