CHALLENGES AND OPPORTUNITIES FOR INCREASING FOREIGN DIRECT INVESTMENT IN CENTRAL ASIA: THE CASE OF ENERGY IN UZBEKISTAN

by

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Abstract

This research aims to identify the challenges and opportunities to increase Foreign Direct Investment (FDI) in the energy sector in Uzbekistan and to identify possible ways to improve the investment climate based upon a comparative analysis of the Central Asian region. The approach of this study is to create a synergy between the discipline of political science and business realities with a focus on policy recommendations. An underlying hypothesis is that the strong nationalization of the energy sector and the lack of an attractive business climate in Uzbekistan hinder FDI inflow; therefore, liberalization policies may stimulate the interest of foreign energy companies. The findings of this study suggest that the government of Uzbekistan should focus on FDI determinants such as business climate, trade openness, political stability, transparency, and infrastructure in order to improve overall investment environment and attract foreign capital.

Keywords: Central Asia; Uzbekistan; foreign direct investments; FDI determinants; energy policy

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List of Acronyms

ADB	Asian Development Bank
CIS	Commonwealth of Independent States
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IEA	International Energy Agency
IMF	International Monetary Fund
OECD	Organization of Economic Cooperation and Development
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax
WTO	World Trade Organization

Chapter 1. Introduction

1.1. Background

Having abundant resources such as oil, natural gas, minerals, growing intraregional and interregional links, and promising economic prospects, Central Asia emerges as a potentially attractive foreign investment destination. Uzbekistan is rich in natural resources, but not as abundant as Kazakhstan in oil and Turkmenistan in natural gas. Uzbekistan is energy-independent, self-sustaining and able to provide subsidies to domestic consumption and export energy resources. It has substantial gas reserves and is the third-largest natural gas producer in the region, behind Russia and Turkmenistan.[1] It has about 1.8 trillion cubic meters of proven natural gas reserves, 590 million barrels of oil reserves and about 2 billion tons of recoverable coal reserves.[2]

The energy sector accounts for around 7% of gross domestic product (GDP) and 25% of industrial output; energy exports (predominantly gas) account for 25% of total commodity exports.[3] The energy composition of Uzbekistan currently rests upon hydrocarbon consumption, mainly gas, which is nearly 97% of the country's energy balance, with the remaining 3% coming in the form of hydro, coal and charcoal.[4] Aging infrastructure and lack of investment have caused energy production to decline rapidly. The government is prioritizing ways to increase natural gas exports and draw foreign investments to the energy sector.

Table 1.1 Uzbekistan Energy Reserves

Resource	Proven reserves	Undiscovered resources (est.)
Natural gas	1,841 bcm	4,000 bcm
Oil	594 million bbl	5,700 million bbl
Coal	1.9 billion tons	5.7 billion tons

[1] Aripdjanov, U. (2017). *Energy 2018: Uzbekistan.* Retrieved from Global legal insights: https://www.globallegalinsights.com/practice-areas/energy-laws-and-regulations/uzbekistan
[2] Asian Development Bank. (n.d.). *Country Partnership Strategy: Uzbekistan 2012–2016.* Retrieved from https://www.adb.org/sites/default/files/linked-documents/cps-uzb-2012-2016-ssa-02.pdf
[3] Konchankyan, A., & et.al. (2013, June). *Uzbekistan: Energy/Power Sector Issues Note.* Retrieved from https://openknowledge.worldbank.org/bitstream/handle/10986/17596/ACS41460WP0Box0Issues0Note00PUBLIC0.pdf?sequence=1&isAllowed=y
[4] Aripdjanov, U. (2017). *Energy 2018: Uzbekistan.* Retrieved from Global legal insights: https://www.globallegalinsights.com/practice-areas/energy-laws-and-regulations/uzbekistan

Source: World Bank team estimate based on UNG website, Government of Uzbekistan portal, BP Energy Report 2011, Energy Information Agency and other public sources; Business Monitor International, Uzbekistan Oil & Gas Report, Q3 2012.[5]

Despite progress in attracting foreign investment to the country, there are still significant shortcomings in this area. *A comparative analysis of FDI inflows to the Commonwealth of Independent States (CIS) countries shows that Uzbekistan is significantly behind the rest of the commonwealth countries in relation to attracting foreign direct investment per capita.* What are the reasons for such low FDI inflow in Uzbekistan and how can this issue be addressed to improve investment climate? The data reveal that other countries in the region such as Kazakhstan and Turkmenistan have been more successful in attracting foreign direct investments over time. What lessons can we learn from the comparative study of FDI determinants in other countries that led to such outcomes?

The attraction of FDI to the energy sector is a meaningful discussion because it has always been the Uzbekistan government's top priority. The majority of published literature and reports by consulting companies, international organizations such as the World Bank, the International Energy Agency (IEA), and the Asian Development Bank (ADB) caution potential investors about political risks, poor economic institutions, and old infrastructure. There are a limited number of studies explicitly focused on Uzbekistan and specific policy options to attract FDI in the oil and gas industry from the perspective of Uzbekistan, which leads to the question of how well it fits into such pattern and why it has fallen behind its neighbors.

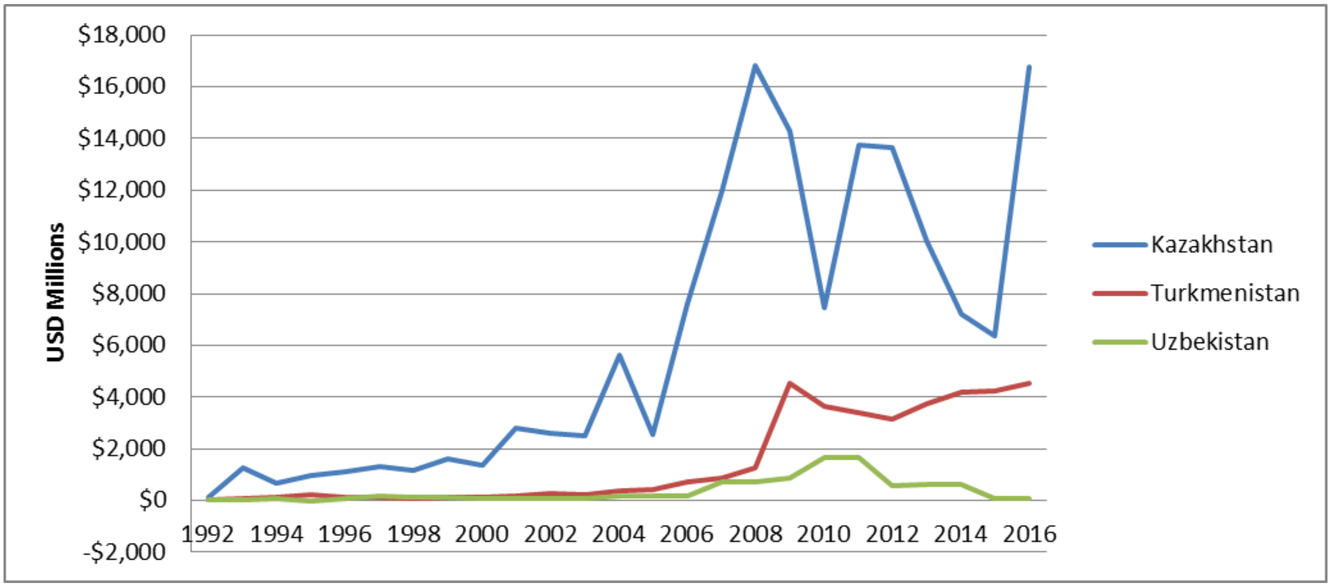
Table 1.2 Total FDI Inflow (2011-2014) (in USD millions)

	2011	2012	2013	2014
Turkmenistan	3,391	3,130	3,076	3,164
Uzbekistan	1,635	563	686	751
Kazakhstan	13,973	13,337	10,221	9,562

Source: UNCTAD database. Retrieved from http://unctad.org/sections/dite_dir/docs/wir2015/wir15_fs_uz_en.pdf

[5] Konchankyan, A., & et.al. (2013, June). *Uzbekistan: Energy/Power Sector Issues Note.* Retrieved from https://openknowledge.worldbank.org/bitstream/handle/10986/17596/ACS41460WP0Box0Issues0Note00PUBLIC0.pdf?sequence=1&isAllowed=y

Figure 1.1 Foreign Direct Investment Inflows in Central Asia (1992-2016)



Source: World Bank Database

This research project seeks to identify FDI determinants that hinder the inflow of foreign capital to the energy sector in Uzbekistan by conducting a comparative analysis of FDI determinants in resource-rich neighboring countries –- Kazakhstan and Turkmenistan. The central research question of this study is the following: **What are the key factors that determine the inflow of FDI to the energy sector in Uzbekistan?** This research question includes the following sub-questions: 1) What are the most influential determinants that impact foreign direct investment inflow in the energy sector in the developing country? 2) Why is Uzbekistan underperforming in some FDI determinants? 3) What policy recommendations could be implemented to improve investment climate?

Ultimately, the study seeks to generalize the findings of this research project to the larger population of the developing countries in the Central Asian region, which are working towards more effective policies to increase FDI in the energy sector. M. Busse and C. Hefeker point out that while economic FDI determinants are focal points discussed in scholarly literature, political institutions and policies received limited attention.[6] Due to its recent history of independence from the Soviet Union, the Central Asian region presents a unique opportunity to analyze FDI factors in the regional

[6] Busse, M., & Hefeker, C. (2007). Political Risk, Institutions and Foreign Direct Investment. *European Journal of Political Economy, Vol. 23, Issue 2*, 397-415.

context. The study explores this issue in the context of Uzbekistan and its energy sector, by understanding the influence of policies and liberalization practices on FDI inflow, by contributing to both academic works of literature as well as to the government, by providing recommendations on investment climate improvement.

After gaining independence in 1991, Uzbekistan has made substantial progress in the transition from a centrally-planned economy to a market economy. Following disintegration of the Soviet Union, Uzbekistan has suffered a decline in real GDP. Similar to many countries in Central Asia, Uzbekistan had to find its way to rebuild and manage its economy after gaining its independence. According to a United Nations Conference on Trade and Development (UNCTAD) report, the government has managed economic reforms gradually to reduce or delay the economic decline in relation to some other countries.[7] At the same time, recognizing that foreign direct investment can contribute to Uzbekistan's growth and development, and also ease the country's transition to a market-based economy, the country has started to draft policies to welcome foreign direct investors.[8]

In geographical terms, Uzbekistan is a landlocked country, which shares its borders with all Central Asian countries -- Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Afghanistan. With a territory of 447,400 km^2 and a population of 29.98 million people, it is the most populous country in Central Asia, presenting a potentially large consumer market. Tashkent is the capital with the population of 222,700 people. Uzbekistan is the only Central Asian country that has borders with all other regional republics, but it does not have access to seaports, which makes it difficult to facilitate international trade and export by sea routes. Therefore, its geopolitical location presents both opportunities, with its largest consumer market in Central Asia, and challenges –- with its geographical location and infrastructure.

[7] UNCTAD. (1999). *Investment Policy Review of Uzbekistan*. Retrieved from http://unctad.org/en/Docs/poiteiipm13.en.pdf
[8] Ibid.

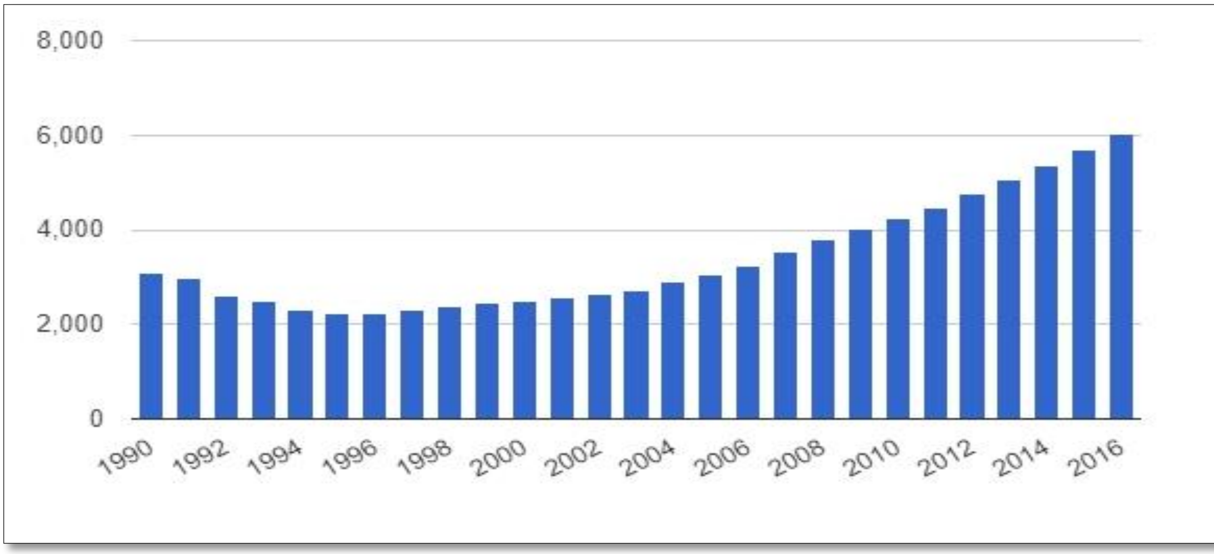
Figure 1.2 Geo-Political Map of Uzbekistan

Source: Retrieved from http://www.nationsonline.org/oneworld/map/uzbekistan-political-map.htm

Uzbekistan's economy has grown rapidly over the past decade and has raised living standards for the significant parts of the population. For instance, increased exports of gas, gold, and copper, combined with high commodity prices, have generated revenues that have financed substantial increases in investment and salaries to bolster consumption. Commodity export volumes, however, will likely decrease. As a result, Uzbekistan will need to find new drivers of economic growth in the future as foreign direct investment is an essential factor in economic growth.[9]

[9] World Bank. (2017). *The World Bank in Uzbekistan: Country Snapshot.* Retrieved from worldbank.org: http://pubdocs.worldbank.org/en/421341493272766409/Uzbekistan-Snapshot-April-2017.pdf

Figure 1.3 Uzbekistan GDP per capita, PPP in USD



Source: Retrieved from http://www.theglobaleconomy.com

Uzbekistan has completed a political transition, with both a new president and a new government in place since January 2017. On December 4, 2016, a presidential election was held in Uzbekistan, following the death of the former President, Islam Karimov. He was the head of the Uzbekistan government for twenty five years from 1991 to 2016. The Prime Minister of Uzbekistan from 2003 to 2016, Shavkat Mirziyoyev, won re-election with 88.6% of the votes.[10]

The government is the principal stakeholder in the energy sector in Uzbekistan.[11] Two key companies govern the energy sector in Uzbekistan: Uzbekenergo and Uzbekneftegaz. The Ministry of Energy and Electrification transformed into Uzbekenergo as a joint stock company, after public sector reorganization in August 2001.[12] Uzbekenergo, a publicly-owned monopoly –- in charge of electricity generation, transmission, and distribution –- operates under the supervision and regulation of the Cabinet of Ministers.[13] Uzbekneftegaz has also been designated as the

[10] Ibid.
[11] Asian Development Bank. (n.d.). *Country Partnership Strategy: Uzbekistan 2012–2016*. Retrieved from https://www.adb.org/sites/default/files/linked-documents/cps-uzb-2012-2016-ssa-02.pdf
[12] Ibid.
[13] Ibid.

"Competent Body" to regulate the oil and gas industry. Foreign investors might consider such a dual role as both a producer and regulator as well as a conflict of interest. [14]

Historically, Russian energy companies have dominated the energy market in Uzbekistan, but only in its upstream energy sector. Recently, more foreign investors from China are interested in Uzbekistan's natural resources, particularly its natural gas. According to Chinese Foreign Minister Wang Yi, China's investments are now matching that of Russia's, highlighting Beijing's growing influence as a regional economic powerhouse.[15]

To summarize, Uzbekistan has both opportunities and challenges in the energy sector. The significant advantages of Uzbekistan are in its natural resources, low labour costs, large population, and potential consumer market. In addition, another advantage includes the government's intentions to move towards adopting new reforms as a means to attract foreign direct investments and improve the economy. The challenges, however, are also complicated and hinder many foreign companies from entering the energy market. These economic hurdles include bureaucracy, poor infrastructure, and inadequate regulation of the foreign currency exchange rates. It is impossible to overcome those difficulties in just a few years, but the present government appears to be laying a foundation by analyzing legislative reforms to improve the investment climate in the energy sector, which is crucial for long-term economic growth.

1.2. Literature Review

Many theories attempt to explain the rationale behind FDI with different authors using various classifications of FDI theories. One of the most referenced authors working on FDI is John Dunning, who classified three main FDI categories based on the motivation behind FDI. The first type is *market-seeking,* which aims to serve local markets. The second type is a *resource-seeking* FDI category in which firms invest in a host country to obtain natural resources, raw materials or low-cost labour. The third type of FDI is *efficiency-seeking* in which a firm decides to invest to increase its margins due to the economies of scale or other factors in geographically dispersed

[14] Barry, M. P. (2009). Foreign Direct Investments in Central Asian Energy: A CGE Model. *Eurasian Journal of Business and Economics 2009 Vol. 2, No. 3*, 35-54. Retrieved from http://www.ejbe.org/EJBE2009Vol02No03p35BARRY.pdf

[15] The Straits Times. (2016, May 25). *China catches up with Russia as major investor in Uzbekistan.* Retrieved from http://www.straitstimes.com/business/china-catches-up-with-russia-as-major-investor-in-uzbekistan

investments.[16] Uzbekistan has the potential to meet all the motivations behind FDI. For *market-seeking* investors, Uzbekistan has the largest consumer market in Central Asia with almost 30 million people. For *resource-seeking* investors, Uzbekistan has 1.8 trillion cubic meters of proven natural gas reserves, 590 million barrels of oil reserves, and about 2 billion tons of recoverable coal reserves.[17] For *efficiency-seeking* investors, Uzbekistan's labour cost is low which can contribute to profit margins. Despite those factors, FDI inflows in Uzbekistan are not as high as in the neighbouring resource rich countries.

This study applies the framework adopted by the World Investment Report in 1998 in which UNCTAD studied the determinants that impact FDI inflow to host countries and classified them into the three groups: economic factors, political factors, and business facilitation factors.[18] Due to the absence of a generally accepted theoretical framework, researchers use empirical evidence for their studies on FDI determinants. The table below categorizes the FDI determinants based on those three categories measured by sub-categories for each FDI determinant.

Table 1.3 FDI Determinants Classification

Economic determinants	Political determinants	Business determinants
Market size	Political risk	Infrastructure
Openness	Corruption	Resources
Labour cost	Taxes	Business climate

Source: adapted from Demirhan and Masca, 2008 and UNCTAD, 1998[19]

Economic Determinants

FDI inflows in Central Asian countries, among them Uzbekistan, are influenced by the governance of the recipient country and the economic liberalization.[20] Moreover, economic factors such as market size, openness, and labour cost have an impact on the decision of firms regarding

[16] Demirhan, E., & Masca, M. (2008). Determinants of Foreign Direct Investment Flows to Developing Countries: A Cross Sectional Analysis. *Prague Economic Papers, 2008, vol. 2008, issue 4*, 356-369.
[17] Asian Development Bank. (n.d.). *Country Partnership Strategy: Uzbekistan 2012–2016*. Retrieved from https://www.adb.org/sites/default/files/linked-documents/cps-uzb-2012-2016-ssa-02.pdf
[18] UNCTAD. (1998). *World Investment Report 1998, Trends and Determinants.* Retrieved from http://unctad.org: http://unctad.org/en/Docs/wir1998_en.pdf
[19] Demirhan, E., & Masca, M. (2008). Determinants of Foreign Direct Investment Flows to Developing Countries: A Cross Sectional Analysis. *Prague Economic Papers, 2008, vol. 2008, issue 4*, 356-369
[20] Metaxas, T., & Kechagia, P. (2016). FDI in Central Asia: The case of Uzbekistan. *Applied Econometrics and International Development Vol. 16-1*. Retrieved from https://mpra.ub.uni-muenchen.de/71326/1/MPRA_paper_71326.pdf

long-term investment in the energy sector. According to Charkrabarti, the larger the local market size, the higher the possibility that FDI will grow and expand.[21] For manufacturing industries, low labour cost is a factor that is essential in the financial calculations of the future profitability. The literature suggests that there is a negative relationship between wage rate and FDI inflow. Economic growth is not considered to be a direct cause for increased FDI inflow; however stable economic growth is a positive factor for long-term investments.

Political Determinants

For economies in transition, factors such as political stability, corruption, and taxation policies are significant for long-term investment. Generally, political stability is a decisive factor for FDI; however, primary resource-driven FDI can take place in the developing regions with weak political institutions. Often foreign firms are ready to take risks for the future possible high returns on investment. According to Globerman and Shapiro, institutional quality and legal environment are some of the most critical factors that influence FDI inflow into the country.[22] Foreign firms usually prefer lower tax rates because lower taxes help maximize profitability margins. Often governments can offer special incentives to the foreign firms depending on the scale of the investment projects. Therefore, in transitional economies such as Central Asian countries, a stable political situation, combined with operational institutions and attractive tax policies, is an important factor that impacts the inflow of foreign direct investments.

Business FDI Determinants

Aside from the political and economic determinants, there are also business facilitation determinants that foreign energy companies are looking for, which are vital in their decision making. These factors include the level of energy-relevant infrastructures such as roads, gas pipelines, railroads, the availability of natural resources, and an environment conducive to business operations in the host country. The presence of natural resources, particularly in the developing country, will likely stimulate resource-driven FDI. Infrastructure can have both positive and negative effects on FDI. For energy firms, poor infrastructure can be an obstacle for the business development and production logistics. On the other hand, it can also present an opportunity for other firms to invest in

[21] Charkrabarti, A. (2001). The Determinants of Foreign Direct Investment: Sensitivity Analyses of Cross-Country Regressions. *Kyklos 54 (1)*, 89-114.
[22] Globerman, S., & Shapiro, D. (2002). Global Foreign Direct Investment Flows: The Role of Governance Infrastructure. *World Development. Vol. 30, Issue 11*, 1899–1919.

the infrastructure. Other determinants of FDI in the oil and gas industry include local and foreign competitors, operation costs, resource and reserves management, and the availability of skilled labor. However, Brock proposes that the infrastructure and the educational levels of the workforce in the recipient country do not influence the amount of the received foreign capital significantly.[23] Lankes and Venables argue that "low-risk companies operating in the host country enhance the attractiveness as they correlate positively with the FDI inflows."[24] In short, having many foreign firms that are already operating in the host country could prompt new foreign investors to take certain risks in the energy sector.

Filling the gap and contribution

The literature addressing the energy sector in Uzbekistan acknowledges the abundance of natural resources, stable economic growth, low labour costs, and a possible opportunity for foreign firms in the Uzbekistan energy market. However, similar to many transition economies there are specific challenges that hinder FDI inflow in the energy sector. In fact, it is evident that foreign firms consider government policies, the presence or absence of healthy competition, and the nationalization practices as some of the crucial factors in their decision making. This study incorporates these variables in my hypothesis as some of the influential factors for the FDI inflow in Uzbekistan and compares these variables with the surrounding regional countries such as Kazakhstan and Turkmenistan. The selection of regional countries for comparison is based on the availability of oil and gas energy resources. Other Central Asian countries such as Kyrgyzstan and Tajikistan do not possess similarly abundant conventional energy resources; therefore, these countries are excluded from this study. Also, I acknowledge the existence of other possible variables such as culture, geopolitical location, and other variables that might impact or influence the FDI in the energy sector in Uzbekistan.

I look to fill in the gap in the reports by consulting companies and international organizations that mostly represent the perspective of foreign investors and caution them about political risks, poor economic institutions, and a strong presence of Russian companies in Uzbekistan. I find that there is a lack of research prepared for Uzbekistan's government that outlines the advantages and disadvantages of adapting FDI policies to increase FDI inflow in the oil and gas industry. As a

[23] Brock, G. (1998). Foreign direct investment in Russia's regions 1993-95. Why so little and where has it gone? *Economics of Transition, 6 (2)*, 349-360.
[24] Lankes, H., & Venables, A. J. (1996). Foreign direct investment in economic transition: the changing patterns of investments. *Economics of Transition, 4 (2)*, 331-347.

result, my research aims to provide a meaningful contribution to the academic literature, to the government of Uzbekistan, and to foreign investors interested in exploring the energy market in Central Asia.

1.3. Research Methodology

I approach the research question by collecting data from both unobtrusive data sources and semi-structured interviews followed by the qualitative analysis of the collected data. First, the analysis of unobtrusive data such as FDI related international rankings, regulations, and statistical data; reports from the World Bank, the IEA, the ADB, and academic literature provide an insight from various angles to address the research question. Second, I have conducted two extensive semi-structured interviews which provide a valuable insight to cross-check the importance of FDI determinants. The table below depicts examples of the data sources used in this study.

Table 1.4 Examples of Data Sources

Unobtrusive Data		**Semi-structured Interviews**
✓ Legislative laws and regulations	✓ UN, World Bank, IEA reports	✓ Energy experts from academic and government sectors ✓ Questions about: - Major challenges for foreign investors - Decision-making FDI determinants - Significant FDI policy reforms in Uzbekistan
✓ Statistical database of FDI inflow historical records	✓ Consulting and business companies reports and analysis	
✓ Media coverage, newspaper articles	✓ Locally published reports on energy	

Source: Author

A review and analysis of the data related to FDI determinants helps to explain investment conditions in the three countries and to approach policy suggestions to attract FDI to the energy sector in Uzbekistan. I analyze FDI determinants such as the macroeconomic situation (measured by market size, population, and liberalization); political environment (measured by political risk, taxation policies, and levels of corruption); and energy business facilitation determinants (measured by infrastructure, availability of natural resources, and cost of doing business). Subsequently, I use the method of difference and compare the FDI climate in Kazakhstan (the most liberal economy in the region), Turkmenistan (fully nationalized economy), and Uzbekistan (nationalized economy in transition to liberalize its practices).

Furthermore, I examine secondary sources such as reports from independent organizations, international rankings, newspapers, consulting agencies, and local institutions to cross check the results from subjective interpretations of the primary data such as interviews. The semi-structured interviews conducted via email and in person add in-depth insights into specific FDI aspects concerning challenges and opportunities for foreign investors in Uzbekistan and provide an additional perspective to address the research question.

Sample

To analyze unobtrusive data from both primary and secondary sources, I use a purposive sampling where I select the samples with the particular purpose. In other words, I use the method of difference and compare the data on FDI determinants regarding foreign direct investments of Uzbekistan, Turkmenistan, and Kazakhstan. I look at the strengths and weaknesses of the existing investment climate in Uzbekistan with similar counterparts in Kazakhstan and Turkmenistan by using measurements from the FDI framework. I use statistical data from the World Bank and the UN to gain a broader understanding of the international ranking perception of Central Asian countries as a potential investment destination. I derive more in-depth insights from interviews with subject matter experts. Selection criteria are based on choosing participants available in Canada via email and in person. I also guaranteed full anonymity to all participants during the interview.

1.4. Limitations of the Study

Some limitations are notable to mention. The first limitation is the number of cases chosen. The study focuses on Uzbekistan with the comparative analysis of Kazakhstan and Turkmenistan due to their similarities in historical development after the collapse of the Soviet Union in 1991 and the endowment of conventional energy resources. I do not include other Central Asian republics such as Kyrgyzstan and Tajikistan due to the lack of similar conventional energy resources in their geographic locations. Another limitation is the number of variables chosen to assess and evaluate FDI determinants in the country. I am fully aware of other potentially missing variables that could hinder FDI inflow; however, in the absence of a definitive FDI framework, I use the UN version with other sub-categories. In fact, there is a lack of previous studies conducted on Central Asian investment climate due to these countries' relatively recent history as independent republics and the lack of reliable statistical data. Therefore, the majority of sources used in this comparative study are from international data sources and interviews.

1.5. Structure

The structure of this research project starts with an overview of the macro investment climate and comparative regional study based on a FDI determinants framework from the literature review. Chapter 2 focuses on the comparative analysis of three countries in Central Asia: Uzbekistan, Kazakhstan, and Turkmenistan. I analyze and compare FDI determinants outlined in the literature review (economic, political, and business determinants) to evaluate the investment climate in these three countries and to identify underperforming FDI determinants in Uzbekistan.

Chapter 3 focuses on Uzbekistan and discusses the investment climate in specific details. Based on the literature review and the FDI determinants analysis from the previous chapter, this section applies the FDI framework to analyze and evaluate underperforming FDI issues in Uzbekistan and the underlying reasons behind such patterns. Thus, this section discusses major causes that hinder FDI inflow into the energy sector.

Chapter 4 outlines the findings and lessons learned from this study and provides recommendations based on the analyzed data to improve the investment climate in Uzbekistan. The chapter concludes with a summary of significant findings and factors necessary to support the investment climate in Uzbekistan and Central Asia.

Chapter 2. FDI in Central Asia: A Comparative Study

2.1. Overview

After the fall of the former Soviet Union in 1991, all Central Asian Republics adopted different practices to improve the economies and attract foreign direct investments to their energy sectors. Of the three republics, Kazakhstan has been the most successful in attracting foreign interest, but all three countries faced significant challenges in the development of oil and gas infrastructure.[25]

Turkmenistan and Uzbekistan have abundant natural gas reserves. According to the U.S. Department of Energy, a lack of sufficient foreign investment, geographical challenges, inadequate export pipeline infrastructure, and political instability have been deterrents of both countries becoming major energy exporters.[26] Kazakhstan is more of a success story regarding foreign investment. After years of foreign investment into the country's oil and natural gas sectors, and with sufficient export options, Kazakhstan has become a significant world energy producer and exporter. As Dr. Michael P. Barry, Professor of Economics and Law at Mount Saint Mary's University, states, the nation is still in great need of investment. The lack of available gas export infrastructure limits export growth."[27]

Opportunities and Challenges for Foreign Investors in Uzbekistan

Uzbekistan's population is approximately 30 million, which is the largest population in the region. As such, Uzbekistan can become one of the largest economies in Central Asia. Its economy, however, is currently only 1/4th the size of Kazakhstan.[28] Even though the government attempted to attract foreign capital, foreign direct investment remained low compared to its neighbour. To address such low levels of foreign direct investment, the government has created several special investment zones and other incentives, including tax holidays and customs waivers. Its aim is to draw investment, but its focus is on specific strategic industry sectors, where

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[25] Barry, M. P. (2009). Foreign Direct Investments in Central Asian Energy: A CGE Model. *Eurasian Journal of Business and Economics 2009 Vol. 2, No. 3*, 35-54. Retrieved from http://www.ejbe.org/EJBE2009Vol02No03p35BARRY.pdf
[26] Ibid.
[27] Ibid.
[28] U.S. Department of State. (2015). *Uzbekistan Investment Climate Statement.* Retrieved from www.state.gov: https://www.state.gov/documents/organization/242000.pdf

government and state-owned enterprises exert a substantial influence. As a result, this strategy limits the interest of investors.[29]

Some of the highest operational concerns facing foreign and private investors include: access to currency conversion, frustrating bureaucratic processes, and an overregulated banking sector.[30] These are some of the key challenges that the government needs to consider in order to improve its investment climate.

Opportunities and Challenges of Foreign Investors in Kazakhstan

Kazakhstan has managed to attract significant foreign investment since its independence. In 2016, foreign direct investment in Kazakhstan totaled $139.6 billion, primarily in the oil and gas sector.[31] Kazakhstan is perceived to have the best investment climate in the Central Asian region compared to Uzbekistan and Turkmenistan.

Overall, Kazakhstan's government has incrementally improved the business climate for foreign investors, and national legislation does not discriminate against foreign investors. Corruption and excessive bureaucracy, however, remain serious obstacles that hinder the inflow of foreign investment into Kazakhstan's economy.[32] Kazakhstan announced in 2011 its desire to join the Organization of Economic Cooperation and Development (OECD). To become a member of OECD, the government of Kazakhstan will need to amend its investment legislation. In brief, the OECD review recommended corporate governance reforms at state-owned enterprises, an increase in private participation in infrastructure, easier access to agricultural land for foreign investors, and better financing support for small and medium enterprises.[33]

Opportunities and Challenges of Foreign Investors in Turkmenistan

Turkmenistan regularly declares its desire to attract more foreign investment. However, many challenges remain. Tight government control of the economy, a lack of transparency, and a

[29] Ibid.
[30] Ibid.
[31] U.S. Embassies abroad. (2017, September 20). *Kazakhstan - 1-Openness to and Restriction on Foreign Investment.* Retrieved from https://www.export.gov: https://www.export.gov/article?id=Kazakhstan-Openness-to-and-Restriction-on-Foreign-Investment
[32] Ibid.
[33] Ibid.

restrictive visa regime have created a problematic foreign investment climate.[34] Historically, as in other Central Asian countries, the most promising areas for investment are in the energy sector such as oil and gas, agricultural, and construction sectors. The challenge, however, was the inability of growing number of foreign companies to convert local manat into hard currency and had to leave the market.[35] Currency convertibility is also a problem in Uzbekistan and one of the main challenges for foreign investors in Central Asia.

While Turkmenistan has the fourth largest natural gas reserves in the world, it ranked only eleventh in natural gas production in 2015. As in other Central Asian countries, energy industries are state-owned. Even though the government has declared that it works towards increasing the private sector's participation in the local economy to 70% by 2020, there are currently no independent estimates or statistics available to verify the official data.[36]

2.2. Macro-Analysis: Business Climate FDI Determinants

Foreign investors should feel comfortable to invest in a foreign territory and know that their investment is sufficiently protected against non-commercial risks. One such condition for attracting foreign investments is the creation of a favourable business environment in the host country. I measure business climate determinants for energy sector using such variables as the availability of natural resources, infrastructure, and indicators of ease of doing business.

Availability of Natural Resources

According to recent studies, natural resources attract foreign capital in agricultural and manufacturing industries.[37] Uzbekistan has received foreign capital inflows mostly in the energy industry. Table 2.1 describes petrochemical resources (oil and gas) in three countries: Uzbekistan, Kazakhstan, and Turkmenistan. Kazakhstan has far more oil reserves compared to its neighbors, whereas Turkmenistan leads with the natural gas reserves in the region. Uzbekistan is the second after Turkmenistan in natural gas exports and self-sustaining with zero imports. As seen in Table

[34] U.S. Embassies abroad. (2017, October 25). *Turkmenistan - 1-Openness to & Restriction on Foreign Investment.* Retrieved from www.export.gov: https://www.export.gov/article?id=Turkmenistan-openness-to-foreign-investment
[35] Ibid.
[36] Ibid.
[37] Doytch, N., & Eren, M. (2012). Institutional Determinants of Sectoral FDI in Eastern European and Central Asian Countries: The Role of Investment Climate and Democracy. *Emerging Markets Finance and Trade, Vol. 8, Issue sup 4*, 14-32.

2.1, Uzbekistan does not lead the region in petrochemical reserves or in export volume, thus it is essential for Uzbekistan to attract foreign investors using other factors.

Table 2.1 Natural Resources (Oil and Gas) Comparison

	Oil				***Natural Gas***			
	Reserves	***Production***	***Import***	***Export***	***Reserves***	***Production***	***Import***	***Export***
Uzbekistan	594 million bbl	52,910 bbl/day	380 bbl/day	27,000 bbl/day	1.841 trillion m^3	55.7 billion m^3	0 m^3	14.7 billion m^3
Kazakhstan	30 billion bbl	1.595 million bbl	145,800 bbl/day	1.292 million bbl/day	2.407 trillion m^3	21.38 billion m^3	4.7 billion m^3	13.7 billion m^3
Turkmenistan	600 million bbl	230,800 bbl/day	0 bbl/day	62,880 bbl/day	7.504 trillion m^3	83.7 billion m^3	0 m^3	40.3 billion m^3

Source: adapted and retrieved from https://www.indexmundi.com/factbook/compare/kazakhstan.uzbekistan; https://www.indexmundi.com/factbook/compare/turkmenistan.uzbekistan

Business Environment

Business environment, economic freedom, and ease of doing business are vital for foreign investors to conduct successful business practices in a host country. The World Bank identifies Uzbekistan as one of the top 10 countries with the most improved economies in 2016/2017 which implemented numerous regulatory reforms to facilitate business ventures.[38] In 2018, *Doing Business* reports Uzbekistan ranked 74th, which is a significant ranking improvement from 59th in 2015 in only a few years.[39] These improvements indicate the new government's approach to implement reforms and positive changes that are aimed to improve the business climate and to attract foreign direct investment. Table 2.2 demonstrates business climate indicators for three countries: Uzbekistan, Kazakhstan, and Turkmenistan. Kazakhstan is leading the region in having the most favorable business climate rankings.

[38] World Bank. (2018). *Doing Business 2018.* Retrieved from http://www.doingbusiness.org: http://www.doingbusiness.org/reports/global-reports/doing-business-2018

[39] Ibid.

Table 2.2 Business Environment Indicators Comparison

	Economic Freedom			Ease of Doing Business		
	2013	*2014*	*2015*	*2013*	*2014*	*2015*
Uzbekistan	46	47	47	46.4	48.5	59.2
Kazakhstan	63	63.7	63.3	62.6	63.3	68.8
Turkmenistan	42.6	42.2	41.4	N/A	N/A	N/A

Note: Economic and Business Freedom index (A scale of 0 to 100, 100 is free.)

Source: The Heritage Foundation, 2016, retrieved from http://communities.lawsociety.org.uk/international/regions/cis/2017-investment-outlook-for-central-asia/5061017.fullarticle

Infrastructure

Foreign investors in the energy industry have industry-specific determinants that could impact the investment inflow to the country. For instance, the availability of robust infrastructure is a significant factor which can impact the return on the investments. Therefore, if the government can ensure stable and operating infrastructure, it can positively impact foreign capital inflow in export-driven industries such as the energy sector. Table 2.3 compares infrastructure conditions in all three countries and demonstrates that Kazakhstan has the most extensive railway and road network, and the second place in the existing pipelines which predominantly carry oil. Uzbekistan is leading the region with an extensive pipeline network, which is used mostly for natural gas. Turkmenistan has the least developed infrastructure in the region.

Table 2.3 Infrastructure Indicators Comparison

Infrastructure			
	Railways	*Roadways*	*Pipelines*

Kazakhstan	14,184 km	97,418 km (total) 87,140 km (paved)	12,432 km (gas) 11,313 km (oil)
Uzbekistan	4,304 km	86,496 km (total) 75,511 km (paved)	13,700 km (gas) 944 km (oil)
Turkmenistan	2,980 km	58,592 km (total) 47,577 km (paved)	7,500 km (gas) 1,501 km (oil)

Source: retrieved from https://www.indexmundi.com/factbook/compare/turkmenistan.uzbekistan and https://www.indexmundi.com/factbook/compare/kazakhstan.uzbekistan

From the analysis of three elements comprising business FDI determinants -- the availability of natural resources, business environment, and infrastructure –- the following conclusions can be emphasized. It is apparent that Uzbekistan is not the most abundant country in oil or gas resources compared to Kazakhstan and Turkmenistan. The areas where Uzbekistan lags in comparison to its neighboring countries lie in infrastructure and business environment, two sectors in which Kazakhstan surpasses Uzbekistan. Foreign investors evaluate all factors before making their decision to commit a significant amount of capital. While the government cannot change the state of natural resources, it can certainly impact business policies and improve available infrastructure.

Table 2.4 Business FDI Determinants Comparative Ranking

	Natural Resources	***Business Climate***	***Infrastructure***
Uzbekistan	3	2	2
Kazakhstan	1,2	1	1
Turkmenistan	1,2	3	3

Source: Author
Note: Evaluation index (A scale of 1 to 3, 1 is the best performing indicator)

2.3. Meso-Analysis: Economy FDI Determinants

FDI inflows have been considered favourably by an increasing number of countries that have multiplied financial and fiscal policies to attract multinational enterprises on their land. They are generally seen as a source of job creation and technological transfers bringing higher productivity in the host economy.[40] There is a lack of consensus within the existing literature on the effect of economic determinants on FDI, with the exception of market size. Measured by GDP or GDP per capita, market size seems to be the most robust economic FDI determinant.[41] Labour cost is also found to be positively related to FDI.[42]

Charkrabarti argues that the market-size hypothesis supports an idea that a large market is required for the efficient utilization of resources, and FDI will start to increase as the market size grows.[43] In addition, there is mixed evidence concerning the significance of openness, measured by the ratio of exports plus imports to GDP, in determining FDI. The maintained hypothesis is: given that many investors consider energy products as export commodities, the degree of a country's openness to international trade is a significant factor in their decision.[44]

Market Size

The market size of the recipient country is considered to be the most important determinant of economic FDI.[45] Market size is usually measured by GDP per capita. Therefore, the expectation is that the countries with a large market size should expect a higher FDI inflow. Another important factor for developing economies, which could be more important than *market size,* is *market growth potential*.[46]

A famous Washington hostess of the 1950s used to tell a young girl "you either have to be pretty, or I suggest you learn to speak French." The same is true for the host countries. "Being

[40] Artige, L., & Nicolini, R. (2006). *Evidence on the Determinants of Foreign Direct Investment.The Case of Three European Regions .* Retrieved from CREPP Working Paper: http://www.crepp.ulg.ac.be/papers/crepp-wp200607.pdf
[41] Ibid.
[42] Ibid.
[43] Charkrabarti, A. (2001). The Determinants of Foreign Direct Investment: Sensitivity Analyses of Cross-Country Regressions. *Kyklos 54 (1)*, 89-114.
[44] Ibid.
[45] Azam, M. (2010). Economic Determinants of Foreign Direct Investment in Armenia, Kyrgyz Republic, and Turkmenistan: Theory and Evidence. *Eurasian Journal of Business and Economics, Vol. 3, Issue 6*, 27-40.
[46] Hornberger, K., & et.al. (2010). *Attracting FDI: How Much Does Investment Climate Matter?* Retrieved from siteresources.worldbank.org: http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/327-Attracting-FDI.pd

pretty" means: being perceived by investors as having inherent attractions such as a large and expanding market. Investors will overlook the most primary requirements in order to be present in such countries. But if you don't happen to be "pretty,"-- that is, if your market is small and unlikely to expand very rapidly and your country doesn't possess inherent attractions-- then, the only way you can attract private capital may be by "learning to speak French," that is: making yourself attractive.[47]

The table below demonstrates the correlation between the market size, measured by GDP per capita, and FDI inflow ranking in Central Asian countries. Kazakhstan leads in both GDP per capita and FDI inflow, followed by Turkmenistan and Uzbekistan. Uzbekistan, however, has the highest GDP growth rate and presents an excellent investment opportunity, which promises potential high returns on investments.

Market size, measured by GDP per capita, is an essential factor to attract FDI inflows to the country. However, it is not the only factor that impacts foreign investors' decision making. If the country does not have the most attractive market in terms of GDP per capita, it should "learn how to speak French," in other words, make itself attractive in other areas to foreign investors. Such areas include political environment, business climate, and tax policies, to name a few, which will be addressed in the following sections.

Labour

Another vital element of economic FDI determinants is labour availability. I measure this variable by the population size, labor force availability, and literacy rate. Population size plays a significant role in a country's purchasing capacity and determines the scale of the internal market. Labour force and literacy rates measure available population for local hiring. Table 2.5 demonstrates that Uzbekistan is the most populated country in Central Asia with the largest potential consumer market, labour force, and the highest literacy rate.

Table 2.5 Economic Determinants – Market Size and Labor Force

	Labour			***Market Size***	
	Population	***Labour***	***Literacy***	***GDP***	***GDP***

[47] Guy, P. (1996). Low-Income Countries: Prospects for Increasing Capital Inflows Focus on FDI. *IMF/WB Conference on External FInance for Low-Income Countries.* Washington, D. C.

		force		***(Growth rate)***	***(Per capita)***
Uzbekistan	29,748,859	18.12 million	100%	7.3% (2017) 6.9% (2016) 8% (2015)	$7,000(2017) $6,700 (2016) $6,300 (2015)
Kazakhstan	18,556,698	9.147 million	99.8%	1% (2017) 0.1% (2016) 1.2% (2015)	$26,100 (2017) $25,600 (2016) $25,700 (2015)
Turkmenistan	5,351,277	2.305 million	99.7%	5.5% (2017) 5.5% (2016) 6.5% (2015)	$18,700 (2017) $17,800 (2016) $17,000 (2015)

Source: retrieved from https://www.indexmundi.com/factbook/compare/turkmenistan.uzbekistan; https://www.indexmundi.com/factbook/compare/kazakhstan.uzbekistan; http://communities.lawsociety.org.uk/international/regions/cis/2017-investment-outlook-for-central-asia/5061017.fullarticle

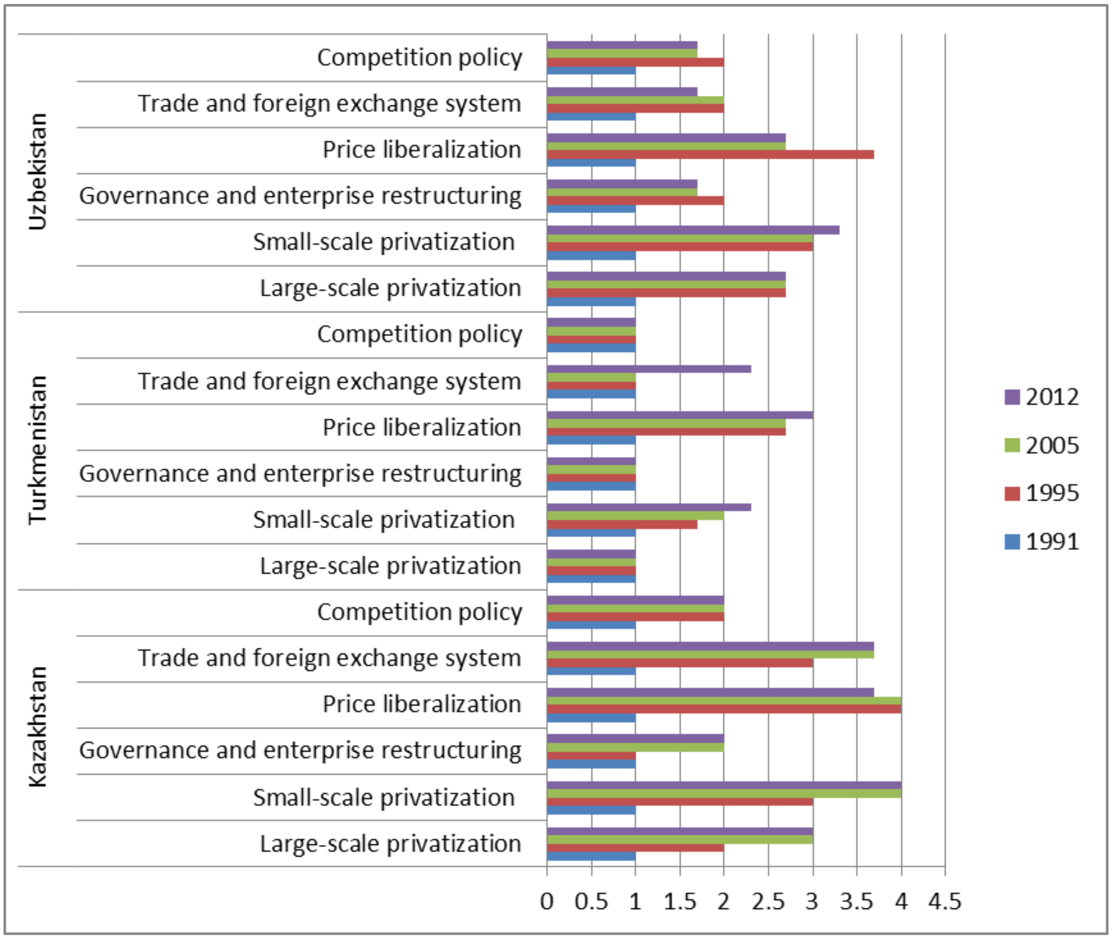
Openness

Chakrabarti states that the level of openness and liberalization is one of the determinants that impact FDI inflow. If the country pursues attracting export-driven foreign investments, factors such as liberalization, privatization, and open trade policies are important to consider. With the recent globalization of the world economy, the growth of the economy is difficult if it is not connected to the world economy through openness and trade.[48]

The following figure compares Kazakhstan, Uzbekistan, and Turkmenistan in competition policy, trade and foreign exchange systems, price liberalization, governance and enterprise restructuring, and small and large-scale privatization. In 1991, all countries started at the same position following the collapse of the Soviet Union with the ranking one on the scale. Over the years, Kazakhstan has achieved the highest rankings in the trade and foreign exchange system, price liberalization, and small-scale privatization categories with ranking four which symbolizes standards of an industrialized market economy. Kazakhstan's FDI inflow is the highest in Central Asia, which correlates to the level of openness to FDI.

[48] Petrovic-Randelovic, M. (2017). Market size as a determinant of the foreign direct investment inflows in the Western Balkan countries. *Economics and Organization, Vol. 14, No. 2*, pp. 93-104.

Figure 2.1 Liberalization/Openness Indicators



Source: EBRD Transition Indicators retrieved from http://www.ebrd.com/pages/research/economics/data/macro.shtml; https://www.adb.org/sites/default/files/publication/159307/adbi-connecting-central-asia-economic-centers-final-report.pdf

Note: The indicators range from 1 (no change from a centrally planned economy) to 4+ (standards of an industrialized market economy.

The analysis using economic FDI determinants of the essential factors that foreign firms consider in their decision-making process is crucial to understanding the variables that impact FDI inflow. I have measured economic determinants using indicators such as market size, labor force, and openness. Following the data and analysis above, it is apparent that Uzbekistan has strong sides in its highest economic growth among three countries, the largest population and available labour force with the highest literacy rate which can translate as a potential local hiring pool as well as an internal consumer market. On the weak side, Uzbekistan is behind Kazakhstan in openness and liberalization policies, which export-driven investors also consider important in this globalized economy. The table below summarizes Uzbekistan positioning regarding the economic FDI determinants.

Table 2.6 Economic FDI Determinants Comparative Ranking

	Market Size (GDP growth)	**Labour Force**	**Openness**
Uzbekistan	1	1	2
Kazakhstan	3	2	1
Turkmenistan	2	3	3

Source: Author
Note: Evaluation index (A scale of 1 to 3, 1 is the best performing indicator)

2.4. Micro-Analysis: Political FDI Determinants

As Globerman and Shapiro argue, institutional quality and legal environment are essential factors that attract FDI inflow to the country.[49] Demirhan and Masca on the other hand, claim that the ranking of political risk among FDI determinants remains somewhat unclear because high returns in the extractive industries could compensate for political instability.[50] Nevertheless, it is difficult to deny that foreign direct investments are expecting long-term results, which means that the decision about investing is a process that considers future perspectives and political environment of the country. The political situation is closely related to the economic situation and subsequently can affect long-term investment projects. The next section compares Uzbekistan, Kazakhstan, and Turkmenistan using political FDI measurements such as political stability, corruption perception, and taxation policies.

Political stability

Political stability, as a factor impacting investment inflow, is considered an ambiguous one. Some studies support the idea that political instability hurts economic growth and investors' decision making, whereas other studies suggest that it does not have a significant effect. For example,

[49] Globerman, S., & Shapiro, D. (2002). Global Foreign Direct Investment Flows: The Role of Governance Infrastructure. *World Development. Vol. 30, Issue 11*, 1899–1919.
[50] Demirhan, E., & Masca, M. (2008). Determinants of Foreign Direct Investment Flows to Developing Countries: A Cross Sectional Analysis. *Prague Economic Papers, 2008, vol. 2008, issue 4*, 356-369.

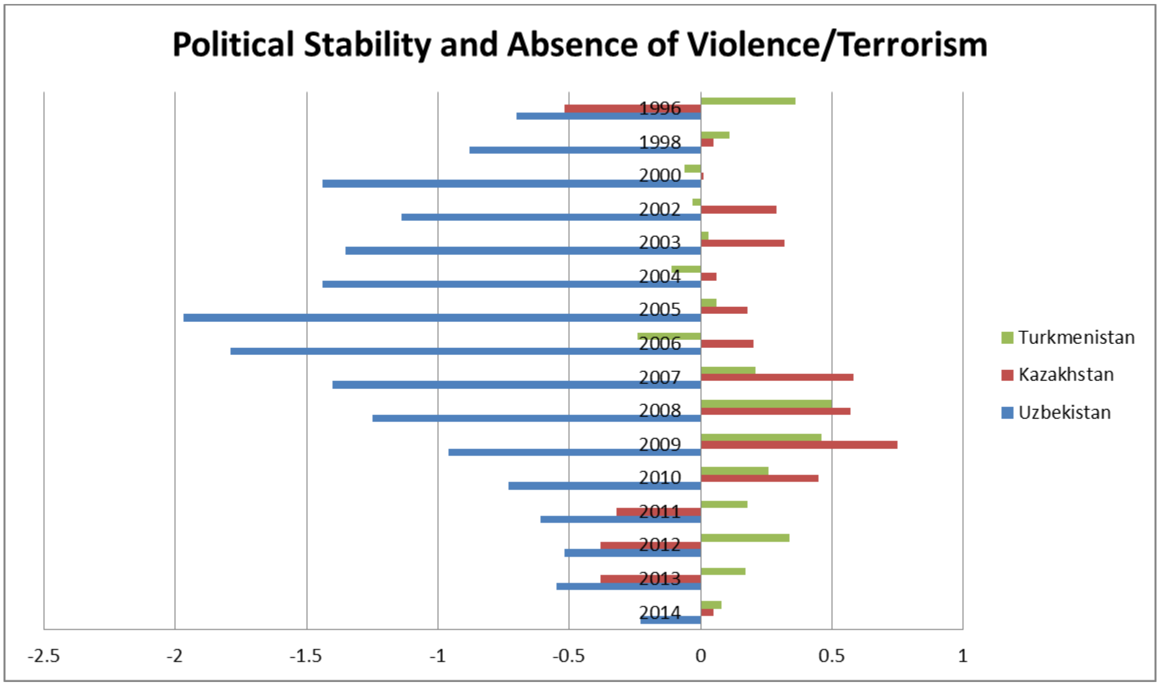
Levine and Renelt concluded that a number of revolutions and *coups* per year is negatively correlated with the investment share of the gross domestic product.[51] Similarly, based on cross-country data, Benhabib and Spiegel concluded that the presence of human capital makes countries more attractive, while political instability may deter it.[52] Moreover, regional political instability also can impact investment potential and economic growth as discussed in the study conducted by Ades and Chua based on data from 118 countries over the period from 1960 to 1985.[53]

On the other hand, other studies claim insignificant impact caused by political instability on FDI inflow. For instance, Bennett and Green used data from international marketing where they have explored the difference between theory and reality. They have found that even though international marketers claim that political instability is essential to their investment decisions, their actions do not support that claim.[54] Also, Wheeler and Mody state that political risk has an insignificant effect on location decisions made by United States multinational enterprises.[55]

The table below compares Uzbekistan, Kazakhstan, and Turkmenistan based on their political stability and the absence of violence and terrorism. World Bank findings suggest that Uzbekistan has the lowest ranked perceived political stability compared to other counties. Kazakhstan, on the other hand, promises a more politically stable environment even though all countries are significantly lower in their perceived political stability compared to the developed countries.

[51] Levine, R., & Renelt, D. (1992). A sensitivity analysis of cross-country growth regressions. *The American Economic Review, Vol. 82, No. 4*, pp. 942-963.
[52] Benhabib, J., & Spiegel, M. (1992). The role of human capital in economic development. Evidence from aggregate cross-country data. *Journal of Monetary Economics, Vol. 34, No. 2*, pp. 143-173.
[53] Ades, A., & Chua, H. (1997). Thy Neighbor's curse: regional instability and economic growth. *Journal of Economic Growth, Vol. 2, No. 3*, pp. 279-304.
[54] Bennet, P., & Green, R. (1972). Political instability as a determinant of direct foreign investment in marketing. *Journal of Marketing Research, Vol. 9, No. 2*, pp. 182-186.
[55] Wheeler, D., & Mody, A. (1992). International investment location decisions: the case of U.S. firms. *Journal of International Economics Vol. 33, No. 1-2*, pp. 57-76.

Figure 2.2 Political Stability and Absence of Violence/Terrorism
(-2.5 weak; 2.5 strong)



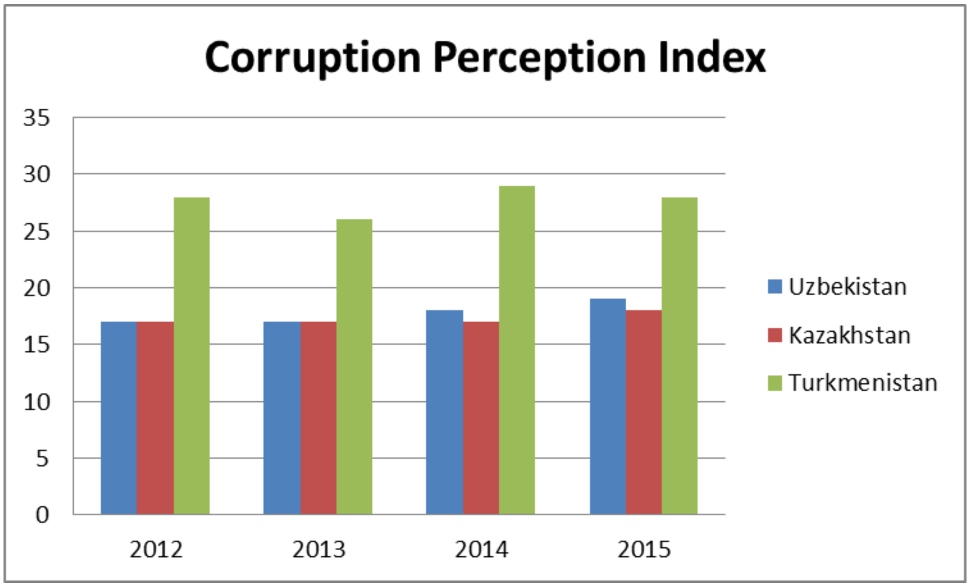
Source: retrieved from the World Bank https://theglobalobservatory.org/catalogue-indices-map/#WorldBankPolitical

The Worldwide Governance Indicators project measures the level of governance in six categories: (1) control of corruption, (2) government effectiveness, (3) political stability and absence of violence/terrorism, (4) regulatory quality, (5) the rule of law, and (6) voice and accountability. The data here reflects the project's index on political stability and absence of violence/terrorism. This index draws from a range of indices from sources such as the Economist Intelligence Unit, World Economic Forum, and Cingranelli-Richards Human Rights Database. Indicators from each source measure perceptions of the likelihood of political instability and politically motivated violence, including terrorism. Scores range from approximately -2.5 (weak) to 2.5 (strong).

Corruption

As discussed in the literature review, corruption is not always the main obstacle for FDI inflow. It also can serve to make investment process more effective in the environment of poor institutional regulation. Figure 2.3 demonstrates that all three countries are ranked low in the corruption perception index (all below 30) with Kazakhstan having slightly better corruption perception. Considering the fact that all of the countries are in a low range of corruption index, other factors must be playing a more significant role in attracting FDI.

Figure 2.3 Corruption Perception Index (100 = no corruption)



Source: retrieved from the World Bank https://theglobalobservatory.org/catalogue-indices-map/#WorldBankPolitical

Note: The Corruption Perceptions Index measures the levels of perceived public sector corruption in countries around the world. The index draws from 13 data sources from organizations such as the African Development Bank, Bertelsmann Foundation, Freedom House, and the World Bank. Country experts and business leaders determine standardized scores for each source with assessments and opinion surveys. Scores range from 0 (highly corrupt) to 100 (very clean).

Tax Policies

Along with political stability and corruption, tax policies are also crucial for foreign firms. Foreign firms prefer lower tax rates as they maximize profit margins and therefore contribute to the higher rate of returns to investors. Table 2.7 demonstrates that Uzbekistan offers the lowest corporate income tax compared to its neighboring countries, which is a good sign for interested foreign firms.

Table 2.7 Taxation Policies Comparison

	Taxation (%)		
	Corporate income tax	*Personal Income tax*	*VAT*
Uzbekistan	7.5	23	20

Kazakhstan	20	10	12
Turkmenistan	20	10	15

Source: PWC Tax Services, 2017, retrieved from http://communities.lawsociety.org.uk/international/regions/cis/2017-investment-outlook-for-central-asia/5061017.fullarticle

Geopolitical interest and competition

Competition and foreign direct investors' presence in Central Asia and Uzbekistan are some of other critical factors to understand the total investment climate. Currently, there are three major players and principal investors in the region in Central Asia, namely, Russia, China, and the European Union (EU). However, their presence varies depending on the country. In fact, the EU (mostly the Netherlands, the United Kingdom, and France) is the most significant source of FDI to Kazakhstan, whereas in Uzbekistan, the majority of investment comes from Russia and China. According to the previous statistics, the largest country with FDI Inflows is Kazakhstan, which has opened its markets to other international players such as EU. As such, Uzbekistan can learn from Kazakhstan to adopt liberalized policies and diversify its energy market by inviting other interested foreign investors.

The following political aspects of investment climate in Central Asia are worth noting. Uzbekistan has Russia as the primary investor in its extraction projects; however, China's presence is growing rapidly. Uzbekistan has to work on its political climate and promise long-term political stability to foreign investors who would consider a long-term capital commitment. Corruption and political instability usually appear together. Even though Uzbekistan ranks behind Kazakhstan, all countries are comparatively lower than other developed countries. Uzbekistan offers the lowest corporate tax rate among three countries which could play to its benefit in attracting foreign investors.

Table 2.8 Political FDI Determinants Comparative Ranking

	Political Stability	*Corruption Perception*	*Tax Policies*
Uzbekistan	3	2	1
Kazakhstan	1	1	2
Turkmenistan	2	3	2

Source: Author
Note: Evaluation index (A scale of 1 to 3, 1 is the best performing indicator)

2.5. Conclusion

In conclusion, Central Asian countries such as Kazakhstan and Turkmenistan have managed to attract the highest amounts of FDI, whereas Uzbekistan has been less successful in that pursuit.[56] Investors are looking at the abundant natural resource sectors in Central Asian countries. The majority of investments are going to extraction, processing, and transportation of hydrocarbon resources. The primary investors of Central Asia are coming from the European Union, China, and Russia, though the mix varies widely.

Despite many attractive determinants, Uzbekistan still has the lowest FDI in the region. This chapter has analyzed three resource-rich countries based on selected FDI categories. The objective of the comparative analysis is to identify the areas where Uzbekistan is underperforming in FDI categories. The results of the comparative analysis summarized in the table below suggest the areas in FDI determinants that need improvement in Uzbekistan. While the government cannot alter the state of abundance of natural resources compared to Kazakhstan and Turkmenistan, other aspects such as trade openness, political situation, corruption, infrastructure, and business climate need improvement. At the same time, Uzbekistan is leading the region in certain FDI aspects as market size (measured in GDP growth), labour force availability, and corporate income tax policies.

[56] Asian Development Bank. (2014). *Connecting Central Asia with Economic Centers.* Retrieved from www.adb.org: https://www.adb.org/sites/default/files/publication/159307/adbi-connecting-central-asia-economic-centers-final-report.pdf

Table 2.9 FDI Determinants Comparative Study Summary

	Economic Determinants			***Political Determinants***			***Business Determinants***		
	Market size	*Labour*	*Openness*	*Political Risk*	*Corruption*	*Taxes*	*Resources*	*Infrastructure*	*Business Climate*
UZB	1	1	2	3	2	1	3	2	2
KAZ	3	2	1	1	1	2	1 and 2	1	1
TUR	2	3	3	2	3	2	1 and 2	3	3

Source: Author
Note: Evaluation index (A scale of 1 to 3, 1 is the best performing indicator)

In Central Asia, Kazakhstan is the leading country with an advanced legal framework focused on attracting foreign capital and investors. The largest country in the region, by land area, has many strong points such as economic potential, access to the markets of other Eurasian Economic Union member countries, a robust legal framework, and favourable conditions for investments.[57]

Uzbekistan is ranked lower than Kazakhstan with its sizeable market (more than 30 million people) and diversified economy. The President-elect Shavkat Mirziyoyev has outlined many plans for systemic economy reforms and the creation of favourable conditions for investors. At the same time, there is a non-liberalized currency market, corruption, and bureaucracy. Given the government's plans, the future economic and investment outlook for Uzbekistan is positive.[58]

Turkmenistan comes in last, despite the availability of massive hydrocarbon reserves, transit potential, political stability, and economic continuity. Turkmenistan's political model allows the authorities to adopt measures to reform the economy and maintain stability in society. However, firm political control also implies potential interference in any economic activity in the country. The

[57] Pritchin, S. (2017, April 4). *Ranking the Central Asian States as Investment Destinations.* Retrieved from thediplomat.com: https://thediplomat.com/2017/04/ranking-the-central-asian-states-as-investment-destinations/

[58] Ibid.

country has a weak protection of property rights, high bureaucracy, and economic dependence on hydrocarbon exports.[59]

Many studies support the theory that there is a positive long-term relationship between FDI and GDP. The most critical factor for determining the scale of FDI inflows into those economies is the rate of return on investments for foreign firms.[60] As a result, to benefit from FDI in the long term, the governments of the Central Asian countries should continue to work towards creating an attractive political, economic, business conducive investment climate that would attract investors.

[59] Ibid.

[60] Ibid.

Chapter 3. Case Study: Uzbekistan

3.1. Overview of Issues from FDI Framework Analysis

Investing in a transition economy has its benefits, but also has risks. When advantages or an expected return on investment is higher than perceived costs, then the investment decision is justified. The FDI determinants analyzed in this study are based on three categories: economic, political, and business determinants. From the comparative analysis of the investment environment in three energy resource-endowed Central Asian countries – Uzbekistan, Kazakhstan, and Turkmenistan -- the study revealed some underperforming FDI determinants in Uzbekistan (see Table 3.1). Those variables are business climate and openness, political risk and corruption, and natural resources (in relation to Kazakhstan and Turkmenistan) and infrastructure.

Table 3.1 FDI Determinants Comparative Study Summary Review

	Economic Determinants			***Political Determinants***			***Business Determinants***		
	Market size	*Labour*	*Openness*	*Political Risk*	*Corruption*	*Taxes*	*Resources*	*Infrastructure*	*Business Climate*
UZB	1	1	2	3	2	1	3	2	2
KAZ	3	2	1	1	1	2	1 and 2	1	1
TUR	2	3	3	2	3	2	1 and 2	3	3

Source: Author
Note: Evaluation index (A scale of 1 to 3, 1 is the best performing indicator)

This chapter looks at issues that hinder FDI inflow into Uzbekistan's energy sector to understand the underlying causes for such patterns. Kazakhstan is leading the region in FDI inflow in almost all above variables; therefore, the following sections examine the reasons behind underperforming FDI determinants in Uzbekistan as well as Kazakhstan's different approaches in order to elicit some lessons.

3.2. Issue 1: Business Climate and Openness/Liberalization

The FDI Framework analysis in the previous chapter indicated that Uzbekistan is underperforming in business climate and trade openness compared to Kazakhstan. Those factors are vital elements for a profitable business and play a role in a decision making for foreign firms. According to the interview data I collected, the answer to the question – *What are the key factors that influence Canadian energy companies to invest in the energy sector in Central Asia?* – is twofold. The interviewees emphasized such factors as "the cost of doing business" and "getting the product to the market." In other words, business environment and trade openness are essential for investors.

Kazakhstan has the most liberal and open economy in Central Asia with the highest-ranked business and investment climate in the region, and therefore, it is significant to examine the factors that play an essential role in its investment climate. Kazakhstan has adopted a more revolutionary liberalization strategy, while Uzbekistan has been more conservative, preferring to transform its economy using gradual approach and slow pace of reforms. As Uzbekistan has struggled with foreign exchange restrictions, declining exports, and import controls, Kazakhstan's macroeconomic flexibility and more market-responsive policies resulted in larger inflows of foreign direct investment.[61] As a result, Kazakhstan has outperformed all countries in the region in FDI inflow. Uzbekistan's economy has received less than one-sixth of the $10 billion invested annually in the Kazakh economy.[62] What is the difference between two relatively similar countries in adopting different economic approaches and subsequent results?

After the collapse of the Soviet Union, there were common features among all Central Asian countries such as the legacy of political and economic structure. Both Uzbekistan and Kazakhstan started their path of independence at the same time in 1991, with similar economic indicators of macroeconomic instability and geopolitical location being landlocked countries. Many inherent differences, however, influenced the approach to economic reforms, liberalization, and openness in both countries, including demographics as well as geography. "Shock therapy" economic reforms in Kazakhstan might be explained by the proximity and socio-economic ties with Russia, which is also

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[61] Alam, A., & Arup, B. (2000). *Uzbekistan and Kazakhstan: a tale of two transition paths*. Retrieved from http://documents.worldbank.org/curated/en/422601468752142315/pdf/multi-page.pdf

[62] Wheeler, E., & Yugai, A. (2018). *Seizing Economic Opportunities in Kazakhstan and Uzbekistan.* Retrieved from https://thediplomat.com/2018/05/seizing-economic-opportunities-in-kazakhstan-and-uzbekistan/

connected with Kazakhstan's population demographics. Kazakhstan has more diversity and a Russian-speaking population with only 40% being Kazakhs, whereas Uzbekistan has a more ethnically homogeneous population with 70% being Uzbek.[63] Subsequently, the Russian population in Kazakhstan had more impact internally. In addition, macroeconomic changes in Russia had more effect on Kazakhstan than on its southern neighbor Uzbekistan.

Another reason for the different policy approaches between Uzbekistan and Kazakhstan lies in their histories. Uzbekistan has been an agricultural nation that is focused on maintaining an agrarian lifestyle and culture for many years that had its influence on more risk-averse lifestyle choices. The people of Kazakhstan have led a nomadic lifestyle for decades, which tends to be more adaptable to new changes.

The nature of the industry in the two countries has also impacted on the openness to foreign capital and the speed of introducing economic reforms in the local economy. In Uzbekistan, cotton production and its export were one of the major contributors to the economy, while in Kazakhstan, it relied predominantly on the extractive industry of energy (oil) and metallurgy. Therefore, Uzbekistan has adopted a more conservative and gradual approach to economic reforms and foreign investments, which was effective at preventing the collapse of the industry, but not necessarily taking bold moves to grow the economy rapidly. On the contrary, Kazakhstan had an urgent need to attract foreign capital to its abundant energy (oil) sector that needed substantial financing. As a result, this need allowed for more privatization. Policy makers had to create market-friendly policies to attract such investments and accommodate their needs. From my interview data, "Kazakhstan, and Turkmenistan rely mostly on oil and gas, and as a result, this reliance ties their economies to the whims of those markets. Uzbekistan is a bit more insulated; therefore, it is less dependent on oil and gas revenues."

Moreover, Uzbekistan is not a member of the World Trade Organization (WTO); therefore, there have been no incorporation of regional or international regulatory systems, norms, or standards in Uzbekistan's regulatory system. In my comparative study of the three Central Asian countries, Kazakhstan is the only member of WTO. These factors inform foreign investors when they make their decisions.

[63] Alam, A., & Arup, B. (2000). *Uzbekistan and Kazakhstan: a tale of two transition paths*. Retrieved from http://documents.worldbank.org/curated/en/422601468752142315/pdf/multi-page.pdf

Financial institutions also lack regulations and adequate implementation. One of the major challenges indicated by many foreign investors is exchange rate and currency conversion. One interviewee commented as follows: "Banking regulations mandate that the currency conversion process should take no longer than two weeks, but current lag times range from three months to well over a year, making import of intermediate goods, raw materials, and manufacturing components difficult." Uzbekistan's reforms have lagged behind in the area of price liberalization, especially in the foreign exchange market. Restrictions on access to foreign exchange by the central bank resulted in a growing parallel market premium over the official rate. Also, Kazakhstan's producers have been more exposed to competitive pressures due to the nature of oil industry compared to Uzbekistan. With an industrial legacy that is more oriented towards the Russian market than that of Uzbekistan, the Kazakh industrial sector has been less able to control internal financial and managerial resources to refocus their economic activities in the face of the initial shock of the breakdown of the Soviet trading system.[64]

Understanding the currency problem for foreign investors, the new government in Uzbekistan is working towards the improvement of relevant legislation. For instance, Uzbekistan adopted Article VIII of the IMF's *Articles of Agreement* in October 2003 and, as a result, committed to currency convertibility for current account transactions. Officially, foreign investors have guarantees to transfer their funds in foreign currency out of Uzbekistan without limitation, if they have paid all taxes and other financial obligations. In 2016, the government published a draft legislation on the liberalization of currency exchange, but the law has not been adopted yet, and there are many uncertainties about the implementation.

Recent developments in Uzbekistan's monetary reforms suggest that the government is still open to the idea to liberalize its economy by making the national currency freely exchangeable. It would be a vital improvement as many foreign investors indicate that currency convertibility is one of the significant obstacles when conducting business or investing a large amount of capital in Uzbekistan.

Privatization is another essential factor for liberalization and creating an attractive business climate. According to an interviewee, there are two models of privatization of energy sector. One is a fully privatized model where all the natural resources are sold off and then regulated by contract or agreement. The second privatization model is partial and occurs when "the state retains the ownership of all resources and simply leases the land and makes companies pay for the right to

[64] Ibid.

extract for royalties." The interviewee recommends Uzbekistan adopt a second model of privatization rather than a full give away of resources as "resources belong to the people, they do not belong to private companies." Moreover, the interviewee also stated that, in Canada, the partial privatization model has been sustainable for years and the government was able to attract the investments from all over the world. Uzbekistan is more likely to adapt a partial privatization model given historical government control of strategic natural resources.

In 2016, the government of Uzbekistan declared that further reforms should be focused on significant improvement of the business climate. Foreign direct investments are considered one of the critical drivers of development in the country. The President challenged all regional governments to improve the attractiveness of their territories for foreign investors and provide progress reports in this area on a quarterly basis. The government also published drafts of law on liberalization of currency regulations (as noted previously) and a policy paper on its five-year development strategy for public review. Uzbek officials continue to stress interest in seeing new companies establish operations in Uzbekistan, but concrete liberalization measures are still under consideration.

The President of Uzbekistan is making significant progress in the form of reforms to promote “economic liberalization aimed at further strengthening macroeconomic stability and the maintenance of high economic growth.”[65] Uzbekistan’s economy has maintained strong government control as many other post-Soviet countries had volatile social and political problems. The government chose a cautious and gradual approach to all reforms, prioritizing political stability and security. “Creating a convertible currency would seem to be the key to success for any reform effort.” [66]

3.3. Issue 2: Natural Resources and Infrastructure

Natural resources in developing countries are both a blessing and a curse. The abundance of mineral resources, especially hydrocarbons, contributed to the rapid growth of Central Asian countries in the form of large infrastructure projects, despite the geographic, geopolitical, and institutional disadvantages. However, if the economy is based only on the resource extraction, it

[65] Gleason, G. (2017, August 4). *Uzbekistan: Evaluating the Chances for a Convertible Currency.* Retrieved from https://eurasianet.org/s/uzbekistan-evaluating-the-chances-for-a-convertible-currency
[66] Ibid.

has its limits. In fact, the global financial crisis of 2008–2009 with the 2014–2015 rapid decline in commodity prices are some of the most prominent warning signs.[67]

According to the 2018 Enerdata report, Uzbekistan requires substantial investment in the energy sector. The oil sector of Uzbekistan, however, is not considered attractive to investors because of its limited resources as compared to its neighboring country, and its lack of infrastructure such as oil pipelines. Moreover, as Gazprom (Russian Energy Company) operates the only infrastructure carrying energy resources from Central Asia, there is an uncertainty of access, which could also discourage investors.[68]

The presence and the type of natural resources may also affect the choice of reform strategy in two countries. Kazakhstan has extractable amounts of every metal in the Mendeleev periodic table, along with the extensive oil field. As a result of such natural resource abundance, Kazakhstan is one of the largest exporters of metals and has a significant potential of unexploited oil reserves.[69] The need to attract foreign capital to exploit the mineral resources may have led to a faster pace of reforms and a greater degree of outward-orientation in Kazakhstan. In Uzbekistan, on the other hand, an alternative set of initial conditions, including a heavy dependence on energy and grain imports as well as a lower level of industrialization, led the government to adopt policies in support of self-sufficiency and import substitution.[70]

This difference in natural resource endowments results in different choices of industrial policy and the nature of adopted reforms. Kazakhstan's economy is concentrated in sectors linked to mineral and petroleum products including petrochemicals and oil refining. Light industry was secondary in importance. Uzbekistan has a more diversified economy. Its resource endowments of cotton and gold may have also played a key role in maintaining foreign exchange inflows and growth, but they served as a launching pad for a wider array of manufacturing activities than has been true in Kazakhstan.[71]

Infrastructure serves as another factor when "getting the product to the market" as it impacts on the costs of transportation. Despite being a landlocked country with limited access to the sea,

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[67] Uuriintuya, B., & Dabrowski, M. (2017). Central Asia — twenty-five years after the breakup of the USSR. *Russian Journal of Economics, Vol. 3, Issue 3*, 296-320.
[68] Enerdata. (2018). *Country Energy Report.* Retrieved from www.enerdata.net/research.
[69] Alam, A., & Arup, B. (2000). *Uzbekistan and Kazakhstan: a tale of two transition paths*. Retrieved from http://documents.worldbank.org/curated/en/422601468752142315/pdf/multi-page.pdf
[70] Ibid.
[71] Ibid.

the improvement of the transportation industry to promote export materials is vital for Uzbekistan. The reconstruction of the transportation system would also increase the performance of the private firms and serve as an attractive factor for foreign investors.

Pipelines and railways are primary infrastructures for energy transportation. In Central Asia, Russia has dominated the market by Gazprom's ownership of the existing pipelines. However, China has been actively investing in oil and gas pipelines, roads and railways, and accompanying infrastructure in Central Asia. One of the infrastructure projects is a completed construction of a major gas pipeline from Turkmenistan. A second pipeline, Line D through Uzbekistan, Tajikistan, and Kyrgyzstan, is scheduled for construction, further increasing China's gas imports from Turkmenistan. "The pipeline broke the previous dominance of Russia's Gazprom, but at the cost of making Turkmenistan nearly totally dependent on China. Turkmenistan's exports to China constituted just 1% of its total exports in 2009, but increased to almost 80% by 2015, almost all of which is natural gas. Turkey is Turkmenistan's second largest trading partner with only 5% of Turkmenistan's total exports."[72]

Figure 3.1. Infrastructure in Central Asia (Pipelines and Railroads)

Source: Retrieved from https://www.sciencedirect.com/science/article/pii/S2405473917300429

[72] Uuriintuya, B., & Dabrowski, M. (2017). Central Asia — twenty-five years after the breakup of the USSR. *Russian Journal of Economics, Vol. 3, Issue 3*, 296-320.

One of the interviewees revealed that without the support of state-owned or state-affiliated entities, foreign investors usually have few business opportunities in Uzbekistan. The government generally welcomes investment projects that are in line with its import-substitution and export-oriented industrialization policy and discourages investments in import-consuming sectors. Thus, traditionally over 70% of all foreign investment has been directed to the oil and gas sector.

Natural gas, cotton, and gold are Uzbekistan's largest sources of foreign exchange earnings. There are isolated cases of foreign companies that have entered the natural gas and cotton production sectors with some success. In theory, private enterprises may freely establish, acquire, and dispose of equity interests in private businesses, but in practice, this is difficult to do.

3.4. Issue 3: Political Risk and Corruption

The literature review suggests that political instability can have an impact on the investment climate in the host country. Therefore, consistency in policies, business climate, and government stability are essential during the decision making process. Corruption is also a factor, which is prevalent in all Central Asian countries. After the collapse of the Soviet system and temporary chaos in all republics, there was a high level of criminal activity and privatization schemes. Corruption and favouritism hinder private sector development and the ability of new foreign investors to compete in a new market.

The interview data indicate that political stability and predictability, as well as transparency and fairness of regulatory system, are important factors for foreign direct investment. Political risks such as war and expropriation are difficult to predict. Therefore, investors need reassurance if they are to invest for the long term.

The recent political transition was a political test for Uzbekistan. Unlike Kazakhstan and Turkmenistan, Uzbekistan did not attract a large inflow of foreign direct investments to its gas sector due to its conservative policies and strong government control. The government understands that it is essential to adopt new reforms to its economic and political system and to attract foreign investors to develop the economy in the globalized market.

Shavkat Mirziyoyev made waves in December 2016 when he announced that he would remove barriers to investment in the Uzbek economy and work to assuage fears relating to corruption and human rights. Privatization talks are also in the process; however, the government will keep control of strategically important sectors such as energy, gold mines, and basic infrastructure. Nevertheless, according to Sodiq Safoyev (Minister of Foreign Affairs), "Even where the government plays a major role, we are open to private local and foreign investment. If an investor is ready to invest in its own exploration operations and finds gold or copper or oil or whatever, then we are happy to let them set up their own production and sales operation." [73] Therefore, the new government sends promising signs that its administration will work to ensure stability and favorable economic reforms to potential foreign investors.

Political stability is important for long-term investors according to the interviewee:

*"I think for almost any energy investor the main concern is **stability** and **predictability**. They are always going to be looking for the regulatory regime, whether it is transparent or not. How the disputes are adjudicated, whether there is a legal system in place that is fair and equitable so that the foreign investors are not discriminated against. . . . The stability of the political system, transparency, fairness of the regulatory system . . . . Those are the critical policy issues foreign firms look into. To the extent that state would reform its regulatory system and clarify the rules and the legal aspects of doing business there, that would help to attract the investments.*"

In late 2016, newly elected president Mirziyoyev published draft legislation for public comments, including draft decrees on the government's five-year development strategy, currency regulation, and the creation of new economic zones. Before that, publishing drafts of laws and regulations for public review was uncommon. Current legislation protecting foreign investors includes the following documents:

- *The Law on Foreign Investments (No. 609-I, issued April 30, 1998, and last revised in 2014);*
- *the Law on Guarantees and Measures on Protection of Foreign Investments (No. 611-I, issued April 30, 1998, and last revised in 2014);*
- *the Law on Guarantees of the Freedoms of Entrepreneurial Activity (No. 69-II, issued May 25, 2000, and last revised in 2012);*

[73] Rapoza, K. (2017, September 14). *Eurasia's Latest Economic Reboot Can Be Found In Uzbekistan.* Retrieved from https://www.forbes.com/sites/kenrapoza/2017/09/14/eurasias-new-perestroika-uzbekistan-silk-road-china/#7f91a4ee6f25

- *the Production Sharing Agreements Law, the Law on Investment Activity (No. 719-I, issued December 24, 1998, and last revised in 2013),*
- *the Presidential Decree On Additional Measures to Ensure the Accelerated Development of Entrepreneurial Activity, Comprehensive Protection of Private Property and Substantial Improvement of Business Climate (issued October 5, 2016), and a number of other decrees and resolutions.*

3.5. Conclusion

Uzbekistan is a relatively new state, and after the collapse of the Soviet system, it had to choose a path of economic development. Uzbekistan understood the importance of natural resources and that attracting foreign direct investment has always been a priority of the government agenda. Uzbekistan has chosen to adopt a more conventional and conservative approach, which led to modest foreign investment inflows, compared to its regional neighbor Kazakhstan that pursued a more liberalized and radical path to open economy. Nevertheless, stable economic growth over the years is attractive for foreign investors. In addition, the recent political transition means that the new government is working towards the liberalization of the economy by reforming the foreign exchange system, as well as by slowly opening up the industries for privatization and public-private partnerships.

Uzbekistan is behind Kazakhstan in openness to international trade and market liberalization. Countries that have liberalized can benefit more from FDI. For example, the spill-over effect in large-scale investment impacted the adjacent construction, real estate, and industrial sectors. Kazakhstan was among the first countries of the former Soviet Union countries to conduct fundamental economic reforms. On the contrary, the late Uzbek President Islam Karimov was primarily concerned with stability and did not initiate any significant economic changes. While food processing and distribution, and textiles were liberalized, the state's continued control of the financial sector prevented that sector from attracting foreign investment. In contrast to the Kazakh financial market, foreign investment has not become the primary source of financing for local companies.

Uzbekistan adopted a more gradualist approach, with the idea that the unrestricted market may not be compatible with the government's aims of socioeconomic development. This approach permitted the government to assume a principal role during transition, not only as a developer and implementer of reforms, but also as a collective entrepreneur, production regulator, and investor in priority sectors.[74] As a result, many of the "first generation" policy reforms, such as price liberalization, trade, and foreign exchange liberalization, and interest rate liberalization were slow to develop in Uzbekistan. In Kazakhstan, on the other hand, a more aggressive liberalization program was initiated and led by a group of young, Western-influenced reformers, who adopted some reforms, which were radically dependent on the free market. Currently, however, the government in Uzbekistan is working on improving an investment climate:

> "We know we need to improve our investment climate," Safoyev says. "We are working with foreign consulting companies, investment banks, and other international financial institutions to make this happen," he says, without naming names.[75]

Another important factor is the reliability of the data. In fact, statistics on the Uzbek economy are very unreliable, with the government statistical agencies unable to accurately represent the extent of market activity. [76] Research and development institutions that have reliable statistical data and methodology are crucial tools that support the decision-making process as well as the access to market intelligence for foreign investors.

Undoubtedly, there is a long road or reform ahead for Uzbekistan. Nevertheless, the new government has proven to be a committed reformer with a president who is determined to transform Uzbekistan's economy into a market economy. The transformation would certainly offer significant opportunities for foreign investors.

[74] Alam, A., & Arup, B. (2000). *Uzbekistan and Kazakhstan: a tale of two transition paths*. Retrieved from http://documents.worldbank.org/curated/en/422601468752142315/pdf/multi-page.pdf

[75] Rapoza, K. (2017, September 14). *Eurasia's Latest Economic Reboot Can Be Found In Uzbekistan.* Retrieved from https://www.forbes.com/sites/kenrapoza/2017/09/14/eurasias-new-perestroika-uzbekistan-silk-road-china/#7f91a4ee6f25

[76] Ibid.

Chapter 4. Conclusion and Recommendations

4.1. Findings

An increasing amount of FDI is entering into the Central Asian economies, attracted by their natural resource wealth. The FDI inflows can enable the host economies to improve their infrastructure, to achieve macroeconomic stability, and to offer tax motives to investors. In addition, the host countries are pushed to improve their governmental policy in order to ensure FDI inflows.

I argue that the key factors that hinder greater amounts of FDI inflows to Uzbekistan are: the poor business climate and the lack of liberalization, perceived corruption and political instability, and under-developed infrastruture. Nevertheless, the current government appears to be ready to make significant progress to improve the business climate and attract foreign investors to its energy sector.

In fact, the overall investment climate in Uzbekistan has demonstrated some improvement in recent years. For example, the government simplified business registration procedures, introduced some additional tax incentives for investors, improved private property protection legislation, and streamlined customs regulations. In 2017, the government reduced the mandatory sales tax rate by businesses of foreign currency earnings from 50% to 25%. The President also announced the upcoming liberalization of the banking sector and transition to a system of free currency conversion. The relevant legislation is currently under consideration.

4.2. Recommendations

- Uzbekistan should consider necessary market reforms to improve business climate and openness in the following sectors: domestic price liberalization, the unification of the exchange rate and current account convertibility, trade liberalization, WTO accession, greater privatization, and the elimination of barriers to private entrepreneurship, both domestic and foreign, and building financial market infrastructures.

- Closer intra-regional cooperation would also improve the business and investment climate. Given the region's geographical location, the cultural similarity, and the Soviet-inspired infrastructure, the unrestricted movement of goods, services, people, and capital among the

Central Asian countries would contribute significantly to the region’s economic development. In addition, closer cooperation would help Central Asian countries to jointly promote their interests.

- Even though privatization is vital for attracting foreign direct investments, my research findings demonstrate that countries can attract FDI in the form of successful public-private partnerships. Therefore, along with economic liberalization, it is also important to form successful and mutually beneficial forms of partnerships with foreign investors. In order to achieve this objective, the government of Uzbekistan should focus on easing business practices, guarantee currency convertibility, and provide competitive incentives to foreign investors.

- The development of a comprehensive energy strategy with clear targets and actions for the medium and long-term development of the energy sector is necessary. Moreover, foreign investors need the clarity and transparency of legislative laws and interpretations (practices) of such laws and justice during dispute resolutions.

- The government should ease the internal procedures of disclosing statistical data to international partners to ensure the accurate representation and portrayal of the country's impressive energy sector developments. In addition, the government should promote research and development activities to encourage smart investments in energy sector.

- As a landlocked country, Uzbekistan’s transportation industry should be improved in order to promote the exports and further develop the country's economic growth. Therefore, the transportation industry should be reformed so that it facilitates the reduction of the transportation costs, as well as the increase in operational efficiency and the reliability of the transportation services. The reconstruction of the transportation system would also stimulate the performance of the private firms, as well as attract foreign investors.

- The lack of an historical blueprint for economic development, political freedom, and democracy in Central Asia has had an impact on the political and economic transition since independence. However this initial fragility should not be considered as a factor that will be permanently in effect. Good policies, political stability, and transparency can help overcome weak institutional legacies.

4.3. Final Words

In sum, this study suggests that the factors that hinder FDI inflows in Uzbekistan are in the areas of business climate and openness, political stability, and robust infrastructure. Furthermore, Uzbekistan needs to improve its financial sector and currency convertibility as well as collaborate with international organizations, such as WTO in order to provide trade openness and international standard regulations. Also, Uzbekistan should work on its incentive policies to become a more attractive investment destination than other resource-rich countries. Nevertheless, recent reforms towards liberalization, openness, and cooperation with new partners, such as China, will most likely bring positive outcomes and foreign capital to Uzbekistan.

The present study has certain limitations. The case study has been limited to the Central Asian region and in particular to Uzbekistan, making it is difficult to generalize the findings in other developing countries. Also, given the recent change of government after decades of one regime, there are likely to be new positive policy reforms that can positively impact FDI environment. Nevertheless, the lessons from the comparative analysis of underperforming FDI determinants could benefit Uzbekistan as well as foreign investors interested in the energy business opportunities in Central Asia.

In conclusion, Uzbekistan should focus on the development of a stable political climate, infrastructure, and business environment to attract foreign investors. These macro improvements in political and economic conditions are also essential to attract foreign capital inflow. Uzbekistan should also consider regional neighbors by learning lessons from more successful counterparts, such as Kazakhstan, in attracting the highest level of foreign direct investments over time. In other words, new reforms in liberalization, political stability, and partnership diversification are essential. Hence, more financial and political measures should be taken for Uzbekistan to improve its rank among the region's top FDI destinations.

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