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FDI TRENDS IN UZBEKISTAN: SPATIAL PATTERNS REALLY MATTER

Abstract: This paper focuses on the spatial dimensions of foreign direct investment in Uzbekistan. This is because the regional/sectoral distribution of FDI and the results of development based on foreign investment have shown inequality for 30 years. Therefore, the study examines the factors that determine foreign investment in the country, the contribution of foreign investment to the growth of the country and regions, the reforms and problems carried out by the government to make the country more attractive to foreign investors. The main topic of the paper is spatial patterns of FDI in Uzbekistan, which deals with theoretical and practical approaches.

Key words: Foreign investment, Spatial pattern, Impact, Industry, Geography, Economy.

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Introduction

The set of economic, political, regulatory, and social opportunities plays a key role in attracting foreign investment. Such opportunities include the following factors: natural conditions, mineral reserves, working capacity and average wages, domestic and foreign market opportunities, the provision of benefits for foreign capital, and more. One of the key factors in the gradual implementation of structural changes in Uzbekistan is the inflow of foreign direct investment (FDI) into the economy. Many studies have shown that Uzbekistan has received less foreign investment than other CIS countries since its independence. However, there is no detailed study of the historical and spatial dimensions of foreign investment in Uzbekistan in recent years.

Therefore, this study aimed to examine the inflow of foreign investment in economic regions of Uzbekistan and its spatial dimensions. Because most studies discussed the overall investment climate in Uzbekistan since independence.

2. Study object

Our study further focused on regional and sectoral distribution of the FDI inwards in Uzbekistan. This is because the distribution of FDI in regions and the results of development based on the FDI inbound have shown inequality for 30 years. Therefore, the study examines the factors that determine foreign investment in the country, the contribution of foreign investment to the growth of the country and regions, the reforms and problems carried out by the

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government to make the country more attractive to foreign investors.

3. Methodology

Geographical comparison, historical, regional analysis, and statistical methods are used in this work. The main topic of the dissertation is *spatial patterns of FDI in Uzbekistan*, which deals with theoretical and practical approaches. Information on the topic of the study is obtained from the State Statistics Committee of the Republic of Uzbekistan, and the international official data (Also, *doing business*, *outsourcing*, *unctad.org*, *World Bank*, etc.).

4. Theoretical background

Interested in the motives for attracting large foreign investment by U.S. corporations, *Hymer* went beyond existing theories and created a framework to explain why this phenomenon occurred. *Hymer* (1976) developed theories of market imperfection aimed at explaining firm behavior in an imperfectly competitive environment, i.e., an oligopolistic or monopolistic environment. *Eclectic theory* gives rise to several factors that determine foreign direct investment, and include market size, labor costs, government incentives, and access to raw materials.

Letto-Gillies Grazia (2012) preceded *Stephen Heimer's theory* of direct investment in the 1960s on the causes of foreign direct investment and multinational corporations to macroeconomic principles explained by the based neoclassical economy.

Scientists from Uzbekistan have studied the location and development of industries as well as attracting foreign direct investment (FDI). In this regard, the standard and geo-economic ideas created in the Western European countries (like France, German, etc.), regional production complexes, and energy production cycles established in the CIS countries, the problems of integrated development of the regions formed in Uzbekistan are particularly noteworthy. The following scientists were engaged in the placement and development of productive forces in Uzbekistan:

A. Vahabov, Sh. Khajibakiev, N.Muminov (2010) described the essence of investment as follows: "Investments are money invested in business entities and other activities to make a profit and achieve positive social results. , bank deposits, shares, other securities, technologies, machinery, equipment, licenses, loans, any other property or property rights, intellectual property".

Oblamurodov (2008) put forward the idea of creating a scientific methodological basis for the

orientation of FDI to the national economy. His research principally contains comparative analysis using foreign experience. *Akramov* (2006) described the theoretical basis for the proper use of FDI in his research work. He put forward the idea of a scientific approach to directing FDIs to industries and making high profits from them.

Ubaydullaeva (2004) conducted a study to assess the effectiveness of the public policy on inbound FDI in Uzbekistan, their use. This study provides an example of foreign experience in attracting foreign investment. She also cited some research on the geography of joint ventures. *Mirzaakhmedov's* dissertation (2003) on "Peculiarities of territorial location and development of joint ventures in the industry" can be considered as the best literature on this matter. Although this dissertation focused on the regional structure of industrial production and the activities of joint ventures, we used it to cover our research topic.

3. Results and Discussion

3.1. FDI trends since 1992

Uzbekistan, with a population of 34.4 million (2021), ranks 42nd in the world in terms of population. Uzbekistan is the 204th largest economy in the world with a GDP of \$58.8B and has diplomatic relations with 137 countries. As Uzbekistan is pursuing political, economic, and legal reforms to increase its competitiveness in inbound foreign investment the inflow of large amounts of direct investment to Uzbekistan is growing.

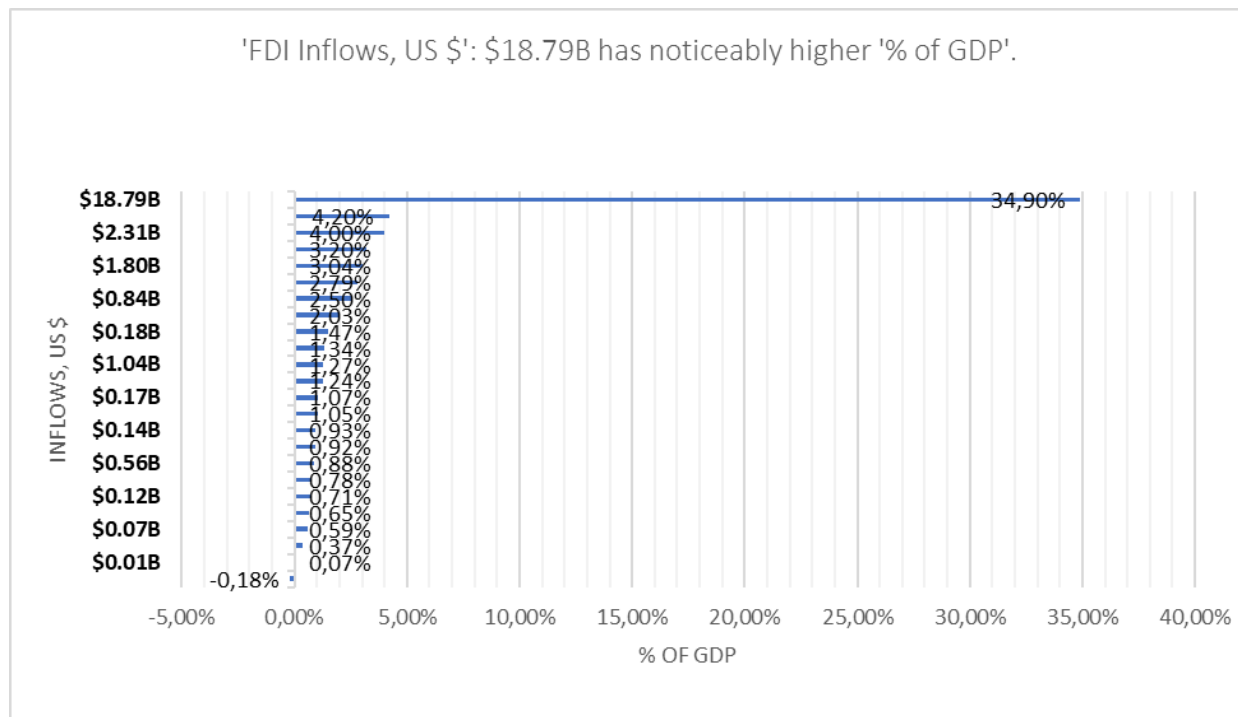
According to statistics from the Ministry of Investment and Foreign Trade of Uzbekistan, for over 30 years, around 50 countries have been investing: \$18,79 billion. The FDI inwards traditionally arrive from Russia, South Korea, China, USA, and Germany, but Canada recently increased its financial presence. Investments focus on the energy sector, including renewable energy in recent years.

Since 1992, Uzbekistan began the transition to a market economy and has pursued a policy of inbound foreign investment to achieve a sustainable economy. This chapter provides historical information on foreign investment. Table 1 shows the FDI data for Uzbekistan for 1992–2020, updated with World Bank statistics. In a developing country, foreign investment, measured as a reserve against income, rises and falls over the years. Throughout the past 30 years, Uzbekistan has seen a significant increase in foreign investment. The figure 1 provided by the World Bank international financial institution shows a record of steady Foreign Direct Investment (FDI) growth in Uzbekistan between a period of 1992 and 2020.

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Figure 1. Uzbekistan: FDI – historical data 1992-2020



Source: World Bank-2020

Chronologically, the amount of foreign investment came in Uzbekistan was reported as 0.01 billion US dollar in 1992, and by 1997 it reached \$0.17 billion. However, starting from 1998 to 2006, we can see a constant fluctuation between \$0.14b and \$0.17b. A sudden increase of \$0.71b US dollars in FDI in 2007 resulted in a growth of Gross Domestic Product (GDP) of Uzbekistan by 3.16%. Compared to the rest of the years from 2007 to 2020, a couple of decline in FDI and GDP were experienced in 2012 and 2014 (\$0.56b and \$0.81b respectively). It is worth noting that the peak of the trend in the table was reported in the last year of those years with \$3.02b FDI and 4.20 percent of GDP growth rate.

Uzbekistan has been achieving economic growth since independence. Many reforms have been implementing to attract foreign investors to increase the flow of foreign investors.

While the persistence of a closed market in Uzbekistan in 1992-2000 led to a slow inflow of FDI, Uzbekistan's joining the international capital movement opened the door to foreign investment. As a result, it has become the fastest-growing economy in the region (i.e., Central Asia).

Considering a situation with inward foreign direct investments in economy of Uzbekistan, at the beginning of the 2000th inflow of FDI to the country

was insignificant, and their cumulative amount by 2004 did not exceed 1 billion dollars.¹

The period of rather low investment activity of the beginning of the 2000th years which was caused internal problems of Uzbekistan's economy. But in 2006-2009 pre-crisis situation in the world market was replaced by expansion of demand for investment resources. Thus, in 2010-2011, rapid growth of inward FDI into Uzbekistan's economy. The growth in volumes of foreign investments demonstrated improvement of characteristics of the investment climate of Uzbekistan and increased in trust to its economy by investors in recent years.

Dynamics of foreign investments in 2006-2011 showed that in process of development of world financial and economic crisis of 2008-2009 foreign investors not only did not leave Uzbekistan, but also continued expansion of the presence in the market of the country.

As a result of continuously reforms during this period, annual foreign investment increased from \$ 0.7 billion in 2000 to \$ 1.64 billion in 2011. Some decrease in inflow of foreign investments to Uzbekistan in 2012 reflected a general situation in world economy. But the cumulative number of foreign investments in economy of Uzbekistan for the end of 2014 exceeded 10 billion dollars including inbound FDI 0.81 billion dollars. The share of FDI increased

¹ It seems that Uzbekistan had not yet established itself as a key destination for the FDI inbounds (UNCTAD -1999).

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from 14.4 percent in 2000 to 79 percent in 2011, to about \$ 2 billion. According to analysis, in 2004-2014, the volume of investments in the national economy increased by 3.2 times, while the volume of foreign direct investment increased by more than 20 times during that period. All this has set out excellent indicators of the economic policy measures taken by the government of the country in the context of the global economic crisis.

By 2020, FDI inflows had exceeded the \$3 billion line. This was because the government has expanded the exchange of delegations with states and international organizations, as well as reached a broader approach to market relations.

3.2. Impact of FDI to economy

Foreign direct investment impacted to modernizing the industrial base and increasing its efficiency of industries. According to the State Statistics Committee, the main inflows of foreign investment are in agriculture, services, tourism, construction and so on.

Chronologically, the GDP growth rate in Uzbekistan was reported as -11.2% in 1992, and by 1997 it reached 5.7%. However, starting from 1998 to 2003, we can see a constant fluctuation between 4.3% and 4.2%. A sudden increase observed in 2007 – 9.4% and it became unique peak until now. Compared to the rest of the years from 2008 to 2020, a couple of decline in GDP was experienced in 2017 and 2020 – 4.4% and 1.6% respectively). It is worth noting that the peak of the trend in the table was reported in the last year of those years with 5% of GDP growth rate (Figure 1).

In 2004-2005, high GDP growth rate was observed without FDI impact in Uzbekistan. This is not because the country's economy is well-established and government policies have yielded the desired results, but because cash inflows from Uzbek labor migrants, mainly in Russia and Kazakhstan, have increased. Therefore, after 2004, Uzbekistan's GDP growth rates remained positive.

By 2007, Uzbekistan's development strategy was mainly focused on the export of natural resources such as natural gas and minerals and the import of equipment. As a result, GDP growth peaked in 2007 at 9.5%. The global financial crisis of 2008 affected both the U.S. and Europe; however, Uzbekistan almost retained its immunity. That is why many investors have turned to countries like Uzbekistan, which have not been seriously affected by the crisis.

For example, after 2011, large foreign companies did not invest in Uzbekistan for some time. But official sources said the situation had little effect on the country's gross domestic product growth rate, which averaged 8% a year. This is because, by 2010, the value of remittances (labor migrants) to Uzbekistan increased sharply and amounted to 10% of

GDP. This has outpaced the inflow of FDI and foreign loans.

In 2020, real GDP growth for Uzbekistan was 1.6% (Figure 1). Though Uzbekistan's real GDP growth changed substantially in recent years, it tended to decrease through the 2001 – 2020 period ending at 0.7% in 2020 due to COVID-19-related blockages and trade disruptions.

3.3. Comparison of FDI impacts: CA and Uzbekistan

So far, Uzbekistan has attracted foreign capital, mainly for the development of several industries. The sector of effective water management has also been developed by attracting foreign investment. In 2000-2018, foreign investment improved the relevant infrastructure for the use of renewable energy technologies. As the tourism sector in Uzbekistan is one of the main sources of income in attracting foreign capital, it has attracted foreign investment in the cultural and archeological sectors. In addition, the mining, service, and textile industries have also attracted large amounts of foreign investment.

In covering FDI trends, it is suitable to compare Uzbekistan with neighboring countries. Because Central Asian (CA) countries have gained independence one after another and have common aspects in introducing FDI into the economy.

Central Asian countries are considered to have landlocked economies, yet they are attracting large amounts of foreign direct investment. According to several studies, the inflow of foreign investment has often not had a significant impact on the development of the local economy. At the same time, the inefficient social health insurance system has led to a reduction in the global competitiveness of the host economy and a reduction in the country's attractiveness to foreign investors.

CA countries have common features in attracting foreign capital: mainly in the natural resources, agriculture, and manufacturing industries. While Kazakhstan and Turkmenistan were the largest CA countries to attract foreign capital between 1992 and 2016. The World Bank (2017) noted that there are potential investment areas common to all five countries with abundant mineral resources, such as agriculture and food exports. Despite widespread corruption, Uzbekistan has been ahead of CA countries in the FDI inbounds due to trade openness and other sensible reforms. As a result, FDI contributed more to economic growth in Uzbekistan compared to CA countries. Most of the Central Asian economies have absorbed agricultural investment in the agricultural and manufacturing sectors. However, Uzbekistan directed the FDI inwards mostly to mining, agriculture, energy, services, textiles, and tourism sectors. The following table compares the impact of foreign investment on CA and Uzbekistan (Table 1).

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Table 1. Comparison of FDI impacts in Uzbekistan and CA countries

	Central Asian countries	Uzbekistan
Growth	FDI inflows led to economic growth and increased productivity	FDI led to financial development and reduced poverty rates
Sector	Most FDI in the energy, agricultural, and manufacturing industry	Most FDI in the mining, agricultural, energy, services, textile, and tourist sector
Natural resources	The countries of the region attracted FDI since they are rich in natural resources reserves	FDI inwards thanks to the country's abundant natural resources
Education & infrastructure	They are not considered key factors in attracting FDI	The government improved both infrastructures and social services
Regime	Democratic regions attract more FDI	Economic regions attract more FDI
Legal framework	Top FDI destinations developed the Rule of law	The legal reforms performed proved insufficient
Environment protection	FDI increased CO2 emissions in the region	Successful environment strategies applied

Source: MPRA Paper No. 63849, posted 25 Apr 2015

Table 1 shows that the legal reforms implemented in Uzbekistan were not sufficient to attract more foreign investment, but the Uzbek government has managed to implement a successful environmental policy in relation to the rest of the region.

In summary, bureaucratic barriers and corruption by lower authorities are almost common barriers to FDI inbound in CA countries. It should be noted that in recent years, Uzbekistan has been offering more financial, social, and government benefits to foreign investors than other CA countries.

4. Conclusion

Inbound foreign direct investment is very useful in shaping and strengthening the national economy of Uzbekistan. The study of spatial patterns of FDI provides a scientific approach to the effective direction of investment flows and the rapid development of economic sectors.

This paper examined FDI flows to Uzbekistan in 1992-2020 and analyzed its impact. The results show that over the past 30 years, Uzbekistan has initially been slow to inbound FDI due to its slow transition to a market economy, the constant existence of a closed market regime, and the subsequent centralized

financial system and poorly developed legal framework. Analyses have shown that the inward FDI is unevenly distributed through economic sectors, despite the inability to achieve large-scale inward bound FDI. In conclusion, it is recommended to further strengthen the ongoing reforms, to form the legal framework in accordance with international standards and to continue offering preferential motivations to foreign investors.

As a result of the policy of openness pursued by President Shavkat Mirziyoev, inbound FDI has begun to be directed to regions and sectors by their potential, while there has been a significant boost in the flow of FDI. Conclusion is that inward FDI should be directed to the specialized sectors of each region based on excellent, scientifically based promising projects with tough protection against corruption. At the same time, it is recommended to address the issue of potential personnel, to guarantee the rule of law and to create clear database that meets international standards.

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