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FDI Scenario in Uzbekistan-Glancing at The First Decade after the Independence

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Uzbekistan－the most populated country in Central Asia－provides an interesting contrast in terms of the transition strategies and economic outcomes. Uzbekistan transitional policies have been much more conservative and in contrast with policies adopted by other transitional economies in its peer group ; preferring to transform its economy using its own form of gradualism and slow sequencing of reforms. In recent years foreign direct investment has become an important feature of the development of the world economy, and Uzbekistan too is coming to terms with these global challenges. This study aims at analyzing the foreign direct investment inflow to Uzbekistan ; the presence of incentives and obstacles for investors as well as government policy for investment attraction has been brought into focus. In the end some suggestions for the promotion of investment-friendly environment have been put forward.

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Key Words : Transitional Economies, Capital Flows, Market Economy, Economic Development, Central Asia, Uzbekistan

1. Introduction

The new field of "Economics of Transition" developed with the transition of former socialist economies to a market oriented economy. International capital flows to the transitional economies represent a relatively small, but growing share of capital flows to developing countries. According to the World Bank, taken all flows together, total net flows to these 25 countries were about $67 billion in 1999 or about 1/7 of aggregate net flows to all developing countries. These countries accounted, however, for about 20 and 22 percent respectively of all developing countries' Gross Domestic Product (GDP) and exports in 1999. As a fraction of their GDP, total inflows were consequently smaller than for many other developing countries, and averaged about 5.1 percent over the 1991-99 period ; representing a lower level of capital flows to these countries during a period when global capital flows were very buoyant.

Private capital flows to developing countries increased dramatically during the 1990s, especially foreign direct investment (FDI) and portfolio equity

investment. While flows to the transitional economies have also been growing fast—for example, portfolio and foreign direct investment flows increased from $1.4 billion in 1990 to $33.5 billion in 1999—between them they still only attract about 16 percent of total private capital flows to all developing countries in 1999. In 1999, FDI to transitional economies, for example, was only $19 billion, equivalent to the total amount received by Malaysia and Mexico in that year.[1)]

The distribution of FDI flows has also been highly uneven. The still relatively low level of, especially private capital flows, reflects the special nature of the economic development processes in these countries. Several factors are important. One of these factors is the fact that these states are all transition economies. This meant, for one that market reforms did not get underway until the end of the 1980s for most of transitional economies—with the notable exceptions of Hungary and Poland—and until 1991 or even later for the former Soviet Union (FSU). Another factor is nature and composition of the capital flows which influenced the transition process. In particular, early in the transition the capital flows were mainly fiscally driven and often from official sources. Annual net flows of official development finance—including official development assistance (grants and official concessional loans) and official non-concessional loans—represented about 40 percent of total net flows in 1990-99 and over 100 percent in 1990-91 (as private net flows were negative in those years).[2)] This reflected the sharp deterioration of fiscal revenues at the onset of the transition process and the lack of creditworthiness of some countries. Associated with this process were low private capital inflows, and, as mentioned, for some countries substantial amounts of capital flight also took place. The low level of private inflows was due to a variety of factors, including partial and incomplete reforms or an uncertain commitment to reform in most countries, high political and social costs of the transition process itself, as well as high levels of corruption and political instability (several countries in the FSU have been affected by civil wars). Many countries in transitional economies also lost financing and aid from the Soviet Union—they had received considerable aid, including through above market export prices and below market import (especially energy) prices, from the Soviet Union, but these flows essentially ceased in 1989—implying a larger financing need for their governments.

In more recent years, there has been a more rapid inflow of private capital, as reform efforts have consolidated and economic prospects improved and, for some countries of FSU such as Latvia, Lithuania and Estonia, as EU-integration became a possibility for the near future. For some countries, short-

1) World Bank, 1999.

2) IMF "Transition Report," 2000.

term capital has recently become an important source of foreign financing. Since most countries have been "late-comers" to the phenomenon of large private capital inflows they have not experienced much of the overheating phenomena which have affected other developing countries in the past (Latin America) and recently (East Asia). The main exceptions indeed were precisely some of the earlier and faster reformers like Hungary, Poland, Czech Republic and Estonia.[3)]

Transitional Economies are divided in two groups, according to the speed of their reforms and the approach which they took for the process of transition: "Shock therapy" and "Gradual" or "Step by Step" transition. The "Shock therapy" countries include Central and Eastern European (CEE)[4)] countries and some countries of FSU. These are countries, which tried to achieve the move toward a market economy simultaneously. This transition strategy is based on pure liberalism, free interplay of market forces and the elimination of all regulatory functions of the government with minimal interference of the state in economic management.

Another alternative was a steady and gradual transformation from the over-centralized administrative command system based on common national property to a mixed market economy by strengthening the state and the thorough implementation of a consistent and gradual strategy of transition. Fostering market relations, supporting private sector development and making maximum use of inherited human resources, as well as real economic and social infrastructures to develop and manage respectively a dual track economy under the transition process have become instrumental pillars of the state-led "Gradual" transition.

Regardless of their approach, the transition to a market economy is far from complete for most of the economies in the region. Distortions in factor markets are still prevalent and the institutional development in areas crucial to beneficial financial integration—particularly the legal system and financial sector—is still limited, especially in many of countries of the FSU. Deficiencies, which in other developing countries have been associated with subsequent problems, including poor resource allocation and financial crises, are thus still prevalent in many transition economies.[5)] By tackling these issues now, these countries could presumably stand to gain more of the benefits and less of the risks associated with more financial integration and large private capital flows.

The aim of this paper is to analyze the FDI inflow to one of the transi-

3) Murphy et al, 1992.

4) CEE countries include former socialist countries like Hungary, Chechoslavakia, Poland, etc.

5) Gelb et al, 1997.

tional countries—to Uzbekistan. Even though Uzbekistan has many advantages compared to other Central Asian countries, the inflow of the FDI was relatively low. I want to analyze the reasons for this relatively low investment flow and try to suggest the creation of an investment friendly environment in order to attract more foreign investors to the economy of Uzbekistan.

2. Focusing on Uzbekistan

Uzbekistan—the most populated country in Central Asia—provides an interesting contrast in terms of the transition strategies and economic outcomes. Uzbekistan has a much younger profile of the population, according to Table 1 with 60 percent of the population under the age of 16 and a more ethnically homogeneous population with 70 percent of the population of Uzbek ethnicity. Uzbekistan has been much more conservative, preferring to transform its economy using its own form of gradualism and slow sequencing of reforms. Uzbekistan is primarily a cotton producing economy with cotton contributing up to 60 percent of the agricultural output and 30 percent of export earnings. The production of cotton also means forward linkages in the economy in terms

Table 1. Uzbekistan-Multiple Indicators

Economic Indicators	
Share of Extractive Industry in Industrial Output	12%
Share of Manufacturing and Food in Industrial Output	70%
Proved Recoverable Oil Reserves (mil. Met tons)	41
Black Market Exchange Rate (% diff. over official)	10
GNP per Capita (US $ 2000)	2,740
GDP (billion US $)	23.7
GDP Growth Rate, 2000	3.4%
Exports (% of GDP)	29
Demographic Indicators	
Population (million)	25.1
Urban Population (% of total)	40.6
Share of Population under 16	60%
Population Growth Rate	2.5%
Percentage of Dominant Ethnic Group (2000)	70%
Social Indicators	
Infant Mortality per 1,000 Live Births (1981-90)	42.7
Poverty (%, headcount index)	24
Life Expectancy at Birth	68.1
Secondary School Enrolment Rate (%)	98

Source: Ministry of Macroeconomics and Statistics

of ginning, and textiles production. This, in combination with an agriculture-based food industry means that more than 50 percent of the industrial output is derived from manufacturing. While the structure of the economy may be associated with Uzbekistan's relatively lower income levels and higher poverty and mortality rates since it became independent, there is also evidence to suggest that the exceptional mildness of Uzbekistan's transitional recession and subsequent growth can, in part, be accounted for by its low degree of initial industrialization and its cotton production. One possible interpretation of this result is that Uzbekistan appears to have been effective at preventive the collapse of its relatively small industrial sector by combining rigid state control with subsidies that were in large part financed by cotton exports. Uzbekistan has a more diversified economy than other transitional neighboring states.

2.1 "Gradual" Transition

The transition from central command system to market economy in Uzbekistan is based on 5 principles. These principles are proclaimed by the President of the Republic of Uzbekistan.

1. Economy over politics
2. State is the main reformer
3. Supremacy of the law
4. Social protection of low income population
5. Gradual transition to market economy

Uzbekistan clearly adopted a more gradualist approach, based on the idea that the unfettered market may not be compatible with the Government's aims of socioeconomic development.[6] Thus, this line of thinking argued that the failures of transition lie in a misunderstanding of the foundations of a market economy-particularly in its informational requirements—as well as in a misunderstanding of the basics of an institutional reform process. Alternative arguments stress that it takes time to build a new world, adjustment costs can be high and politically and socially destabilizing, and that the pace of new job creation is likely to be slow.

In Uzbekistan, gradualism received official support primarily on grounds of national and historical factors including ethnic diversity, the younger age profile of the population, low living standards relative to the rest of the former Soviet Union, the need to maintain social cohesion and stability, and the deeply-entrenched public psychology of dependency on the state.[7] This implied that the state was given a principal role in the transition process not only as the developer and implementer of reforms—but also as the collective

6) Milanovic, 1998.
7) Gilman, 1981.

entrepreneur, production regulator, and investor in priority sectors. Many of these justifications, therefore, are linked to the earlier discussion of initial conditions. As a result, many of even the "first generation" policy reforms, such as price liberalization, trade and foreign exchange liberalization, and interest rate liberalization were slower to develop in Uzbekistan.

2.2 Policy for Economic Growth

Its own resource endowments of cotton and gold may have also played a key role in maintaining foreign exchange inflows and growth, but they mainly served as a launching pad for a wider array of manufacturing activities, whether this is sustainable or not is, of course, a different issue. Consequently, by 1999, Uzbekistan's GDP had recovered up to 96 percent of its 1991 level. In fact, over the five years 1995-99, Uzbekistan experienced a cumulative 10 percent real economic growth.[8] The quality of fiscal adjustment has been poor in most CIS countries, but Uzbekistan has had a much larger emphasis on social and physical investment, and has managed to avoid any large buildup of payments arrears.[9] Uzbekistan may have had larger overall fiscal contraction, but was that appropriate in terms of maintaining social welfare and enabling future growth? The data suggests that Uzbekistan may indeed have managed the fiscal adjustment better, notwithstanding the large unknown stocks of contingent liabilities. In Uzbekistan, there is no evidence to suggest a systemic buildup of budgetary arrears, though delays in wage and pension payments are reported. Public investments in Uzbekistan were 7 percent of GDP.[10] Investments in productive physical assets—roads, schools, and other infrastructure—have received special attention in the Uzbekistan government's public investment program, though there are some questionable investments in the industrial sector. Furthermore, in 1998 Uzbekistan invested 7.2 and 3.3 percent of GDP on education and health respectively.[11]

Table 2. GDP of Uzbekistan

	1993	1994	1995	1996	1997	1998	1999
GDP at Market Prices in mln. of Soums	5,113	64,878	302,787	559,072	976,826	1,358,781	1,942,109
GDP % Change Over Previous Year	−2.3	−5.2	−0.9	1.6	2.5	4.4	4.1

Source : Ministry of Macroeconomics and Statistics.

8) World Bank Country Report, 1999.
9) Ethier et al, 1995.
10) Ministry of Macroeconomics and Statistics, 2001.
11) World Bank, 1998.

Traditional ways of looking at external vulnerabilities—such as months-of-import coverage and external debt-to-GDP ratios—are misleading in the case of Uzbekistan. This is because imports in Uzbekistan are severely compressed through administrative means and therefore give an upward bias to the import coverage figures. Similarly, the foreign exchange is administratively set at a grossly over-valued rate. As a result, the GDP figure in US dollars is biased upwards and the ratio of external debt-to-GDP is biased downwards as the borrowings of Uzbekistan are in dollars. Liquidity indicators for 1999 were reasonable with debt-service to exports of 18% for Uzbekistan and foreign exchange reserves were adequate to provide coverage against short-term debt flows and debt-service.[12] However, the ratio of the debt-service to exports has been increasing, partly driven by new short and medium term borrowings.

Since there is shortage in hard currency reserves, for its economic development Government of Uzbekistan adopted "import substituting production" and "export oriented production" strategies. As a result of the production of import substituting products Uzbekistan has already become completely self-sufficient with regards to its oil and gas. Furthemore grain independence has been achieved.

With regards to the "export oriented production" strategy the government is encouraging the development of textile, mining, automobile and some other industries in order to increase supply of hard currency for its reserves. The priority given to this strategy also implies an increased trend towards the development of the processing of agricultural products in order to achieve exportation of not only raw cotton, but also of processed fruits and vegetables.

3. FDI in Uzbekistan

The inflow of FDI to the particular country depends on several conditions. One of these conditions is factor-price condition, which assumes presence of natural resources and cheap labor. The second condition is Kindleberger's condition, which means foreign investors should have monopolistic advantage against local industries and producers in the host country. The third one is Lenin's condition, which points out the possibilities of investment only in the presence of sufficient infrastructure and required quality and quality of labor. Even if wages would be cheaper than in other countries and foreign investors would have monopolistic advantage, investors never invest their capital without sufficient infrastructure and required quality and quantity of labor. The Southeast Asian countries could offer the required quality of labor and infra-

12) Transition Report, 1999.

13) Sasaki T, 1998.

structure as well as lower wage rates compared with Japan.[13] We can also include here the presence of social infrastructure in this condition. In fact these countries have offered favored Law conditions and built special investment areas. So, in fact, they did receive a bulk of FDI. In case of Uzbekistan, even though the availability of natural resources, a low wage rate and low market prices serve as an attracting instrument for FDI, the absence of a good infrastructure, laws concerning FDI owned operations and some other concerns make investors doubtful.

According to Table 3, in 1998, FDI per capita was $ 9, while cumulative FDI inflows over 1989-98 were $ 717 million in Uzbekistan. In relative terms, Uzbekistan saw more FDI flows into sectors with larger multipliers—automobiles, electronics, textiles, chemicals, mining, and agro processing. At the same time, this does not mean that despite their short-term economic gains, these foreign investments in Uzbekistan are viable over a more medium-to longer term horizon. Much of the foreign investment in Uzbekistan is directed by the Government into sectors that the Government feels are 'strategic' for the future and are consistent with its vision of an industrialized nation, but not necessarily with the country's comparative advantage. Uzbekistan-as part of its import-substitution industrialization strategy—has been more selective in opening sectors of its economy to foreign investors. Thus, widespread and rapid liberalization of the economy has not been a necessary driving force in its development strategy. A strategy of picking 'winners' entails high risks and is typically subject to large economic losses over time. Moreover, the distorted policy environment in Uzbekistan, particularly as it relates to the incentive bias against exports, is already undermining the profitability and growth prospects of these new industries. After good progress in the early years, in Uzbekistan, the process of foreign exchange liberalization was reversed in late 1996, when a system of multiple exchange rates was formally introduced. Growing restrictions on access to foreign exchange and smaller sales of foreign exchange by the Central Bank led to a growing parallel market premium over the official rate, which by end-1999 had reached a maximum of over 500 percent.[14] But the multiple exchange rate system in Uzbekistan introduced an insidious system of taxation and subsidization which severely distorts the prices faced by producers and consumers. Combined with soft budget constraints, the consequent fall in industrial output—which usually results from the restructuring of potentially viable and the liquidation of non-viable enterprises—has been much smaller in Uzbekistan.

14) Transition Report, 2000.

Table 3. FDI Flows to Uzbekistan

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Net FDI (Million US $)	9	48	73	89	90	167	226	201	231
GDP (Million US $)	1979.5	5104	5695.4	9179	12037	10840	10596	7453	na
Total Flows / GDP (%)	0.5	0.9	1.3	0.98	0.75	1.54	2.13	2.7	na

Source: Transition Report 2000.

3.1 Government Policies towards FDI

The Government of Uzbekistan has created favorable conditions for a very few showcase foreign investors, but the overall investment climate is poor. Uzbekistan has the potential to be a regional economic powerhouse, but, while the Government of Uzbekistan in principle seeks foreign investment, it has yet to create the necessary conditions to attract the investment it needs. The government actively courts foreign investment in productive capacity, and provides significant tax benefits to such undertakings, particularly if the production in question is for import substitution or for export. But severely restricted access to foreign exchange, cumbersome banking procedures, and other bureaucratic problems discourage investment. Moreover, the Government has not grasped the importance of predictability and transparency to foreign investors. It often unilaterally revises the conditions under which investments are made, leaving investors with little recourse. The government's tendency to legislate by decree further complicates the situation; the result is an internally incoherent and arbitrary structure, rather than the stable framework a foreign investor expects.

Larger companies usually address this problem by seeking a presidential or ministerial decree that lays out the privileges and responsibilities of all the parties, and provides exceptions to any problematic or unclear legal provisions. Such big investors like Daewoo Auto, British American Tobacco, Nestle and Coca-Cola receive special attention from the government and have access to limited exchange of their profit by official exchange rate. Obtaining such decrees, however, is an expensive, time-consuming and non-transparent process. Accordingly, smaller foreign companies must take the structure as it is; they often approach the problem by engaging in a joint venture with an Uzbek partner, often a state-controlled enterprise. It is easier to create a joint venture with state-controlled enterprise rather than a private one in terms of bureaucratic procedures.

Investors also seek to have their projects included in the government's National Priority Investment Program (NPIP), which was created in 1994 by the special decree of Cabinet of Ministers to channel the inflow of FDI to the specified economic sectors in order to produce domestically import substitut-

Table 4 . Foreign Direct Investment by Sectors of Economy

(in mln. of soums)

	1994	1995	1996	1997	1998	1999	2000	2001	2002
Industry :	**5831**	**40064**	**66985**	**87781**	**114253**	**175239**	**221472**	**478269**	**88232**
Energy	3023	15204	55124	66333	78552	91137	101333	316095	30378
Mettalurgy	1966	5470	7607	11009	10639	16641	19154	61513	8678
Chemical and oil	113	791	3142	7003	8262	55792	59029	48576	5048
Machine building	367	17648	5089	6930	11614	15396	30601	84221	14725
Light industry	441	2843	9224	6101	17214	12057	17503	70123	16332
Food industry	290	1551	6736	14068	13650	13169	18677	23352	3245
Transport	**1014**	**6164**	**26021**	**47695**	**67158**	**59990**	**108493**	**136762**	**30367**
Communication	**42**	**534**	**5265**	**10515**	**10674**	**9925**	**16183**	**24741**	**4900**
Agriculture	**1524**	**7455**	**10315**	**18408**	**23803**	**43921**	**42629**	**55120**	**17721**
Construction	**924**	**6373**	**10585**	**19150**	**23376**	**27063**	**34843**	**50683**	**13488**
Others	**4413**	**24838**	**37577**	**69372**	**131416**	**192287**	**296075**	**323033**	**97346**
All Foreign Investment	**13748**	**85428**	**156748**	**252921**	**370680**	**508425**	**719695**	**1068608**	**252054**

' Data is for the first quarter of the year.

"Including Services.

Source : Ministry of Macroeconomics and Statistics.

ing and export oriented products. The NPIP is renewed on an annual basis in order to support strategically important sectors of economy. Projects included in the program are generally granted preferential access to foreign exchange as well as additional tax benefits and a smoother dealings with bureaucratic system. Again, however, the process by which projects are included in the program is not transparent. Many of the projects on the list are public infrastructure project for which debt rather than private equity financing is sought.

The government tends to seek big-name strategic investors, especially in those fields it considers to be underdeveloped and that it wants to expand. The fields currently targeted are manufacturing, telecommunications, mineral extraction, oil and gas, textiles, apparel and food processing. The government is eager to attract foreign technology and aims to develop a manufacturing base for import substitution. Through joint ventures, Uzbekistan assembles Korean automobiles and American and German agricultural equipment, and manufactures cigarettes with a British partner. Joint ventures with Swiss and American firms are also active in the field of food processing and packaging. A number of manufacturing JVs, most prominently with the Korean firm Daewoo to produce consumer electronics and telecommunications equipment, which

started its operations in 1993 and was closed in 1998, however, due to the bankruptcy of DAEWOO Corporation in Korea as well as currency convertibility problems in Uzbekistan.

Table 5. Volume of Exports/Imports by Joint Ventures in the Republic of Uzbekistan

(in mln. of US $)

	1999	2000	% change
Exports	371.5	451.6	121.6
Imports	1027.8	760.5	74

Source: Ministry of Macroeconomics and Statistics.

Uzbekistan's outdated legal and regulatory framework is particularly noticeable in the mining and oil and gas sectors. Draft petroleum legislation to allow for Production Sharing Agreements has languished for over three years without being submitted to Parliament. As an interim measure to attract investment, the government enacted a decree in May 2000 that provides some tax breaks for investors in the sector, but does not address the basic legislative inadequacies. The current mining regime is a Soviet era law on subsoil; U.S. mining companies are advocating a concession law. One potentially significant benefit for foreign investors is the Ten-Year Guarantee, which claims to protect investors against adverse legislative or regulatory changes for the first ten years of their investment. In practice, however, attempts by foreign investors to apply this protection against adverse changes such as tax increases or changes in the foreign currency regime have proven fruitless.

The government is undertaking a privatization program, but in the current investment climate it has failed to attract serious foreign interest. An aggravating factor is the government's reluctance, in most cases, to grant foreign investors even the 51 percent of shares needed for day-to-day operational control, let alone the 76 percent required under Uzbekistan's corporate law for serious restructuring.[15] Under the government's program, which is supported by a World Bank loan, large companies are being developed for case-by-case privatization, while many smaller ones are being privatized through a series of auctions, during which shares are offered to a number of private investment funds (PIF). Foreigners are encouraged to purchase these shares, and a 1998 decree guarantees that shares held for at least one year may be converted back into foreign exchange; however, the lack of a secondary market has impeded trading in these shares.[16]

15) Law on International Investments, 1998.

16) Transition Report, 2000.

3.2 Shortfalls in FDI Attraction

While the government has justified exchange controls as a means of channeling Uzbekistan's foreign exchange reserves into investment in high priority sectors, even priority manufacturing companies report significant obstacles to their operations. Some investors have been forced to cease operations for months at a time because they lack the foreign exchange to import needed parts and raw materials. Others are unable to pay debts to foreign creditors, in at least one case even for capital equipment purchased for a government priority project. Even where conversion at the official rate is possible, the cumbersome application process makes it difficult to plan production schedules. Foreign exchange at the overvalued official rate has become scarcer each year since 1996 (understandably since the rate has become more and more overvalued).[17] A further disincentive to both investment and exports is the requirement that businesses earning foreign exchange must surrender a portion of it into soum (national currency) at the official exchange rate. This surrender requirement, raised in January 1999 to 50% from an already steep 30%, is the effective equivalent of a hefty tax on exports.[18] Furthermore, businesses report that the government has been assessing the surrender requirement on revenues as projected by the government, rather than on actual revenues, resulting in a significantly higher penalty. When implementing the surrender requirement the government said it was temporary, for one year, but nearly a year and half later the government still refuses lower or eliminate it. Some foreign investors have negotiated special decrees that exempt them from the surrender requirement.

3.3 Creating a Favorable Investment Climate

The Government's policy intended for the creation of favorable investment climate provides significant incentives and tax benefits. The financial and economic incentives system has the greatest impact on the overall investment climate. The system promoting foreign direct investment in the production sphere mainly concentrates on export-oriented industries, especially such industries as textile, mining and car production. In 1999, the highest foreign investment inflow took place in the energy (30 percent), transportation (13 percent) and agriculture (12 percent) sectors.[19] In the first half of 2000, foreign investment was actively courted in the petrochemical and transportation industries.[20] And over 54 percent of total foreign investment has been related to

17) In October of 1996 the exchange of national currency into hard currency was officially stopped for almost all companies, which forced most of businesses to close.

18) Tanzi and Tsibouris, 1999.

19) Ministry of Macroeconomics and Statistics, 2001.

20) Zettlemeyer, 1999.

those industries. Tashkent city and the Fergana region account for 40 and 26 percent respectively with the regards to total.[21)]

The government monitors the realization of large investment projects. It gives preferences to high technology production projects. As a result of its investment policy the following investment projects have been realized: construction and completion of Shurtan gas and chemical complex, organization of cellulose production at Ferghana furan compounds plant, expansion of Kizilkum phosphorite combine.[22)] In 2000, a number of joint ventures began their operations such as "Hobas-TAPO" with the production of non-metallic pipes with a capacity of 270 km per year, "Uzsmatana-Santehnika" with water counters production with the capacity of 750 thousand units per year, "Oltin Deri" on 45 thousand units of leather products in Andijan region, plant on production of 390 million units of medicines and 6.6 million ampoule infusion solutions per year and etc.[23)] In order to depress import productions, and to increase foreign exchange earnings, the government enacted the production localization program based on domestic raw produce in September 2000. "Addi-

Table 6. Distribution of FDI and Loans in Uzbekistan

(in mln of soums)

	1998	1999	2000	2001
Korakalpak Republic	2112	2862	2380	5480
Regions:				
Andijan	6980	1862	1659	15628
Bukhara	1171	2876	3290	3311
Jizzak	636	1412	5032	14898
Kashkadarya	844	35330	38952	81735
Navoi	1230	4773	9347	39737
Namangan	7280	1483	960	9030
Samarkand	7575	7153	5667	8216
Surkhandarya	357	1707	1370	923
Syrdarya	589	1953	3714	5116
Tashkent	5203	4642	18856	24769
Fergana	15327	11837	14342	46833
Khorezm	2368	3853	2477	9025
Tashkent city	25846	38887	62535	70883
Republic of Uzbekistan	**77518**	**120630**	**170581**	**335584**

Source: Ministry of Macroeconomics and Statistics.

21) Ministry of Economics and Statistics, 2001.

22) Ministry of Macroeconomics and Statistics, 2001.

23) Ministry of Macroeconomics and Statistics, 2002.

tional measures to attract foreign investment in joint ventures establishment," enacted on October 2000, has offered additional tax benefits for foreign investment companies that are set up in rural areas.

3.4 Public Investment Program

The Public Investment Program (PIP) listing the most important projects determines the government's investment policy. According to the PIP of 2001, the share of foreign investment and credits under the government guarantee in total investments is 28.5 percent, and 5.2 percent of them are foreign direct investment related. Domestic investment sources are as follows: corporate net incomes (22.1 percent), commercial banks credits (1.6 percent), budget resources (20.8 percent). Foreign credits account for 82.76 percent of total foreign investments; the remaining 17.24 percent accounts for foreign direct investment. Due to the increasing requirements for the preparation of feasibility studies, project documents and project finance sources, the number of investment projects in the PIP has decreased since 1999. In 1999, PIP consisted of 181, in 2000-91, and in 2001-75 projects.

In 2001, the greatest part of investment and credits has been achieved in fuel-energy and industrial complex. On the other hand, the PIP of the last years was socially oriented, so that in 2000, 7.1 percent of the total investments were achieved in area of social welfare, including education, health services, etc. In 2001 it reached 14.1 percent from total investments. Apart from the above-mentioned areas, great attention is paid to small and medium businesses. According to the PIP of 2001, credit lines for their development are over 10 percent of total credits.[24)]

Among the greatest investment projects, listed in the PIP 2001-the booster station construction at Shurtan gas condensate deposit site (106.0 mln. USD), the JV "Uzeksayd" accumulators' production (37.9 mln. USD), mining and processing the gold ores JV "Amantaytaw Goldfields" (33.7 mln. USD), the creation of JV "Kabul-Ferghana Co. ltd." based on Ferghana textiles combine (33.0 mln. USD), spinning production complex JV "Oqsaroy tuqimachi ltd." (28.7 mln. USD), the completion of spinning production construction JV "Chinoz tuqimachi ltd." (US $27.5 mln.).[25)] The summary list of investment proposals includes 115 investment projects with roughly estimated 5.9 billion US dollars of foreign investment. There are huge investment opportunities in the energy sector such as reconstruction and modernization projects of Tashkent, Navoi, Novo-Angren hydroelectric power stations; Mubarek and Tashkent heat power plants. Foreign investment is actively directed into the

24) Ministry of Macroeconomics and Statistics, 2002.

25) Ibid., 2002.

chemical industry. The projects of the Samarkand chemical plant reconstruction, Kungrad sodium plant construction, and Tubegatan potassium salt mining are planned to be realized with foreign investment. Under abovementioned and agriculture irrigation and reclamation development projects, technological equipment is supplied at the expense of foreign investment. Several projects of "Almalik Mining and Smelting Company" are to be realized with foreign equity participation.[26)]

Table 7 . Number of Joint Ventures by Regions

	1998	1999	2000	2001
Korakalpak Republic	12	15	18	24
Regions :				
Andijan	88	99	91	97
Bukhara	54	46	44	46
Jizzakh	34	46	41	34
Kashkadarya	46	51	44	51
Navoi	31	35	33	26
Namangan	73	74	66	77
Samarkand	144	141	137	121
Surkhandarya	47	52	42	43
Syrdarya	30	27	16	20
Tashkent	128	154	168	183
Fergana	78	75	60	68
Khorezm	36	35	34	34
Tashkent City	2477	2744	2760	2621
Republic of Uzbekistan	**3278**	**3594**	**3554**	**3445**

Source : Ministry of Macroeconomics and Statistics.

4. Concluding Remarks

The findings suggest that despite a much fractured economy and fragile political situation at the time of independence, Uzbekistan has been able to follow a policy that paved the way for economic stabilization ; though the economy is still far from being in satisfactory condition. The government's policy of gradual change has proved to be much in line with the needs of the country and this policy has been particularly helpful in averting and avoiding economic jolts and uncertainty. The gradualism approach provided gestation periods for the policies to be absorbed by the economy that is still shaping up and

26) Ministry of Macroeconomics and Statistics, 2002.

feedback from the implemented projects helped to redesign of certain policies in time. The progress on the FDI and foreign trade has been far less than commendable as strict foreign exchange regulations proved a bottleneck in encouraging foreign investment into the country. Again, the directional policy of the government in allowing foreign investment in certain priority areas also hampers the natural course of the investment and in my opinion has either slowed the pace of foreign capital inflow or diverted it to some other countries where it found more favorable conditions. These features are different from East Asian countries including China. These countries have also protected domestic industries and firms, while promoting exporting industries through admitting 100% foreign owned FDI concerning exports and establishing FDI-preferential districts. The Asian experience shows that a liberalized approach, but not *laissez fair* approach, as well as the current targeted investment allocation approach is more likely to result in better FDI flows in the country. Finally, gradualism needs to be coupled with instant actions and policy making in areas that are lagging behind due to misallocation in the past.

As for the factors which really matter to the attraction of FDI to the region, I must say that no other country in the region has as much potential as Uzbekistan has. Uzbekistan is rich in natural resources, some of which are already being extracted but most are still unexplored. Furthermore it has a relatively developed human capital base with a cheap wage rate. Since it has a very important geopolitical position in the region and a vast domestic market, Uzbekistan could be very progressive in attracting the FDI. Of course the current situation in Uzbekistan is not ideal for FDI inflow, as there is lack of sufficient infrastructure, as this is one of the preconditions for investors. Bureaucratic obstacles, as well, make foreigners reluctant to invest in the country. But the main obstacle for investors is still the dual exchange rate and limited exchange of national currency into hard currency. In order to be progressive in attracting FDI, the following additional steps are recommended to create an FDI friendly environment in the country.

First, the existence of the different exchange rates severely undermines the country's ability to utilize its growth potential. That is why the first task for the government of Uzbekistan should be to reform the exchange regime, in order to eliminate the multiple exchange regime and make the national currency fully convertible. Secondly, the scope of laws and decrees must be revised. Since they do not fully protect foreign investment or guarantee free exchange of income into hard currency. Thirdly, since no country can develop with only foreign aid and investment, incentives should be created for increased domestic savings, for the purpose of increasing domestic investments. Only with the help of domestic savings, a country can reach a high level of growth. A fourth

point is to build a market infrastructure, for a transitional country, like Uzbekistan is. With the poor market infrastructure and maintenance, attraction of foreign direct investment is very low. That is why building national roads, railroads, international airports also becomes a priority.

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