

## CHALLENGES AND OPPORTUNITIES FOR IMPROVING THE INVESTMENT CLIMATE IN UZBEKISTAN

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### ABSTRACT

The research work aims to develop scientific and practical recommendations for improving the investment climate in Uzbekistan. In recent years, owing to the immensity of the challenges and a lack of institutional and human capacity, the government will have to focus on tackling the impact of the COVID-19 pandemic and the related economic fallout (including the collapse of global energy prices, reduced Chinese demand and the return of labor migrants from abroad.) This presentation aims to give some insights into the investment environment and the analyses of factors influencing it. The findings of the study will benefit both local investors and foreign investors who are interested in assessing investment opportunities in Uzbekistan.

**Keywords:** Investment, foreign direct investment, free economic zones, investment attractiveness.

## ЎЗБЕКИСТОНДА ИНВЕСТИЦИОН МУҲИТНИ ЯХШИЛАШ МУАММОЛАРИ ВА ИСТИҚБОЛЛАРИ

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### АННОТАЦИЯ

Тадқиқод иши Ўзбекистонда инвестиция муҳитини яхшилаш бўйича илмий ва амалий тавсияларни ишлаб чиқишга қаратилган. Сўнгги йилларда муаммоларнинг кўплиги ва институционал ва инсоний салоҳиятнинг етишмаслиги туфайли ҳукумат эътиборни Ковид-19 пандемиясининг таъсири ва у билан боғлиқ иқтисодий таназулга қарши курашишга қаратиши керак. (Хорижий мамлакатлар талабининг камайиши ва чет элдан меҳнат муҳожирларининг қайтиши...) Ушбу тақдирот инвестиция муҳити ва унга таъсир этувчи омиллар таҳлили ҳақида баъзи тушунчалар беришга қаратилган. Тажқиқот натижалари маҳаллий инвесторлар учун ҳум, Ўзбекистондаги инвестиция имкониятларини баҳолашдан манфаатдор бўлган хорижий инвесторлар учун ҳам фойдали бўлади.

**Калит сўзлар:** Инвестициялар, тўғридан-тўғри хорижий инвестициялар, эркин иқтисодий зоналар, инвестицион жозибадорлик.

## ВЫЗОВЫ И ВОЗМОЖНОСТИ ДЛЯ УЛУЧШЕНИЯ ИНВЕСТИЦИОННОГО КЛИМАТА В УЗБЕКИСТАНЕ

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### АННОТАЦИЯ

Целью научно-исследовательской работы является разработка научно-практических рекомендаций по улучшению инвестиционного климата в Узбекистане. В последние годы из-за масштабности проблем и нехватки институционального и человеческого потенциала правительству придется сосредоточиться на преодолении последствий пандемии COVID-19 и связанных с ней экономических последствий (включая обвал мировых цен на энергоносители, снижение китайского спроса и возвращение трудовых мигрантов из-за рубежа). Целью данной презентации является дать некоторое представление об инвестиционной среде и анализе факторов, влияющих на нее. Выводы исследования принесут пользу как местным инвесторам, так и иностранным инвесторам, заинтересованным в оценке инвестиционных возможностей в Узбекистане.

**Ключевые слова:** инвестиции, прямые иностранные инвестиции, свободные экономические зоны, инвестиционная привлекательность.

### INTRODUCTION

Uzbekistan, a land abundant in historical wonders and natural riches, is at the start of a new stage of economic development. On the Great Silk Road lie its cities whose names breathe of Oriental exotics - Samarkand and Tashkent, Bukhara and Khiva, which used to be stopping places for traders and served as a channel for international cooperation in the field of diplomacy, culture, science, and tourism. Recent Liberalization reforms in economic and legal sectors are considerably opening up the country to foreign trade and investment, as if they are returning Uzbekistan to its roots, restoring its traditional role throughout the centuries as a trading hub. However, owing to the immensity of the challenges and a lack of institutional and human capacity, the government will have to focus on tackling the impact of the COVID-19 pandemic and the related economic fallout (including the collapse of global energy prices, reduced Chinese demand and the return of labor migrants from abroad.) This presentation aims to give some insights into the investment environment and the analyses of factors influencing it. The findings of the study will benefit both local investors and foreign investors who are interested in assessing investment opportunities in Uzbekistan.

### Why Invest in Uzbekistan

With a population of 33 million, it is the most populous country in the region. The country is distinguished by its wealth of natural resources and its good location on the historical Great Silk Road

Currently, the Republic's economy is the second fastest-growing in the CIS with the nominal GDP last recorded at 69.2 billion US dollars.

Significantly, the decision of the Head of State decided to introduce a visa-free regime for the entry of tourists from 86 countries. According to Gallup rating, Uzbekistan is in 5<sup>th</sup> place on the list of the safest countries in the world.

Moreover, an "investment visa" has been introduced for investors who have contributed at least \$ 200,000 US dollars.

The introduction of free conversion of the national currency, the reduction of trade barriers, and customs payments allowed for a significant increase in the volume of trade.

One of the key benefits of opening a business is the low cost of energy. In comparison, to neighbor countries, Uzbekistan has one of the lowest prices for gas and electricity.

Moreover, the republic has developed infrastructure, namely roads, electric networks, railways, gas pipelines, 11 international airports, and many more.

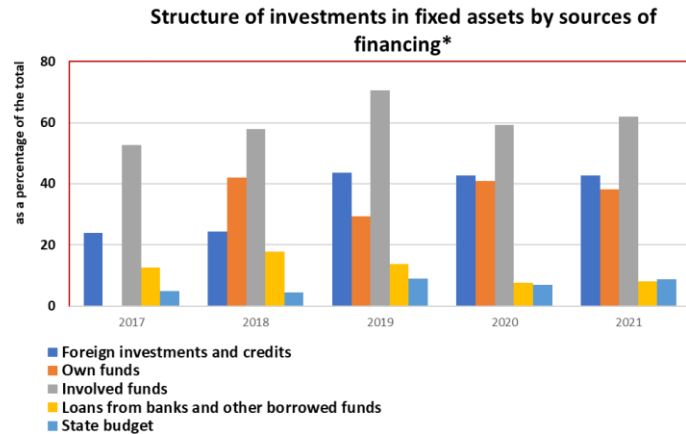
To attract foreign capital, there are 22 Free economic zones, a business ombudsman institution has been introduced, The Tashkent International Arbitration center has been established, and a draft unified law on Investments.

Uzbekistan has been involved in the CIS(Commonwealth Independent States) Free trade zone with 275 market access.

Over the past 2 years, large-scale reforms have been carried out in the tax system, including reductions and cancelation of certain types and obligatory payments.

In addition, It is planned to introduce a procedure for providing residence permits to foreign investors, subject to investment in the Republic of Uzbekistan.

New Silk Road connectivity, tax incentives, and comprehensive structural and regulatory reform make Uzbekistan an attractive Central Asian powerhouse. There is no doubt that ongoing reforms will help to provide a great opportunity to each investor.



1. Source: Created by the author on the materials of the website of the State Committee of the Republic of Uzbekistan on statistics.

The problem of developing investment resources, both regionally and locally, is of great importance. Main sources of regional investment can be own funds of regional budgets; Businesses' funds; or direct foreign investment.

In addition to borrowing from national banks on a short- and long-term basis, enterprises can use the attraction of loans from foreign banks, consortiums of banks, as well as international financial organizations.

The 2021 figures differ significantly from 2017 due to reforms and the impact of the virus on the economic system of the Republic of Uzbekistan. Based on the experience of Uzbekistan, the financing of fixed investments is mostly realized at the expense of its own, involved, and foreign investments and credits.

As can be seen, there is no Equity fund source in financing the investment, whereas in leading foreign countries, the bulk of financing of the economy comes from an Equity fund, bonds, and a smaller bank financing.

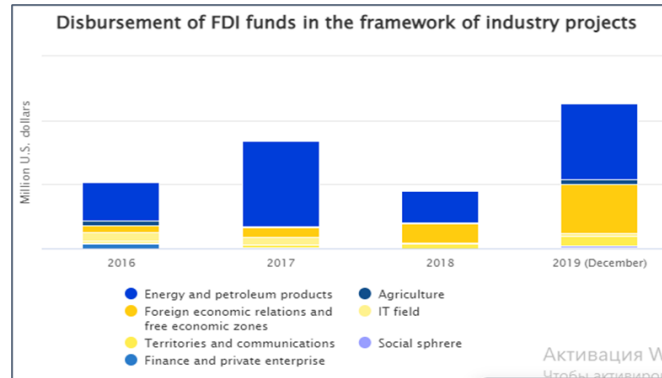
## LITERATURE REVIEW

### Foreign Direct Investment – Uzbekistan

Foreign direct investment (FDI) is one of the main catalysts for the development and encouragement of the economic activities of SMEs.

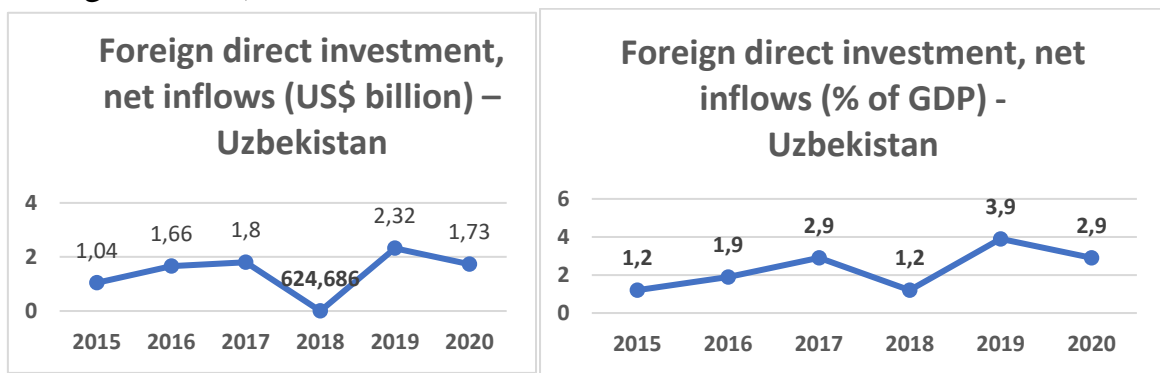
In 2019, FDI reached a record level of \$2.3 billion. The most attractive for foreign investors were the energy and petroleum products, the field of information and communication technologies, the chemical industry, textile, and construction. Agriculture, fisheries, and food production, as well as socially-oriented investments (health, education, leisure, and cultural activities), accounted for five percent of total inflows. High growth in foreign direct investment is observed in some areas of the Republic of Uzbekistan: Surkhandarya, Navoiy, and Namangan regions.

Disbursement of FDI funds in the framework of industry projects



2. Source: <https://mift.uz/en/investment-statistics>

However, the COVID-19 pandemic significantly impacted the Uzbek economy and FDI inflows. As reported in the World Investment Report 2021, FDI inflows slowed down to \$1.7 billion in 2020 (UNCTAD, 2021). Also, the country’s FDI performance remains lower than that of other countries in the region. For example, the data show that in terms of FDI inflows per capita, Uzbekistan surpasses only Tajikistan. It is smaller than that of other comparator countries in relative terms (as a percentage of GDP): 2.9% in 2020.



3. Source: Created by the author using <https://data.worldbank.org/indicator>

(Russia, China, Germany, and South Korea became the leaders in forwarding investments into Uzbekistan’s economy.)

### METHODOLOGY

The study is conducted using data from two main sources: interviews and document analysis. In addition to interviews with Uzbekistan’s representatives of the scientific community as well as field experts conducted during the study, the presentation uses qualitative and quantitative comparative analysis. Document analysis includes statistics and policy reviews of official government bodies and international organizations. Moreover, international and domestic publishing was used for the imperative analysis of the Uzbek economy.

### FINDINGS & DISCUSSION

The adoption of a new investment law

The Law on Investments and Investment Activity (the Investment Law) was passed in 2019. The Investment Law provides the incentives available for investments and investment activity. For all investors, these can take the form of tax and non-tax incentives granted. The Investment Law still contains a 10-year stability clause. When a new provision is detrimental, it does not apply to investors for 10 years “from the date of investment”. This is assessed differently depending on the type of investment.

Efficient business establishment procedures

Uzbekistan has made, in particular since 2017, important reforms to improve the business environment, including simplifying and digitalizing procedures. Uzbekistan has become a world reference in this area. The licensing regime was overhauled by the Law on Licensing. By fostering transparency, and digitalizing processes, the new law aims to eliminate bureaucratic barriers and corruption factors

Access to information.

One of the objectives of the ongoing reforms is to ensure that all parties have easy access to information. In this regard, all laws, regulations, decrees, and resolutions of the President and the Cabinet of Ministers are available online on a dedicated website,

Enhanced institutional structure for investment promotion

(Since 2019, the Ministry of Investment and Foreign Trade (MIFT) has had the mandate to elaborate on and implement the investment policy of the country. The Uzbekistan Investment Promotion Agency (UzIPA), restructured in 2019 and reporting to the MIFT, is responsible for investment promotion and facilitation functions.)

Foreign exchange

Convertibility of the Uzbekistani so‘m (UZS) and canceling the multiple exchange rates system. Foreign investors are now allowed to open bank accounts in foreign currency and the conditions for the repatriation of capital and profits are provided for in the Investment Law

World Bank’s Doing Business Index.

15	Taiwan, China	80.9	67	Colombia	70.1
16	United Arab Emirates	80.9	68	Oman	70.0
17	North Macedonia	80.7	69	Uzbekistan	69.9
18	Estonia	80.6	70	Vietnam	69.8
19	Latvia	80.3	71	Jamaica	69.7
20	Finland	80.2	72	Luxembourg	69.6
21	Thailand	80.1	73	Indonesia	69.6
22	Germany	79.7	74	Costa Rica	69.2
23	Canada	79.6	75	Jordan	69.0
24	Ireland	79.6	76	Peru	68.7
25	Kazakhstan	79.6	77	Qatar	68.7
26	Iceland	79.0	78	Tunisia	68.7
27	Austria	78.7	79	Greece	68.4
28	Russian Federation	78.2	80	Kyrgyz Republic	67.8
29	Japan	78.0	81	Mongolia	67.8
30	Spain	77.9	82	Albania	67.7
31	China	77.9	83	Kuwait	67.4

4. Source:<https://documents1.worldbank.org/curated/en/688761571934946384/pdf/Doing-Business-2020-Comparing-Business-Regulation-in-190-Economies.pdf>

Over the past five years, 22 free economic zones (before that there were only 3) and more than 400 small industrial zones have been established.

#### Opportunities in Industrial zones

According to the new Law of SEZ and the Tax code, investors in special economic zones of Uzbekistan may expect:

- Holidays for paying property taxes, land taxes and taxes for the use of water resources, VAT exemptions.

- Exemptions from paying customs payments for construction materials and technological equipment that cannot be sourced locally, raw materials, and components used to produce export-oriented output.

Benefits in the free economic zone are granted for a period from 3 to 10 years depending on the number of investments made

#### Challenges in Industrial zones

Including delays in launching the projects (648) as well as in approval of master plans of small industrial zones (96).

Similarly, 37 percent of industrial zone areas have been criticized for not being supplied with electricity, water, gas, roads, and sewerage.

#### World Bank's Doing Business Index.

No	Indicators	DB-2019	DB- 2020	changes
	Ranking	76	69	+7
1.	Starting a business	12	8	+4
2.	Dealing with construction permits	134	132	+2
3.	Getting electricity	35	36	-1
4.	Registering property	71	72	-1
5.	Getting credit	60	67	-7
6.	Protecting investors	64	37	+27
7.	Paying taxes	64	69	-5
8.	Trading across borders	165	152	+13
9.	Enforcing contracts	41	22	+19
10.	Resolving insolvency	91	100	-9

5. Source: Author's calculation based on the World Bank Doing Business Index Reports, 2019-2020

In 2020 Uzbekistan was among the world's top 20 reformers, rising from 76<sup>th</sup> to 69<sup>th</sup> place in the Doing Business Rating. Worth noting, that it is ranked 8<sup>th</sup> in Starting a Business and there were significant positive changes in indicators such as Protecting investors and Enforcing contracts in 2020 compared to 2019.

Moreover, despite positive changes, indicators in Construction permits and Trading across borders are unsatisfactory, (and in 2020 they hold 132 and 152

positions). According to the index of ease of doing business in 2020, our country is inferior to such trading partners as Russia, and Kazakhstan, not to mention developed countries. A comparison of indicators of post-Soviet countries with higher ratings – Georgia (7th place), Azerbaijan (34th place), and Kazakhstan (25th place) – demonstrates in which areas we are lagging.

However, such rankings do not necessarily reflect the overall investment climate as they don't capture some other aspects of doing business in the country.

### **Challenges in attracting both Foreign and Local Investments**

Entry restrictions remain unclear. The Investment Law and The Law on Denationalization and Privatization provide a list of areas and state assets of national security and strategic sectors with restrictions on foreign investment and privatization. (including land with mineral and water resources, the air basin, flora and fauna, cultural heritage sites and assets, state budget funds, foreign capital and gold reserves, the Central Bank, enterprises that facilitate monetary circulation, military, and security-related assets, and enterprises...)

An uneven level-playing field. Also, due to the prevalence of state-owned monopolies in several sectors, in reality, the right to establish business enterprises is still limited in some sectors. (in the transportation, banking, and energy)

Implementation and enforcement issues. The capacity of government agencies needs to catch up with the pace of reforms, while the constant flow of new regulations is overwhelming for officials. Some reforms are also getting lost in the long chain from the presidential decree to implementation. All of this makes forecasting hard for investors.

Differential treatment of investors. There are various examples of situations where domestic and foreign investors are treated differently. For instance, a business establishment is less expensive for domestic companies. At the same time, foreign investors benefit from an array of incentives from the Investment Law, the Tax Code, or investment contracts. These discrepancies may negatively affect the development of small and medium-sized enterprises (SMEs)

Lack of clarity on the investment promotion strategy. As reported by businesses and investors, some fundamental problems exist such as lack of transparency in public procurement, insufficient enforcement of intellectual property rights, and inconsistent compliance with official policy regulations and guidelines.

Lack of skilled workforce and local experts. As per the interviews conducted, it was noted that the scarcity of skilled labor force influences the effective management of investment projects in such investment industries as chemistry, energy, and engineering.



## RECOMMENDATIONS

As a result of the study, the recommendations have been made for eliminating the barriers that hinder the creation of a favorable investment climate.

In particular, the attention should be focused on developing an investment policy statement and ready-made platforms for doing business for investors, and improving transport and logistics infrastructure.

Development and launch of a permanent survey of investors' and potential investors' opinions on measures necessary to improve the investment climate in Uzbekistan.

Elaborate on an investment promotion strategy and related capacity-building activities. This involves ensuring regular meetings of foreign journalists with heads of state authorities, business, science, and culture to form an adequate, free from stereotypes perception of the country and its social-economic development abroad.

One of the prerequisites is an increase in the quality of labor resources in parallel with the increase in capital reserves.

Improvement of investment institutions, formation of the venture investment market, improvement of the system of insurance of investment and innovation risks

According to some scientists, participation of Uzbekistan in such indices as Genuine savings, and the Global Competitiveness Index allows investors to identify the country's ability to achieve sustainable economic growth, assess technology, government institutions, and macroeconomic status.

## CONCLUSION

In conclusion, I would like to note that the investment climate in Uzbekistan is certainly improving. The measures specified in the Presidential decrees are being implemented to simplify procedures ensuring transparency and accessibility of public services. As a result, the openness of the country is increasing, difficulties and problems are recognized, and concrete steps are being taken to overcome them. There is growing interest from foreign investors, including institutional investors. If the pace of reforms, including liberalization of the financial market, integration into world capital markets, and the creation of an effective system of property rights protection, continues, Uzbekistan may become a very attractive country for investment in the near future.

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