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Structure of Foreign Investments in Uzbekistan

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Abstract: *This article describes the application of financial mechanisms to attract foreign investment in Uzbekistan. Based on studying foreign experience author concluded that the basis and principles for development of the financial strategy of a project company. The prospects of developing financial mechanisms for attracting foreign investment are analyzed.*

Keywords: *Foreign Investments, Financial Mechanism, Tax Incentives, Free Economic Zones, Financial Incentives, Investor.*

Introduction

The importance of foreign investment, primarily direct investment, is to ensure sustainable economic growth in the country, further deepening structural reforms, accelerating the investment activity of enterprises and modernizing production, technical and technological re-equipment. This, in turn, will enable the introduction of advanced technologies, create new jobs and, thereby, ensure sustainable economic development of the country. The experience of developed countries shows that attracting foreign investment is an important factor in the development of countries.

The third direction of the Strategy of Action in the five priority areas of development of the Republic of Uzbekistan for 2017-2021 is focused on the further development of international economic cooperation, including expanding ties with leading international and foreign financial institutions, pursuing a rational foreign borrowing policy and the effective use of foreign investments and loans.

Effective attraction and use of foreign investments requires a system of public policy measures to support economic development, including the restructuring of the economy through its technological modernization. It is necessary to develop mechanisms for the effective attraction and use of foreign capital based on the peculiarities of the country. All elements of the mechanism for attracting foreign investment should be used to the maximum. The government aims to achieve socio-economic development of the country and to improve living standards of the nation. Financial resources in the form of national or foreign investments are required to achieve these strategic objectives.

Theoretical frames of financial mechanisms

Financial instruments being under the notion of subordinated debt are debt fund obligations that are paid after the senior debt and before the payment of dividends on common shares of the company. Financial instruments which are used for the accumulation of funds within the scope of each category are presented in Fig. 1.

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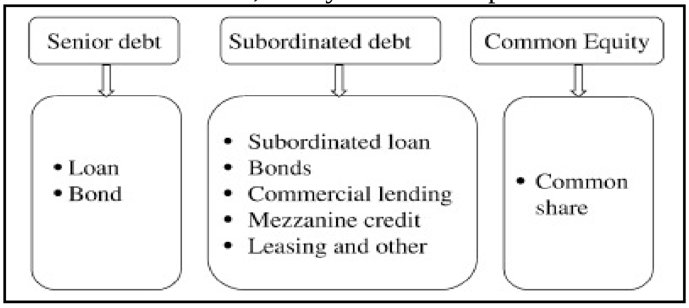

Fig. 1. Financial instruments for project financing.

Source: https://www.sciencedirect.com/science/article/pii/ S0386111215000163

Sponsors of the project, banks, pools of banks, international financial institutions, any counterparty of the project company, and the budgets of different levels can be sources of funds. They can provide for the project capital from different categories and use one or several financial instruments. For example, sponsors provide capital and subordinated loan for the project. A number of authors have noted this possibility, describing the advantages and disadvantages of financial instruments. However, they did not recommend any financial strategy for the project company to raise capital, only giving limited recommendations for the selection of a particular tool.

Literature review

Issues of financing private and public projects and public and private financing of infrastructure were studied by VialetaKhmel, Shengchuan Zhao [2], M. Brennan, E. Schwartz [3], A. Solovey [4], N.S. Grigg [5], H. Strauss [6], R. Hrab [7], S. Borins [8], E. Engel, R.D. Fischer, A. Galetovic [9], B. Weber, H.W. Alfen [10], S. Gatti [11] and others.

Analysis and results

The existing model of financial and investment processes in the Republic of Uzbekistan is ineffective in attracting investors. The securities market and banking system of the Republic of Uzbekistan do not perform their functions adequately to accumulate domestic savings and convert them into investments. Also, there is a general lack of confidence in the investment activity of companies and banks, or a low level of awareness about securities and investments. Although the main investors are the enterprises themselves, the share of enterprises and the population in the structure of investments by sources of funding accounts for 29.3% of total investments. Thus, the total financial investment potential of the country's economy is not fully used.

In addition to internal resources, foreign investors can also be sources of investment.

To solve the problems of attracting foreign investment, it is necessary to develop a comprehensive program for attracting foreign investment in accordance with the development priorities of the national economy. In this regard, it is planned to adopt the Investment Policy Strategy of the Republic of Uzbekistan until 2025. This strategy should be aimed at creating a favorable investment climate in the Republic of Uzbekistan, which will strictly correspond to the strategic development of production capacities in the medium term. The strategy includes regions and areas where foreign capital should be directed.

There are the following elements of the financial mechanism for

attracting foreign investment in the Republic of Uzbekistan:

1. Foreign loans.
2. Acquisition of foreign equipment under international leasing.

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3. Attracting foreign capital through the establishment of enterprises with a share of foreign capital, including the sale of shares to foreign investors and the establishment of enterprises with full foreign capital;
4. Attracting foreign capital on the basis of concessions or product sharing agreements.
5. Creation of free economic zones through active attraction of foreign investment in a given area.
6. Tax holidays and benefits
7. Financial incentives
8. Issue of state guarantees or transfer of gold for temporary storage.
9. Financial Instruments

The above forms of attracting foreign investments have long-term strategic character. With the correct formulation of the case, it is possible to solve the structural and intersectoral problems of the economy with less investment (especially in foreign currency) in a relatively short period of time, which can only be done with the help of foreign investment. They also help accelerate technological inequality with leading industrialized countries.

Taking into account the positive aspects of these forms of cooperation in stabilizing and stimulating the country's economy, it should be noted that all of them, like long-term stocks, are more prone to inflation, political instability and economic shocks than instant trading, exchange and other current operations.

Items 1-2 of the financial mechanism do not provide for the attraction of foreign capital into entrepreneurial activities. Credit or leasing involves the attraction of financial resources in the form of loans and requires repayment of interest, which is the loan capital. The positive side of this form of foreign investment attraction is that the equipment purchased on credit remains at the disposal of the investor.

Historically, international loans have been the first form of international financing. Foreign credit is closely linked to domestic credit and participates in value modification, provides reproduction and serves all stages of its development. Foreign loans contribute to the intensification of export-import relations, ensure the competitiveness of domestic goods and increase exports. In this context, they play an important role in the country's foreign economic activity. Foreign loans can be provided by governments, international organizations, and various companies. Despite all the positive aspects of this instrument, the country needs to control the volume of foreign loans. External loans increase the country's external debt. In addition, it is well-known that the loan amount should be paid at accrued interest.

Leasing is an effective tool for attracting foreign investment, because it provides a mechanism for financing and investment at the same time. Leasing is an effective tool for updating the material and technical base of the enterprise in the absence of own funds or borrowed funds. At the same time, leasing provides benefits not only to domestic enterprises, but also to foreign manufacturers. They gain access to new markets for their products. Local investors receive an additional financial instrument to attract financial resources.

According to the rules of the International Monetary Fund, legal entities' obligations on leasing transactions are not considered in determining the country's external debt. In this regard, the states strongly support the development of international leasing.

However, there are disadvantages of this element of the mechanism of foreign investment attraction too. There is currency risk for investors in international leasing. An exchange rate risk is likely to cause the investor to lose financial resources.

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Elements 3-5 have more social impact as these forms create many new jobs for the locals. This will improve the welfare of the population.

Attraction of foreign capital in the concession agreement and product sharing agreement enables effective integration of domestic labor and natural resources, production and scientific and technical potential, as well as domestic investments with investments of foreign investors. A foreign investor implementing an enterprise or concession agreement with a foreign investor in the field of natural resources development has the right to independently manage the extracted natural resources and meet its obligations to the host country in accordance with the contract.

Creation of joint ventures (JVs) in attracting foreign capital is a mutually beneficial mechanism for all participants in the process. One of the benefits of setting up a joint venture is to create new jobs. New jobs with relatively high wages will be created, which in turn will have a positive impact on the well-being of the population. One important factor is that a joint venture will bring advanced technological equipment and modern management practices to the investing country. The establishment of a joint venture means the emergence of a new taxpayer and a new source of revenue for the state budget. The emergence of new competitive products manufactured by the joint venture in the local market will improve the quality of local manufacturers' products. Clearly, the establishment of a joint venture will have many benefits for the host country.

Such advantages also apply to foreign investors. Establishment of a joint venture will allow a foreign investor to enter the local trading market in more preferential terms. Manufacturing is done with a relatively cheap labor force. The foreign investor will also have access to the natural resources of the host country (if there is a joint venture in the oil and gas sector, etc.). However, it is important for us, first and foremost, that the receiving side has an advantage.

There are a number of disadvantages along with the advantages of entirprise with foreign investments. In this case, it is about losing control of the enterprise. A foreign investor who has made a contribution to the charter capital of a joint venture may also participate in the management of the enterprise. In turn, a proportion of income and profits of a foreign investor is transferred to a foreign investor.

In the world practice, there are cases of unfavorable treatment of foreign investors. There were problems in the form of a reduction

in the share of local investors in the authorized capital. There are • cases when the contribution of a local investor is underestimated and the value of the foreign investor's equipment is overestimated.

- In this regard, it is necessary to develop a methodology for the investor;
- transfer of part of extracted (produced) production or its equivalent to the state;

obtaining by the investor of part or equivalent of extracted (produced) production.

assessment of buildings and structures that have been contributed by local investors to the authorized capital of enterprises with foreign investment. In some cases, there have been cases of outdated technology and equipment. When choosing this mechanism for attracting foreign investment, the country should consider the existence of such disadvantages.

Enterprises with 100% foreign investors also play an important role in attracting foreign capital. In this case, a foreign enterprise will be established in the national economy at the expense of a foreign investor. The foreign investor will be able to use their local labor resources, sell them in the local market, and save on their own tax and customs benefits available in the host country.

Establishing a foreign enterprise (IE) also has advantages in terms of investment risk. In this case, the responsibility for the successful operation of the business lies solely on the foreign investor. The receiving party will have an additional taxpayer who will create more jobs, create new quality

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products and services. It is advisable to set up foreign enterprises in the non-strategically important sectors, as well as in small businesses, for the country's economy, especially for the host country.

One of the forms of attracting foreign capital is concession contracts. Concession is a type of long-term lease, reflecting the relationship between government and private capital. Its object is property and right to carry out activities in the mineral deposits. The development of natural resources often involves concessions: oil, gas, coal, metal ores, precious metals and stones, minerals, and the use of water resources and public lands. The investor has the right to search and extract natural resources, to take risks and independently carry out the activity at his own expense. This removes the financial burden from the state as the concessionaire independently finances all costs associated with this activity. The receiving country receives income from the activity in the form of royalties, as well as taxes and mandatory payments.

Despite its advantages, such mechanism of attraction of foreign investments will not be the leader in our country, as it cannot attract large amount of foreign capital. However, this tool can be used to diversify instruments to attract foreign investment.

Production Sharing Agreement in the Republic is governed by the Law of the Republic of Uzbekistan dated July 12, 2002 No. 312-II "On Production Sharing Agreements". In accordance with Article 20 of this Law, investors, as well as their contractors and subcontractors, are exempt from all taxes and other mandatory payments imposed in the Republic of Uzbekistan related to the prospecting works in subsoil blocks specified in the contracts. [1]

Extracted (manufactured) products are distributed between the state and the investor in accordance with the contract, which should include the following terms and conditions:

- determination of total volume of extracted (produced) products and their value;
- determination of the part (including the maximum amount) of the extracted (manufactured) products as compensation products to the investor;

determination of the part of the extracted (produced) product to be provided to the state for the purpose of reimbursement of expenses related to the results of the exploration and development of a subsoil block granted for use by the A production sharing agreement is one of the most beneficial subsurface use agreements. This agreement very effectively attracts high-tech equipment and qualified specialists for countries with little experience in the use and extraction of mineral resources. However, this tool can only be used in areas with large deposits of natural resources. It is advisable to use other elements to attract foreign investment in areas that do not have rich natural resources.

The creation of a free economic zone (FEZ) to attract foreign investment will have positive consequences. Free economic zones are territories within the country for doing business at the national and foreign levels with the status of a legal entity and the privilege of doing business.

Free economic zones help to solve economic, foreign trade and social problems of the region and the country as a whole. With the help of free economic zones, foreign direct investment is attracted, modern high-tech industries are established, industrial potential of the regions are developed. The following privileges are granted to business entities in the FEZ:

Foreign trade incentives

- ✓ Tax incentives
- ✓ Financial incentives
- ✓ Administrative privileges

The Republic of Uzbekistan has accumulated sufficient experience in using this tool on three successful projects (Navoi, Angren and Jizzakh) and has moved to a wider use of this tool. In 2017, seven specialized pharmaceutical zones were created at once in order to effectively use their own

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plant raw materials and develop the domestic pharmaceutical market. Currently, 22 free economic zones have been created in the Republic of Uzbekistan.

After examining the activity of the FEZ in the Republic, it can be concluded, that after more than 10 years of operation, the FIEZ has not become a locomotive of industrial development in the Republic. There is no medium or long-term strategy for the development of free economic zones, taking into account the economic, social, scientific and technical characteristics of each free economic zone. There are cases when there is no cooperation or specialization between the FIZ participants. There is no single state body responsible for coordination of work and solving problems in the operation of the FEZ. There is a case of excessive regulation by the state (central and local) authorities. Procedures for registration, granting of land plots, approval of investment projects and connection of enterprises to external engineering and communication infrastructure are unreasonably delayed.

It is expedient to undertake a number of measures to organize efficient operation of FEZs in the Republic:

- when registering FEZ participants, efforts should be made to minimize the time it takes to start investing activities;
- reduction of the number of controlling entities in the FIEZ should be carried out from central to local governance, local governance and control;
- development of a long-term concept for the development of free economic zones, taking into account the comparative advantages of the regions.

Of course, free economic zones are an important tool in attracting foreign investment. Free economic zones help to reduce the imbalance in the distribution of foreign investment between the regions. The creation of free economic zones in densely populated areas and in the absence of natural resources gives more ffective results.

One of the important directions for attracting investors is the improvement of tax legislation, the rational creation and use of tax benefits. First of all, in order to improve the investment climate and provide tax incentives, more attention should be paid to manufacturing enterprises and enterprises engaged in innovative activities. World practice implies the provision of tax benefits by partial or complete exclusion from the tax base of enterprises engaged in innovative activities and at the same time sometimes exceeds the cost of innovative development.

Tax incentives are essentially intended to influence the economic decisions of the investor. They are an important tool of tax policy, in particular, its function of regulation. Many developing and transition economies are actively using tax incentives to attract FDI.

It should be noted that tax incentives along with economic and political stability, legal protection and other factors affect the decision of the investor when making investment decisions. If the economy is not attractive for strategic investments, the main foreign investments will be invested in short-term and high-income projects, in which the presence or absence of tax benefits is not an important factor in making a decision.

Excessive and systematic tax exemptions for investors mean that they are short-term and unpredictable, and can have a negative impact on investor's investment decisions.

There are several factors to attract foreign investment:

- International competitiveness. In the presence of neighboring countries with similar investment attractiveness, tax incentives can be a deciding factor for an investor to invest.
- Compensation for market unattractiveness. If objective conditions (geographical distance, lack of stable investment legislation) do not make a country or industry attractive, the investor can receive compensation in the form of tax incentives to balance deficiencies in other areas.

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- Development of individual regions. In order to reduce unemployment and social instability, it may be beneficial for the state to abandon financial gains (or some of them) in return for the adverse effects of foreign investment in economic development.
- Addressing macroeconomic issues. Establishment of tax incentives can be aimed at the development of certain sectors of the economy.

Establishing tax incentives to a foreign investor in the host country contributes to increased foreign capital inflows. However, the state that wants to benefit from tax benefits must also pay attention to some specifics. For example: the introduction of tax incentives reduces state budget revenues; The use of tax incentives to attract investments can improve the well-being of the people in the area to which they are applied, which could have external negative consequences for the population in other areas where they have not been implemented.

Conclusions

The use of financial incentives is an important tool in attracting foreign investment. Financial incentives require significant financial costs, which means creating additional funds. In this regard, financial incentives are more widely used in the practice of developed countries. In developing countries, the use of tax benefits is more common.

Financial instruments can also be an important tool for the country in attracting foreign investment. However, in order for this instrument to work effectively, it is necessary to develop the stock market of the country. Currently, qualitative and quantitative changes are taking place in the financial market of the Republic of Uzbekistan, and its diversification should be noted in various directions.

The securities market, while maintaining speculative features, is beginning to perform more actively in the investment function, which is reflected in the increase in IPOs, cheaper corporate debt and longer maturity. The stock eXchange is developing a variety of modern instruments, such as the sale of government securities for both domestic and global markets.

All elements of the above financial mechanism are important in attracting foreign capital. However, when choosing one or another form of attracting foreign capital and pursuing appropriate state policies, domestic peculiarities must be taken into account. However, it is important to remember that the goals and opportunities for attracting foreign capital in various forms are not the same at different levels of management. In this regard, when comparing different types of foreign investments, the objectives and interests of the subjects of the investment process should be taken into account.

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