

## **FOREIGN DIRECT INVESTMENTS AS A FACTOR OF INCREASING COMPETITIVENESS OF THE ECONOMY**

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### **Abstract**

*The article analyzes the research on the impact of foreign direct investment on the country's economic growth. It is considered how foreign direct investments affect the competitiveness of the economy, the negative and positive consequences of attracting foreign investments. The analysis of attraction of foreign investments in the region of Eastern Europe and the CIS is carried out. The dynamics of attraction of direct foreign investments in the Republic of Uzbekistan, the state of the investment climate and investment attractiveness of the country are analyzed. At last, the directions of further improvement of the investment policy of Uzbekistan are indicated.*

*Keywords: Foreign direct investment, competitiveness, Uzbekistan, Eastern Europe, CIS countries, investment climate, investment policy, investment quality, policy improvement*

### **INTRODUCTION**

Foreign direct investment (FDI) has become a key source of growth in many countries with economies in transition. In this regard, one of the objectives of the investment policy of many developing countries and countries with economies in transition is to attract FDI in the country's economy.

It is assumed that FDI will positively affect the development of the economy, bring new technologies, open new markets and improve management and business practices. The main result achieved by the recipient countries is to cover a significant portion of the capital needed to make investments through capital inflows from abroad. Many countries do not have the ability to fully cover the need for financial resources only at their own expense, which leads to the use of foreign investment in national economies. Thus, in 2017, foreign investments and loans in the amount of \$3.2 billion were attracted to the economy of Uzbekistan, which is almost 15.3% of the total volume of capital investments.

In the world economic literature, a lot of work has been devoted to the study of the influence of foreign direct investment. For example, Solow (1957), in his theory of economic growth, relies on neoclassical production function, pointing out that not only capital and human resources, but also technological progress, have a great influence on economic growth.

Based on the work of Solow Findlay (1978) (Findlay, 1978), a model that reflects the positive impact of FDI on the economy of the country in which they are directed. The author showed that the inflow of FDI increases the level of technological progress and argued that the main reason for the positive impact of FDI is due to the fact that FDI is the channel through which new management practices and technologies are transferred to the country. Unlike Solow, who considered the technological progress of the exogenous variable, Blomstrom and Kokko (2003) based their work on the Romer endogenous growth model, (1986). Analyzing the incentives for attracting FDI, the authors concluded that the most important is not the growing role of foreign companies, but the overflow of technologies and skills that comes from them to domestic companies. However, according to the authors, the attraction of foreign capital should be accompanied by the stimulation of domestic investment and the educational process, since only in this case the enterprises will have motives for investing in new technologies, management methods and knowledge.

The topic of the general influence of FDI on the economic growth of the country is not new and has been widely studied at macro and micro levels. Some of those who studied this issue are Aitken and Harrison (1994). Considering the behavior of Venezuelan firms, they came to the conclusion that the enterprises in which foreign investments were invested are more productive than domestic ones, that an increase in the share of foreign capital leads to an increase in the efficiency of the economy.

However, the obtained results also showed that the productivity of domestic enterprises is reduced due to the growth of the productivity of joint ventures, i.e. Revealed the negative impact of FDI on the productivity of the industry. The same question was raised by Bitzer and

Gorg (2005). The authors tried to determine the direction of the effect of attracting investments in the country.

Analysis of data from 10 industries in 17 countries showed that attracted foreign capital improves the productivity of the economy. At the same time, the force of influence grows as the size of the country decreases. Borensztein and Lee (1998) in the process of studying the impact of FDI on economic growth, using the example of 69 countries, concluded that the direction of the effect of attracting FDI depends on the level of development of human capital in the country. In addition, it turned out that FDI increases the total amount of capital in the economy by stimulating domestic investment. Alexynska (2003) studied the same issue on the example of 18 countries with economies in transition. The results showed a stable positive relationship between the level of foreign investment and the productivity of the country's economy, and the fact that the direction of the effect of attracted investment depends on the level of development of human capital in the country.

In accordance with the World Investment Report 2001 (UNCTAD) (World Investment Report, 2001), theoretically, the strength and direction of the impact of FDI differs depending on the sector of the economy in which they were directed. The effect of inflows of FDI is different, All sectors of the economy have their own distinctive features and are associated with other sectors in their own way.

## **FDI INFLOWS BY SECTOR**

There are three main sectors of the economy: primary, secondary (industrial) and tertiary (service sector). The primary sector of the economy includes the production of raw materials and food: agriculture and forestry, fishing, mining, geological work, etc. Usually the process of production in this sector is very difficult to divide into parts and this requires great effort and capital. Investments involved in this sector are usually produced in large volumes, and foreign investors are more likely to regard them as inter-firm loans or money exports due to restrictions on foreign ownership of property. Therefore, the connection of this sector with the rest of the economy is weak enough. In addition, due to the fact that the amount of capital involved in the primary sector is very large, there is the possibility of developing the so-called Dutch disease.

Investments directed to the primary sector of the economy can cause earnings growth in this sector and therefore stimulate the flow of labor from other sectors of the economy. In turn, this can lead to de-industrialization and, as a result, other sectors of the economy and the secondary sector in particular will become less competitive. Consequently, the inflow of FDI into the primary sector of the economy does not contribute to the development of the economy of

the country to which they are directed, and the effect of such investments can have a negative impact on economic growth.

The secondary or industrial sector of the economy deals with the transformation of raw materials into the final product. Activities related to the secondary sector include metallurgy, automotive, chemical and petrochemical industries, light and food industries, and construction. Unlike the primary sector of the economy, the impact of FDI on the industrial sector is much more pronounced, as is the linkage of this sector with other activities in the economy. The secondary sector usually uses different types of products produced by other sectors as intermediates in its production process. In addition, foreign investors tend to invest their money in the various enterprises of the country in which they plan their activities, in order to profit, rather, from their functioning in the domestic market than from exports. In this regard, the achievement of this goal stimulates foreign investors to create new jobs, develop new technologies and management methods, conduct various trainings for employees, which as a result increases the overall competitiveness of the sector. Thus, the inflow of FDI into the secondary sector usually has a positive effect on increasing the competitiveness of the country's economy.

The tertiary sector of the economy or the services sector includes such sectors as transport and communications, information technology, healthcare, finance, restaurant business, education, etc. Foreign investors can improve the efficiency of this sector by attracting new knowledge, technologies and bringing the general level of development of the service sector closer to world standards by improving the quality of services provided and reducing costs. However, many industries in the services sector are quite capital-intensive, for example, telecommunications and the banking sector, and therefore are less competitive than the industrial sector. In this regard, there is a possibility that foreign competitors will oust domestic companies from the market. Therefore, in order to obtain a general positive effect of FDI inflows into the tertiary sector, properly functioning legislative and regulatory systems are very important, as well as a favorable situation prevailing in the market of services in the country attracting foreign capital.

Despite the huge role played by FDI in the modern world, there are also a number of negative consequences from attracting FDI. One of them is connected with the ability of foreign investors to use the difference in international pay. Due to the fact that foreign companies have the opportunity to pay higher salaries, they are trying to attract more qualified labor. Consequently, less skilled workers have to work in domestic enterprises with lower wages, which leads to inequality, and, ultimately, to social tension within the country. The second is that enterprises financed by foreign investors have the opportunity to control most of the market and

force domestic enterprises to withdraw from the market. Such actions adversely affect the level of competitiveness, therefore, FDI may not have an expected positive effect on the economy of the country in which they were directed (Lipsev and Sjöholm, 2004).

Thus, the impact of foreign investment affects the economic achievements of the recipient countries differently. In some cases, it may be more or less obvious. Sometimes even negative, depending on many factors, the most important of which are the policies pursued by the transnational company and the economic policies pursued by each of the countries receiving the investment.

### **FOREIGN DIRECT INVESTMENT IN COUNTRIES WITH ECONOMIES IN TRANSITION**

Attracting foreign direct investment, countries with economies in transition rely on capital inflows to finance the development of the economy. Indicators such as the percentage of FDI inflows in total investment in fixed assets (PSI) and the percentage of accumulated FDI in GDP can be used to measure the share of FDI. However, these indicators need to be compared with absolute indicators such as GDP, the amount of annual inflows and accumulated FDI to obtain a full picture of the importance of FDI as a source of development financing.

In general, in countries with economies in transition, FDI plays a greater role in the formation of fixed capital than developed and developing countries. Particularly significant is the share of accumulated FDI in GDP in the Eastern and South-Eastern Europe region, which is two to three times higher than the average in developed, developing countries, as well as in the CIS region. It should be noted that the spread of the values of indicators for individual countries with economies in transition is very high.

The percentage of accumulated FDI in GDP in Eastern and South-Eastern Europe is the highest (more than 50%), mainly in countries that have relatively high FDI per capita (Bulgaria, Estonia, Hungary, Czech Republic, Slovakia).

The analysis of FDI as a source of financing for the development of the economy in the CIS countries shows that in Russia, which is the leader in inflow of FDI in the region, foreign direct investment accounts for about 20% of total investments in fixed assets, and accumulated FDI is a quarter of GDP.

In other countries, there is an ambiguous situation. In FDI countries that are lagging behind FDI per capita, the share of FDI in total investment in fixed assets and in GDP can be very high (Georgia, Kyrgyzstan), medium (Moldova, Ukraine, Armenia, Uzbekistan), low (Azerbaijan, Tajikistan), which depends from the activity of domestic investors and the size of the country's GDP.

Considering the situation with attraction of direct foreign investments to the economy of Uzbekistan, it is worth noting that in the early 2000s. The inflow of FDI into the country was insignificant, and their accumulated volume by 2004 did not exceed 1 billion dollars. The share of FDI in the structure of investments in fixed assets barely reached 10%, and they did not have a significant impact on the process of structural transformation of the economy, development of industrial production and increase in the volume of foreign trade.

The accumulated volume of foreign investments in the economy of Uzbekistan at the end of 2011 exceeded \$ 6.7 billion. The increase in foreign investment indicated an improvement in the characteristics of the investment climate in Uzbekistan, as well as the increased confidence in the economy of Uzbekistan by investors in recent years. A slight decrease in the inflow of foreign investment to Uzbekistan in 2011 reflects the overall situation in the world economy.

Analysis of the investment climate and the dynamics of foreign investment in the economy of the Republic of Uzbekistan shows that over the past 5-6 years the country has made significant progress in forming a positive business and investment climate, in reforming the legislative and administrative system of the country, which is confirmed by high ratings from international rating agencies and a number of well-known international organizations. In the 2012 UNCTAD annual World Investment Report "Towards a New Generation of Investment Policies," the estimates of the Index of Attractiveness for FDI and the Index of Potential FDI indicate that Uzbekistan is a country with high attractiveness for FDI.

Foreign investments and credits in the total volume of disbursed investments amounted to 26.9% against 20.1 in 2015. The volume of direct foreign investments and credits amounted to 12395.2 billion UZS, an increase of 63.7% compared to the previous year.

Table 1 Dynamics of development of foreign investments and credits

<b>Indicators</b>	<b>Unit.</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>
Foreign investments and credits	<b>Billion. UZS</b>	8182,7	10829,2	16309,0
Share of foreign investment in total investment	<b>%</b>	20,1	21,9	26,9
Direct foreign investments	<b>Billion. UZS</b>	6273,1	7569,0	12395,2
Share of foreign direct investment in total investment	<b>%</b>	15,4	15,3	20,4
The share of foreign direct investment in total foreign investment	<b>%</b>	76,7	69,9	76,0

Source: State Committee on Statistics of the Republic of Uzbekistan

In January-December 2017, the total volume of investments in fixed assets in the national currency amounted to 60719.2 billion UZS, or 107.1 percent to the corresponding period of 2016. Investments in fixed assets in dollar terms amounted to \$ 16.3 billion. USA. The ratio of investment in fixed assets to GDP was 24.4 percent, which is 0.3 percentage points higher than the level of the same period last year. As a result of implemented measures to further create a favorable investment climate and increase investment attractiveness, the volume of disbursed foreign direct investment and loans increased by 63.7 percent to 12395,2 billion UZS.

The growth in the share of foreign direct investment contributes to an increase in the attraction of "long money" to the real economy and the reduction of "short money" - portfolio investment in the economy of our country. In recent years, the share of foreign direct investment is about 85% of foreign investment. This ultimately contributes to the growth of efficiency in the use of foreign investment.

The development of industry and, especially, the manufacturing industry occupies a special place in the modernization of the economy. Therefore, the structure of investment in industry should gradually change in favor of the manufacturing industry.

The share of foreign investments and loans to fixed assets in GDP in January-December 2017 amounted to 6.5% and increased, as compared with the previous year, by 1.2% points. The share of foreign investment and loans in fixed capital in GDP in 2016 was 5.3 percent.

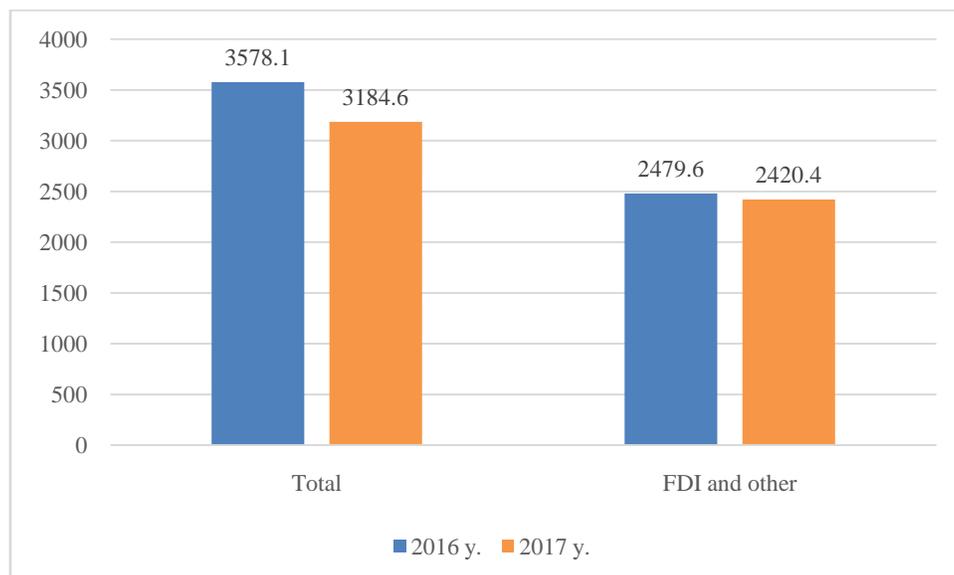


Figure 1 The development of foreign investment and loans (million USD)

Source: State Committee on Statistics of the Republic of Uzbekistan.

The total volume of utilized foreign investments and loans in dollar equivalent amounted to \$ 3,184.6 million, of which \$ 2,420.4 million are direct and other foreign investments and loans, or, compared to 2016, with an increase of 40, 7%.

As a result of measures taken to increase investment attractiveness, the volume of direct and other foreign investments and loans used in January-December 2017 increased by 33.2% of the item and amounted to 12,395.2 billion UZS, or 20.4% of the total investments.

The share of direct and other foreign investments and loans in fixed assets in GDP in January-December 2017 amounted to 5.0% and increased, as compared with the previous year, by 1.3% points.

Significant volumes of foreign investments and loans were disbursed in the following economic activities: crude oil and natural gas - 56.5% of total foreign investments and loans, and increased by 25.6% in terms of January-December 2016, respectively, information and communication - 9.5% (by 2.3% of the item).

At the same time, the volumes of the following economic activities decreased: transportation and storage - 9.0% (by 4.1% points), electricity, gas, steam and air conditioning supply - 2.4% (by 9.9% points) , chemical production - 1.9% (by 13.9% of the item).

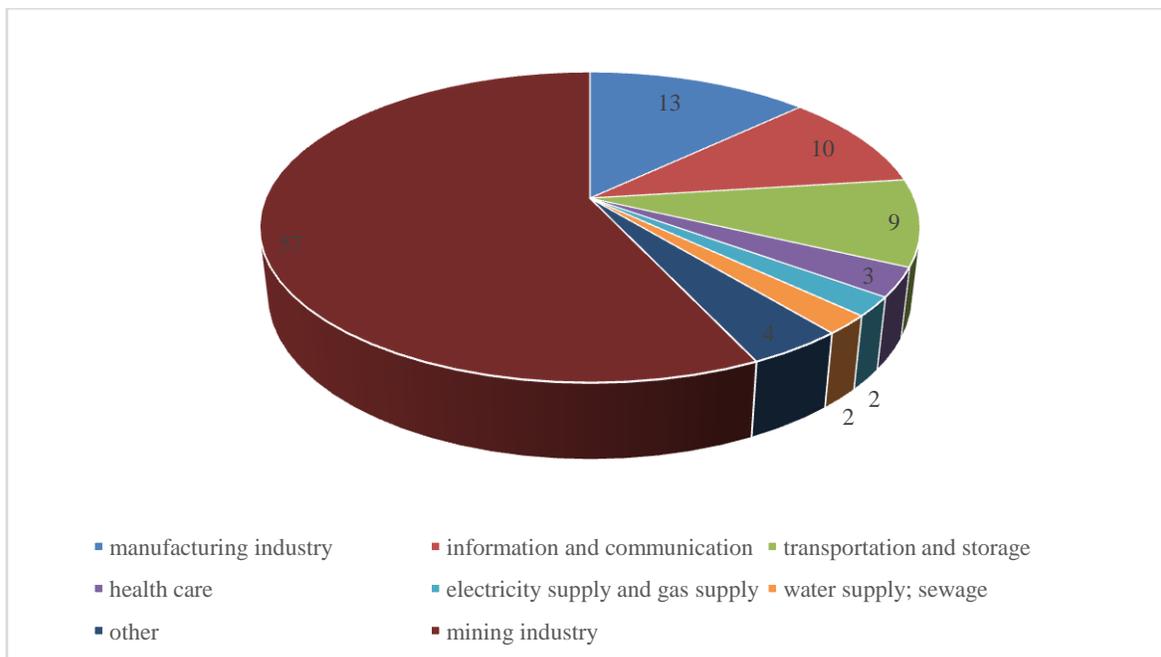


Figure 2 Use of foreign investments and loans in certain types of economic activity

Source: State Committee on Statistics of the Republic of Uzbekistan

In 2000, the volume of foreign direct investment and loans amounted to \$ 105.2 million, or 3.4 percent of the total investment in fixed assets; in 2005, \$ 422.6 million, or 14.9 percent, in 2010 \$ 2,454.7 million or 25.3 percent. The structure of foreign investments and loans in fixed capital for 2016 is characterized by the following data:

Table 2 Structure of foreign investments and loans in fixed capital for 2016

	billion soums	as a percentage of the total volume	
		under warranty government	Direct and other
<b>Total</b>	<b>10611,4</b>	<b>30,7</b>	<b>69,3</b>
including:			
state	1536,4	76,4	23,6
non-state	9075,0	23,0	77,0

Source: State Committee on Statistics of the Republic of Uzbekistan

The share of foreign direct investment and loans of the non-state sector of the economy in the total volume of foreign investment and loans in the Republic of Uzbekistan for 2016 amounted to 77.0 percent.

The strategy of encouraging the attraction of foreign investments should ensure the successful solution of the set tasks. In particular, an important place is the improvement of financial and credit, tax levers and incentives, as well as non-financial methods. The latter can be attributed market infrastructure, ensuring the normal functioning of foreign capital; providing the necessary factors of production information; banking services, various kinds of communications, management services, transportation, etc. Tax concessions and general conditions provided to foreign investors and FDI in the country are quite effective and create a generally favorable investment climate.

One of the components of the investment policy of Uzbekistan is a regional investment policy. In the conditions of liberalization of the economy, ensuring its sustainable growth, the role of the regional economy is growing, the development of which requires the development and implementation of an independent regional investment policy as an integral part of the regional socio-economic policy. Its essence and peculiarity lies in the fact that for the development of the national economy as a whole, first of all, it is necessary to achieve development not of individual regions, but of all regions and, if possible, achieve correct, rational, equal distribution of foreign investments in all regions.

## THE POLICY OF UZBEKISTAN IN ATTRACTING FDI

Assessing the position of Uzbekistan as a recipient country of foreign direct investment in the future, it can be concluded that with an abundance of natural resources, the country lacks sufficient infrastructure security and raises specific risks. As a result, investments in Uzbekistan are carried out mainly by the largest TNCs specializing in resource industries, as well as companies interested in the capacious domestic market of the Central Asian region. The economy of Uzbekistan has been developing dynamically over the past few years, it has a great potential for attracting foreign investments, especially direct investments, in the conditions of a deficit of domestic investments, enabling access to new technologies and increasing the competitiveness of products.

Along with the growth in inflow of foreign investments, the problem of the "quality" of investments arises, that is, attracting investments aimed at creating and developing new efficient production lines, redirecting investment flows from the extractive sector to the high-value-added industries and high-tech industries, and increasing the competitiveness of the national economy.

A necessary condition for strengthening the country's competitive position and expanding the flow of foreign direct investment is the diversification of the forms of attracting FDI and optimizing their use. The attraction of foreign investments to the economy of Uzbekistan with the aim of developing and modernizing the production and infrastructure sphere, technical and technological renewal of production, on the one hand, and with the necessary guarantees for investors, on the other, can be realized through mechanisms of public-private partnerships. Favorable for the economy of Uzbekistan, the conjuncture resulting from the prolonged price increase for the goods exported by the country during 2008-2016 contributed to the accumulation of significant capital, part of which was directed to the formation of the Fund for Reconstruction and Development of the Republic of Uzbekistan. The funds of the Fund for Reconstruction and Development of the Republic of Uzbekistan are directed, among other things, to the implementation of the largest infrastructure projects jointly by the state and foreign business.

To date, the Government of Uzbekistan has approved more than 34 projects with financial resources from the Fund for Reconstruction and Development of the Republic of Uzbekistan, having an important social and economic importance for various regions of the country, amounting to \$ 780 million, primarily those that are being built together with foreign Partners.

Public-private partnership, thus, allows the implementation of expensive projects with the involvement of private investors and without undue burden on the country's budget (Sinyakova, 2009).

A promising area for stimulating capital inflows is the removal of unnecessary restrictions on their activities in the economy of Uzbekistan. When implementing long-term investment policy, Uzbekistan relies more on fiscal, that is, Tax and customs privileges. However, attention should also be paid to increasing the information transparency about the opportunities and conditions for investing in regions and branches of the economy of Uzbekistan. At the moment, measures are already being taken in this direction. In particular, the Comprehensive Program was adopted, corresponding to the methodology developed by the World Bank and aimed at further liberalizing, simplifying, reducing the cost and ensuring transparency of all procedures related to doing business in the country.

## CONCLUSION

Uzbekistan faces a difficult task of attracting foreign investment to the country, while ensuring compliance with the requirements of foreign investors and directing the attracted capital to achieve national goals and ensure economic development. Foreign direct investment can serve as a mechanism to increase Uzbekistan's competitiveness in the global economy through the use of existing competitive advantages and the introduction of new ones. Increasing the role of regions in activating investment processes can be carried out in the following areas:

- development of regional investment legislation;
- support of investments from local authorities by providing incentives within the competence of the regions. This, in fact, is also part of the legislation, and, by the way, is often the most active;
- formation of investment openness and attractiveness of the regions, their investment image, including through the compilation of directories of enterprises, investment project directories, etc;
- carrying out active activities to attract foreign investment. It is characteristic that with the still small attractiveness of the country as a whole for foreign investors there are regions in which this index is comparable with the countries of Europe;
- formation of investment infrastructure.

Based on the assessment of the current level of stimulation of foreign investment and the objectives of the state investment policy, we define the most important tasks for further stimulating the attraction of foreign capital:

- develop the most favored nation treatment for foreign investment in combination with mechanisms of restraint and balances;

- improve the mechanism of legal support the inflow of foreign and domestic investment, taking into account the achievement of their equal conditions;
- provide relevant state guarantees and incentives to attract foreign investment in priority sectors and territories of the republic;
- develop an institutional structure that allows for the insurance of foreign capital;
- improve the organizational and economic mechanism for encouraging foreign investment;
- to improve the investment climate of the republic to attract foreign capital.

The strategy of encouraging the attraction of foreign investments should ensure the successful solution of the set tasks. In particular, the improvement of financial and credit, tax levers and incentives, as well as non-financial methods, is important. The latter can be attributed market infrastructure, ensuring the normal functioning of foreign capital; providing the necessary factors of production information; banking services, various kinds of communications, management services, transportation, etc.

An important condition for increasing the inflow of foreign direct investment is the implementation of a state policy aimed at creating stable conditions for the functioning of foreign investors in the national economy. Achieving this goal will contribute to enhancing the national competitiveness and more active integration of our country into the international economic system.

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