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RETHINKING FDI-LED GROWTH IN UZBEKISTAN: FROM SEZs AND INCENTIVES TO AN INSTITUTION-BASED INVESTMENT MODEL

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Abstract
This paper examines the balance between foreign capital (FDI) and domestic investment in Uzbekistan's industrial modernization. Evidence suggests that investment effectiveness depends on institutional quality and competitive discipline, whereas excessive incentives may entrench quasi-monopolies and crowd out domestic capital. We argue for refocusing investment policy from inflow volumes to value-added, localization and sustained outcomes, and outline priorities for mobilizing domestic resources (reinvestment, savings) alongside selective FDI.

Keywords: FDI; domestic investment; institutional environment; privatization; quasi-state sector; crowding-in/out; investment policy.

Introduction

Since 2017 Uzbekistan has moved from a tightly controlled, state-led model towards a much more open economy. Currency liberalisation, price and trade reforms, and an active privatisation agenda were all framed around one core idea: foreign direct investment (FDI) should become the main engine of growth and modernisation. In official strategies and presidential speeches, FDI is expected to compensate for limited domestic savings, finance infrastructure and upgrade industry in a relatively short period.

On the surface, recent numbers appear to support this narrative. Since the late 2010s gross fixed capital formation has remained high by international standards, and the share of foreign sources in total investment in fixed capital has approached around two thirds in some years. Within this foreign component, non-guaranteed FDI and other private inflows now dominate, while the weight of government-guaranteed loans has gradually declined. Uzbekistan thus looks, at first glance, like a textbook case of an FDI-led development strategy in a late-reforming transition economy.

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International experience, however, shows that the impact of FDI is highly conditional. The literature on financial globalisation and growth finds that external capital can support investment and productivity only under specific macroeconomic and institutional conditions (Prasad et al., 2007; Herzer et al., 2008). More recent, institution-centred contributions stress that late industrialisers succeed when foreign capital is embedded in domestic industrial policy, learning and capability building, rather than when it is attracted mainly through broad liberalisation and tax holidays (Chang, 2002; Rodrik, 2008). De Soto (2000) adds that without secure property rights and effective enforcement, both domestic and foreign capital risk remaining under-utilised.

The Uzbek case reflects these tensions in a particularly clear way. In some sectors – notably textiles, parts of agro-processing and pharmaceuticals – foreign investors have contributed to deeper value chains, export growth and the diffusion of modern production standards. In others – most visibly the automotive industry and some projects in construction, real estate and special economic zones (SEZs) – generous tax incentives, trade protection and administrative privileges have often produced enclave-type structures with weak competition, modest productivity gains and limited linkages to domestic small and medium-sized enterprises. The same toolbox of incentives thus generates very different outcomes depending on sectoral context and institutional design.

Against this background, the paper asks a straightforward question: to what extent does Uzbekistan’s current incentive- and SEZ-based model of attracting foreign capital support sustainable structural transformation, and to what extent does it lock the economy into a fragile, externally dependent path? To answer it, the study documents recent trends in the scale and composition of foreign investment in fixed capital, examines sectoral outcomes in key tradable industries, and benchmarks Uzbekistan’s approach against that of other late reformers. The paper’s contribution is to shift the focus from the volume of FDI towards its social and economic effectiveness and to outline an institution-based, domestic-capital-oriented investment model for Uzbekistan and similar late-liberalising economies.

Methods

This paper synthesizes theoretical and empirical insights from development and industrial-policy literature, with a focus on:

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(i) the distinction between centralized and decentralized sources of finance;
(ii) comparative effects of FDI and domestic investment on growth and structural change;
(iii) the role of institutional design—privatization, competition policy, and neutrality of incentives—in shaping investment outcomes [3; 5].
We contrast channels of crowding-in versus crowding-out and consider macro-financial stability issues (exchange-rate and debt exposure) pertinent to external versus internal financing. The analysis is grounded in the author's dissertation framework on optimizing Uzbekistan's investment policy.

Results

Three domains of results emerge [2; 3]. First, FDI's strongest contributions emerge where foreign capital is embedded into open supplier networks and competitive product markets, yielding demonstrable gains in productivity, export sophistication and knowledge spillovers [4]. Second, domestic investment exhibits higher persistence and lower volatility, especially when reinvestment is encouraged and access to finance is broadened via formalization of assets and strengthened banking channels [1; 2]. Third, incentive-driven deals that privilege individual investors risk entrenching quasi-monopolies, compressing fiscal space and weakening innovation incentives—effects that are particularly salient in quasi-state segments of industry. See Table 1 for a comparative summary.

Table 1 Foreign vs. Domestic Investment: Comparative Characteristics

Criteria	Foreign capital (FDI/external)	Domestic investment (internal)
Source & control	Non-resident capital; external lenders; potential policy dependence	National firms, banks, household/institutional savings; embedded in local economy
FX & debt exposure	Higher FX/debt vulnerability; profit repatriation	Lower FX risk; earnings retained/recycled domestically
Volatility to shocks	High (global risk cycles, country risk)	Lower; driven by domestic macro & institutions
Technology/markets	Potential tech & market access (non-automatic)	Builds local capabilities; supplier networks deepen
Incentive sensitivity	Often requires discretionary incentives/special regimes	Responds to predictable, universal rules and profitability
Competition impact	Risk of crowding-out if misdesigned; quasi-monopoly risks	Typically strengthens SME supply chains and competition
Fiscal return	May erode via tax/custom incentives	Broader tax base from retained earnings and local spending

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Analysis and Discussion

See Figure 1 for an overview of complementary pathways [2; 1]. The evidence suggests that maximizing inflows is less effective than optimizing the composition and institutional embedding of capital. In sectors with scale economies and technology gaps (machinery, pharma, green energy), selective FDI can accelerate capability building provided it operates under competitive neutrality and clear commitments to localization and knowledge transfer.

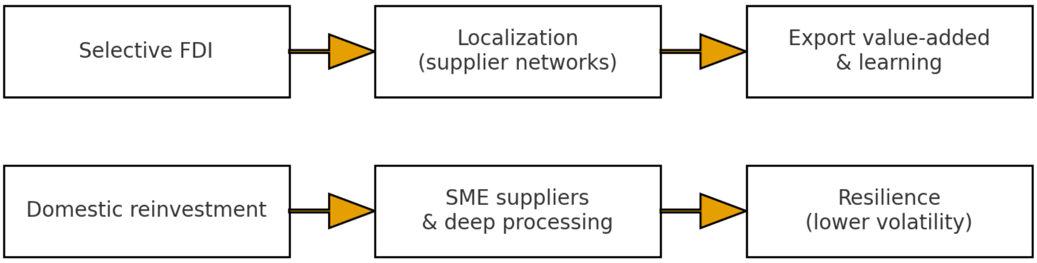

Figure 1. Rebalancing pathways: selective FDI and domestic reinvestment

Conversely, modernization of existing plants, deep processing and SME supplier development are better served by domestic finance, reinvested profits and decentralized sources. A decisive shift from discretionary privileges to universal rules helps equalize conditions for resident and non-resident investors, mitigates crowding-out and improves the fiscal return of industrial policy. Privatization 'by rules'—public listings, minority stakes with post-transaction obligations, and robust antitrust oversight—replaces rent-seeking with market discipline in the quasi-state sector.

Conclusion

Uzbekistan's investment strategy should prioritize a balanced architecture of external and internal sources. Foreign capital is most valuable as a catalyst of technological and export-upgrading under competitive neutrality; domestic investment provides the backbone of sustained industrial growth. Re-anchoring policy objectives in value creation—rather than headline inflows—aligns industrial upgrading with macro-financial resilience and institutional development. [2]

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Recommendations

1. Replace individual incentive deals with transparent, time-bounded, performance-conditioned regimes open to all qualified investors.
2. Concentrate selective FDI on technology-intensive segments where domestic capabilities are scarce; require clear localization and supplier-development commitments.
3. Strengthen domestic investment by encouraging reinvestment (tax-neutrality of retained earnings, accelerated depreciation) and widening access to credit via asset formalization.
4. Advance privatization through public offerings or minority stakes with post-transaction obligations, backed by antitrust safeguards to prevent market foreclosure.
5. Track outcomes in terms of value-added, export sophistication, employment quality and fiscal return, ensuring that policy support follows demonstrable economic benefits.

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