

The Role of the State in Promoting Investment Activity

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Abstract: This article examines the state's role in promoting investment activity in Uzbekistan. It reviews the fiscal, monetary, regulatory, and institutional measures employed by the government. Effective models of public-private partnership and co-financing are also explored. The paper analyses the unintended consequences of state support for investment and discusses mitigation strategies. Finally, it proposes short and medium term reform measures aimed at enhancing private sector investment.

Keywords: investment promotion, public-private partnership, fiscal measures, monetary mechanisms, road map

Introduction

In recent years, investment activity in Uzbekistan has increased markedly. Thanks to the economic reforms launched in 2017, the country is transitioning from a closed to a more open, investor-friendly economy. Foreign investors recognize Uzbekistan's abundant natural resources, its young and growing population, and its direct access to regional markets. Measures such as liberalization of the foreign-exchange regime, overhaul of the tax system, and establishment of free economic zones (FEZs) have helped attract international capital. As a result, foreign direct investment (FDI) inflows in 2023 were 86 % higher than in 2016, reaching over USD 30 billion. Only 13 % of that total was financed from state sources, while the private and corporate sectors provided the remaining 87 %. These figures clearly demonstrate the state's success in mobilizing private capital.

Nonetheless, critical questions remain regarding the scope, instruments, and effectiveness of state intervention in investment promotion. Which policy tools does the government employ, and how effective are they? How do incentives differ across industries and regions? What outcomes have public-private partnerships and co-financing mechanisms achieved? How does Uzbekistan's experience compare with that of peer economies—such as Kazakhstan, Vietnam, and Poland—and what lessons can be adapted? Have any adverse effects, such as market

distortions, crowding out of private investors, or rising public debt, emerged? Finally, what short-, medium-, and long-term reform roadmap should policymakers prioritize to ensure sustained growth in private-sector investment?

This article seeks to answer these questions through a comprehensive analysis of the state's role in investment processes. The paper is structured as follows. Section 2 reviews the theoretical foundations and prior research on state-led investment incentives. Section 3 presents the findings in fiscal, monetary, regulatory, and institutional instruments currently used in Uzbekistan. Section 4 discusses the development and outcomes of public-private partnership (PPP) and co-financing models. Section 5 addresses the risks and drawbacks of state intervention, considering counterarguments and unintended consequences. Section 6 proposes a roadmap of short-, medium-, and long-term policy measures to enhance the investment climate. The paper concludes with key findings and directions for further research.

Literature Review

In economic theory, various approaches address the state's role in stimulating investment. According to the market-failure framework, government intervention is warranted when market conditions impede adequate capital allocation to certain sectors or when projects with high social returns—such as infrastructure, innovation, or human capital—fail to attract private financing. At the same time, excessive state intervention carries risks that are widely recognized in the literature. A prominent concern is the “crowding-out” effect, whereby public investment and subsidies may squeeze out private-sector activity or lead to inefficient allocation of resources. For instance, concessional lending by state banks can distort market signals and inhibit the development of private banking. Fitch Ratings data indicate that, although the share of state-subsidized low-interest credit in Uzbekistan has declined in recent years, preferential lending contracted more slowly than expected in 2023, exacerbating budgetary pressures. This evidence suggests that public interventions should be deployed with caution and subject to clear temporal limits.

Empirical studies offer mixed findings on the effectiveness of fiscal incentives. Z.Z. Erkinov (2022) finds that tax breaks have a statistically significant positive effect on investment activity. By contrast, the International Monetary Fund (2024) has recommended that Uzbekistan reassess its existing tax incentive regime and broaden the tax base to ensure fiscal sustainability. Thus, the academic consensus counsels prudence in deploying fiscal stimuli.

On special economic zones (SEZs), X.K. Kulimova et al. (2025) document that preferential regimes in Angren, Navoiy, and Jizzakh SEZs have led to rises in capital inflows, export volumes, and employment. However, they caution that the long-term impacts on economic stability and interregional competitiveness remain under-researched. Other scholars highlight potential downsides of SEZs: in some cases, zones reduce local budget revenues and simply relocate existing production (“territorial migration”) without generating net added value nationwide. Furthermore, when special preferences expire, investors may exit the zone,

undermining sustainable growth. Russian economist R.I. Zimenkov (cited in Ilyosova, 2023) critiques small industrial zones as “hidden subsidies,” arguing that certain groups benefit from incentives while potentially repatriating capital abroad. These opposing views underscore the need for robust monitoring and evaluation of SEZ instruments to safeguard their effectiveness.

Results

In recent years, the Government of Uzbekistan has implemented a comprehensive package of instruments aimed at attracting investment and stimulating private-sector activity. Below, we describe the main measures in force and summarize their observed impacts.

1. Fiscal incentives and subsidy programs. Tax policy has been actively leveraged to encourage investment. The Tax Code enacted in 2020 established a unified framework for investor incentives, enabling the President by decree to reduce prevailing tax rates by up to 50 percent for a maximum of three years; full tax exemptions are now strictly limited.

The most attractive fiscal incentives today target investors operating within Uzbekistan’s over twenty free economic zones (FEZs) and special industrial zones—such as Navoiy, Angren, Jizzakh, Urgut, Qo’qon, Hazorasp, and the pharmaceutical parks Nukus-Farm and Sirdaryo-Farm. Zone residents enjoy exemptions from land tax, real-estate tax, and water-use fees. Under the Law of 12 July 2022, FEZ participants also benefit from corporate income-tax holidays.

Beyond FEZs, the state has introduced special tax regimes in sparsely populated or border districts to stimulate regional investment. In September 2021, Sokh district (Fergana region) and selected remote villages adopted a 1 percent profit tax (for legal entities), personal income tax, and turnover tax rate. This geographically differentiated approach aims to balance investment flows by lowering the tax burden in less-developed areas to spur business creation and expansion.

Sector-specific fiscal measures further enhance targeted industries. By Presidential Decree UP-220 of 9 September 2022, income-tax and property-tax rates for renewable-energy producers (solar and wind) were cut by 50 percent. This incentive not only improves the financial viability of “green” projects but also aligns with national goals of energy security and environmental sustainability.

The government also provides direct subsidies and grants. Since 2019 a hotel-development support scheme has subsidized new builds of at least 50 rooms at a fixed per-room rate. As a result, several dozen new hotels have opened in key tourist destinations such as Samarkand, Bukhara, and Tashkent city.

2. Monetary and credit incentives. Credit-policy tools play a significant role in mobilizing capital. For many years, state-owned commercial banks have extended concessional loans — at

below-Central Bank refinancing rates—to priority sectors such as agriculture (e.g., cotton seed production), industrial modernization, and housing construction.

A cornerstone of macroeconomic policy has been currency liberalization. The Central Bank now adjusts its policy rate in line with inflation, supporting macro-financial stability. This relatively tight monetary stance has helped anchor inflation and exchange-rate expectations, thereby fostering a more predictable environment for investors.

3. Institutional initiatives and development-finance bodies. To coordinate investment promotion and state support systematically, Uzbekistan has created several new institutions. In 2017 the State Committee for Investments was established (later merged into the Ministry of Investments, Industry, and Trade—MIIT), within which the Investment Promotion Agency provides foreign investors with advisory and information services, and assists in project preparation.

State-owned banks remain key financiers of large projects. Historically, O'zmilliybank has channeled export-credit lines to industrial ventures; Asaka Bank has financed the automotive sector; and Ipoteka Bank has specialized in mortgage and housing finance. In mid-2023, the government sold its stake in Ipoteka Bank to foreign investors, while postponing the planned privatization of controlling shares in O'zsanoatqurilishbank and Asaka Bank—processes that Fitch Ratings notes are proceeding more slowly than expected, reflecting ongoing challenges in bank transformation.

Another institutional instrument is the National Investment Program, adopted annually for three-year periods. The 2023–2025 Program envisages the mobilization of USD 55.4 billion across 768 major projects in energy, transport, chemicals, metallurgy, agriculture, and social sectors. Financing is to be jointly secured from the state budget, public-private partnerships, international financial institutions, and private investors.

Collectively, these measures have underpinned a substantial rise in investment activity. From 2016 to 2023, foreign direct investment inflows grew by 86 percent, reaching over USD 30 billion—of which 87 percent originated in the private sector, with only 13 percent from public sources. Fiscal incentives in FEZs and special districts have attracted new capital to underserved regions; renewable-energy tax breaks have boosted “green” projects; concessional lending has supported priority sectors; and institutional reforms have improved the business environment and investor services. Nonetheless, the long-term effectiveness of some instruments—particularly SEZ incentives and subsidized credit—requires ongoing monitoring to prevent market distortions, fiscal strain, and unsustainable dependencies.

Discussion

The state's incentives for investment invariably entail certain risks and trade-offs. Selective support can distort market signals and, in some cases, lead to non-optimal resource allocation.

Within a given sector, this may provoke unfair competition: in Uzbekistan, tax breaks chiefly favor new or foreign investors, leaving domestic firms—especially small and medium-sized enterprises—“unprivileged” and compelled to operate on unequal terms. Consequently, the private sector fragments into “preferred” companies receiving incentives and those that proceed under standard regulations. Moreover, the dominance of state-owned enterprises poses a further risk. The Uzbek economy still features a high state share, and in strategic sectors state corporations predominate. This dual structure affects foreign entrants in two ways: on one hand, they may safely partner with a state firm as a joint-venture or supplier; on the other, direct competition with resource-rich, politically empowered state entities is virtually impossible, impeding broader economic diversification.

Investment-promotion policies also drive up budget expenditures and public debt. Since 2017 Uzbekistan’s public debt has surged, reaching roughly 38 % of GDP (up from ~8 % in 2016). As of January 1 2023, public debt stood at 36.4 % of GDP—some USD 29.2 billion—largely to finance large infrastructure and industrial projects through external borrowing.

Beyond state regulation, external factors such as global economic shifts, geopolitical tensions, and neighboring countries’ developments shape the investment climate. For instance, the 2022 Russia–Ukraine conflict disrupted Central Asian logistics, weakened remittance-dependent currency inflows, and spurred inflation in Uzbekistan. To retain investors, the government relaxed foreign-exchange controls and maintained a flexible exchange rate. Simultaneously, regional sanctions against Russia prompted some firms to relocate to Uzbekistan; the state adopted a neutral stance, neither granting them special incentives nor denying access to existing benefits (e.g., dozens of Russian software engineers took positions at Tashkent IT Park).

Several limitations emerged during this study. First, many aspects of Uzbekistan’s investment policy lack complete statistical evaluation, since the reforms are recent; thus, the article occasionally relies on provisional or qualitative assessments. Second, transparency issues—such as undisclosed public-private partnership terms and confidential investment agreements—hinder precise quantitative risk analysis. Third, the multi-dimensional nature of this topic (economic, legal, political) demands deep, specialized study in each domain; within the constraints of this paper, we have offered only an integrated, applied overview, acknowledging that each facet merits its own in-depth research.

Conclusion and Recommendations

Based on the foregoing analysis, we propose a roadmap of short-, medium-, and long-term measures to strengthen Uzbekistan’s investment promotion policy:

Short-term priorities (1–2 years):

Revise and rationalize tax incentives. Conduct a comprehensive evaluation of existing tax preferences to identify and repeal those that no longer generate economic benefit or have expired. To that end, establish annual **tax expenditures accounting**, publishing transparent reports on foregone revenues by incentive type. This will reveal each preference’s fiscal “cost” and guide rationalization. Moreover, all new investor-specific incentives should be conferred only by parliamentary statute, ensuring full legislative scrutiny and transparency.

Enhance PPP risk governance. Reassess the current cap on public-private partnership (PPP) commitments—set at USD 6.5 billion—and gradually reduce it to limit contingent liabilities. Introduce a requirement that all PPP contract terms be submitted to Parliament for review, thereby improving oversight and decision-making quality.

Accelerate and de-politicize privatization. Expedite planned sales of state banks (e.g., Uzsanoatqurilishbank, Asaka Bank) and state stakes in key enterprises (Uzbekneftgaz, Uzmetkombinat) within firm timelines. All initial public offerings (IPOs) and tenders should follow international best practices and enlist reputable financial advisers to ensure market credibility.

Modernize SME support mechanisms. Recognize that small and medium enterprises (SMEs) are critical for job creation and innovation. In the near term, reduce bureaucratic barriers for SMEs by cutting licensing requirements by 30–40 %, streamlining inspection procedures, and eliminating notarial formalities in business registration. Move SME lending toward market-based terms: reform the Entrepreneurship Fund’s guarantee and interest-subsidy schemes so they operate on commercial principles and target viable business plans. Expand microcredit programs and crowd-funding platforms to deliver rapid support to SMEs.

These immediate actions will enhance policy clarity, strengthen public accountability, and unlock private-sector dynamism—laying the foundation for deeper structural reforms in the medium and long term.

Medium-Term Reform Directions (3–5 years)

Enhancing the legal framework and judicial system. Although numerous laws concerning the investment climate have been enacted in Uzbekistan, their application in practice remains uneven. Over the next three to five years, it is essential to institutionalize specialized courts or chamber panels for resolving investment disputes. Strengthening the judicial and legal framework will send a powerful signal to both domestic and foreign investors about the reliability of Uzbekistan’s rule of law.

Advancing international integration and market linkages. A key goal for the next 3–5 years is World Trade Organization (WTO) accession. WTO membership would assure investors that Uzbekistan’s economy adheres to global rules, safeguarding against unexpected protectionism or discriminatory measures. To this end, Uzbek legislation—particularly on agricultural and

industrial subsidies—must be harmonized with WTO requirements. Concurrently, Uzbekistan should expand its network of free-trade agreements. As an observer in the Eurasian Economic Union (EAEU), the country must decide whether to pursue full membership or negotiate a broad preferential trade pact. Likewise, the 2021 “Generalized Scheme of Preferences +” (GSP+) arrangement with the European Union should be upgraded in the medium term to a comprehensive Deep and Comprehensive Free Trade Agreement (DCFTA). Achieving these objectives will transform Uzbekistan into not only a supplier for its domestic market but also a producer for major regional markets.

Deepening financial markets and facilitating credit access. Over the coming 3–5 years, Uzbekistan must deepen its capital markets and broaden its stock exchange. Mobilizing investment through equity and bond issuance—rather than relying solely on bank loans—will enhance private-sector access to capital. To stimulate the corporate bond market, targeted tax incentives could exempt individuals from income tax on interest earned from corporate bonds. Such measures would encourage citizens to reallocate savings from bank deposits into bond investments, creating long-term domestic funding sources for projects. Further, developing institutional investors—such as pension funds and insurance companies—will strengthen the capital market ecosystem.

Investing in education and skilled workforce development. Medium-term improvements in the investment climate are inseparable from human capital enhancement. Accordingly, the state should continue aligning the education system with labor-market needs. Notably, involving the private sector in vocational and technical education has shown promise: nearly 200 colleges and technical schools have transitioned to private management, with curricula designed in collaboration with employers. Within three to five years, this reform will yield graduates whose skills directly match industry requirements. The government should also impose medium-term obligations on large investors—via public-private partnership contracts—to train local personnel and allocate a specified share of management and engineering positions to Uzbek specialists.

Promoting innovation and R&D. Transitioning Uzbekistan’s economy toward higher value-added activities is a medium-to-long-term priority. To attract investors not only to build factories but also to establish R&D centers, a system of tax credits and grants should be introduced within three to five years. For example, firms could deduct from their corporate-income-tax base an amount equal to their expenditures on research, development, and technological innovation. Such incentives would spur domestic companies to invest in innovation. Additionally, the Ministry of Innovation or the Ministry of Education should encourage major foreign firms to open joint research centers—for instance, R&D labs in information and communication technologies (as already seen in IT Park), and analogous facilities in chemicals, energy, and agriculture.

Ensuring regional investment balance. A medium-term objective is to achieve balanced investment growth across all regions, not solely Tashkent and major cities. The existing

regional incentive framework—dividing the country into five zones based on development needs—should be periodically reviewed and recalibrated to address evolving disparities.

By implementing these medium-term measures, Uzbekistan can steadily transform its investment environment year by year toward an economy underpinned by a dynamic private sector, with the state serving as a prudent regulator and catalyst. Continuous risk monitoring and timely policy adjustments will be crucial throughout this transition. Investment promotion is not a one-off task but an ongoing process. Given the evolving global dynamics, technological innovations, and geopolitical shifts, state policy must remain agile and responsive.

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