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The impact of foreign investment and tax-based governance on the economy of Uzbekistan

Abstract. Today, no country can achieve proper growth and development without active participation in international trade and the global economy. Many developing countries, faced with the need to upgrade and strengthen the economy in the long term to access new technologies, have faced the challenge of managing technical knowledge, which in most cases is significantly associated with a lack of resources. Strengthening the local economy in a situation of resource scarcity is associated with the potential role of foreign direct investment in relation to the long-term growth and development of the economy in these countries. Therefore, in this study, using panel data for the years 2022-2024 of Uzbekistan, a model has been presented to examine the impact of taxes and attracting foreign direct investment on the economy using the panel data method. The variables used included: gross domestic product, taxes, foreign direct investment inflows and government performance.

The results showed that the tax variable has a negative effect on attracting foreign direct investment, and the variables of gross domestic product, government performance and growth in attracting foreign capital

have a positive effect on direct performance. It should be noted that the reduction in taxes on foreign capital and as an incentive from the government to attract capital is effective and can lead to higher growth in attracting investment, and in other economic sectors, the amount of tax revenue should be managed by the government.

Keywords: Foreign Direct Investment; GDP; Taxes; Panel Data; Government Performance; Investment Flow

JEL Classifications: E24; E41; E64; I18; J28; J31

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1. Introduction and Brief Literature Review

Over the past two decades, foreign direct investment has become a prominent phenomenon in the economic life of countries, with the benefits of direct investment in the form of issues such as increased economic growth, job creation and technology transfer, increased competitiveness, improved financial and human resources, and other such benefits (Etim et al., 2019; Rambe & Khaola, 2022). Foreign direct investment by multinational companies has experienced significant growth in recent years. The coincidence of this phenomenon with the substantial increase in demand for skilled labor over the past two decades has led experts and policymakers to consider foreign direct investment as a prominent and influential factor in employment changes in investing and capital-receiving countries (Tran et al., 2023).

In the recent world of «global value chains», foreign direct investment and trade have increased significantly to become the twin engines of global economic prosperity. Multinational corporations account for 80 % of international exports. Their unique expertise and knowledge represent an explosion in the world economy, and they also provide similar benefits to host and source countries. The relationship between foreign direct investment and trade in developed and developing economies is very strong and is very important as a source of external financing. In a study conducted by Tran et al. (2023), the role of the degree of development of a country in the effect of FDI on economic growth was examined. According to the results of his research, different levels of development did not affect the result of the effect of FDI on economic growth in either the short or long term, but the short and long term effect of FDI on economic growth in less developed and richer countries of this set was less than its effect on undeveloped countries, so the effect of FDI on economic growth in less developed countries is greater. Mohamed et al. (2021) based on an endogenous growth model concluded that foreign direct investment increases long-term growth by affecting the rate of technological diffusion from the industrial world to the host country. They believe that the beneficial effects of FDI on economic growth are through higher efficiency. This type of investment is achieved due to advanced technology, not simply through greater capital accumulation.

One of the important indicators of government tax performance is the tax revenue to GDP ratio. According to the Ott (2024), this ratio in 2020 was 22, 25 and 21% in developed countries such as the United Kingdom, France and Sweden, respectively, and in the same year for developing countries such as Turkey, Brazil, Russia and Uzbekistan, this ratio was 20, 16, 15 and 8%, respectively. Also, in many developed countries, 90% of current government payments are financed through taxes, which for Uzbekistan has fluctuated between 25 and 40% in recent years, hence, identifying the factors affecting government tax performance is of great importance.

Studies (Kumar et al., 2024; Sebo et al., 2025) show that among the factors that have affected various aspects of government economic performance in recent years, especially tax performance, is the good governance index. The good governance index includes the components of the right to express opinion and accountability, political stability, government effectiveness, quality of regulations, rule of law, and control of corruption, which affect the tax performance of governments through multiple channels. With the formation and development of growth models in the economic literature, the category of investment and capital supply has become one of the fundamental topics of economics in the focus of attention of researchers and policymakers (Cosma et al., 2023; Farah et al., 2025). The corporate tax system reflects current economic realities. Thus, the tax system of large companies needs fundamental reforms based on principles, because it is one of the effective factors in attracting foreign capital. In a world where an increasing number of governments are competing fiercely to attract multinational companies, financial incentives have become a global phenomenon (Mariotti, 2024; Furajli et al., 2025).

The decline of trade barriers, higher capital mobility, and the formulation of precise tax policy are important challenges for developing countries. Replacing domestic taxes with taxes on foreign trade (tariffs) will be accompanied by increased concerns about the diversion of profits to foreign investors, which has occurred in many developing countries due to the abuse of tax laws and the lack of adequate training of tax auditors and is currently unavoidable. The situation of taxes on this income is a major challenge for developing countries. This trend has become particularly problematic in a number of Latin American countries that have suspended taxes on financial income in order to encourage financial capital to remain in the country (Solorza, 2021). It can be said that taxes are a type of social cost that the people of a nation are obliged to pay in order to benefit from the facilities and resources of a country. So that the alternative capabilities of these facilities and resources are provided (Aisyah, 2025). Taxes have a negative and significant effect on the attraction of investment. According to Zhao et al. (2023), taxes on the performance of investment companies are carried out in two ways: first, on the total supply of the main factors of production by increasing or decreasing the net return (after tax deduction) or profit, and in the second stage, on the efficiency of using resources of the income tax system.

The impact of a favorable business environment on increasing the attraction of domestic and foreign direct investment, job creation, and GDP growth is evident. Improving the business environment and improving the aforementioned indicators in the global arena is not only a positive and fundamental step towards strengthening the private sector's participation in the economy and improving the level of employment and production in the country; but also, from the perspective of foreign investors, it is definitely one of the most important indicators for entering the host country and a necessary condition for promoting and facilitating the flow of technology into the country. Although the overall impact of business environment improvement indicators on foreign direct investment flows is assessed as positive, the effect of each of its sub-indicators on foreign investment flows varies depending on the income level and development level of countries. In addition, private domestic investors also have different effects on foreign direct investment flows depending on the level of development of countries. The purpose of this article is to examine the role of the level of development of countries in the impact of business environment improvement indicators on foreign direct investment flows and to estimate its effect through panel data econometric models.

2. Method

Considering the purpose of this article, which is to examine the effect of foreign direct investment and tax-based governance on economic growth, the two main hypotheses of this research are:

H1: Foreign direct investment affects economic growth.

H2: Tax-based governance affects economic growth.

H0: The variables are non-stationary.

The study of the relationship between foreign direct investment and tax-based governance on economic growth in Uzbekistan has been considered. Data on annual GDP growth, growth in foreign direct investment inflows, tax rate and human capital were extracted from the World Development Index 2020 (Ott, 2024).

In specifying the model, an attempt has been made to use the theoretical foundations of the latest and most famous growth models. Also, in selecting the variables used in the model, an attempt has been made to select the most important variables in terms of impact, considering the theoretical basis, which at the same time have sufficient consistency with the economy of Uzbekistan. Considering the above, the following model has been used to estimate the data:

$$GDP = C + W_1 FDI + W_2 Tax + W_3 GP, \quad (1)$$

where:

GDP: Annual Gross domestic product growth;

C: constant;

W: weight coefficient;

FDI: Growth in foreign direct investment inflows;

Tax: Growth of Tax income;

GP: Growth Government Performance.

The difference between this model and the models identifying factors affecting the attraction of foreign direct investment is the tax variable, which in fact, taxes on profits, income, and taxes levied on capital and assets in the country can act as a deterrent to the attraction of foreign investment, and the government takes steps towards the development and attraction of foreign investment by reducing these types of taxes and implementing tax exemption laws for foreign direct investment. In fact, in previous studies (Temouri et al., 2022; Rambe & Khaola, 2022) where taxes were included as an independent variable, all taxes received by the government were included, which means that taxes such as taxes on wages and individuals would not affect the attraction of foreign direct investment. However, in this study, taxes on profits, income, and capital assets were included in the model as taxes that affect foreign direct investment.

3. Results

The amount of foreign and domestic investment in each sector of Uzbekistan in 2020 is presented in Figure 1. As shown in Figure 1, the largest amount of foreign investment is in the oil and gas sector, which requires technology and the presence of international giants, and given the potential of the agricultural and tourism sectors, it requires attracting more investment.

In order to provide correct inferences about the variables, one must first ensure the reliability of these variables over time. Ignoring this may lead to providing incorrect inferences about the critical quantities of the model and the production of false regression. Therefore, in this study, the reliability of the variables used was tested using the Fisher test. The results are summarized in Table 1.

The results indicate the stationarity of the research variables. In these tests, the hypothesis H0 is based on non-stationarity and the hypothesis H1 is based on the stationarity of the variables. As can be seen in Table 1, all variables are stationary at the zero level. In addition, the stationarity of all variables in the different countries under study in this study has been examined, and the results indicate the stationarity of the variables at the level.

Accordingly, the results of estimating the model in a static state using the fixed effects approach in sections and applying the weighted least squares method (weight in sections) are shown in Table 2.

The results of estimating the model in a static state using the fixed effects approach in sections and applying the weighted least squares method by considering different weights in sections are shown in the above equations. The results of the fixed effects indicate that the foreign direct

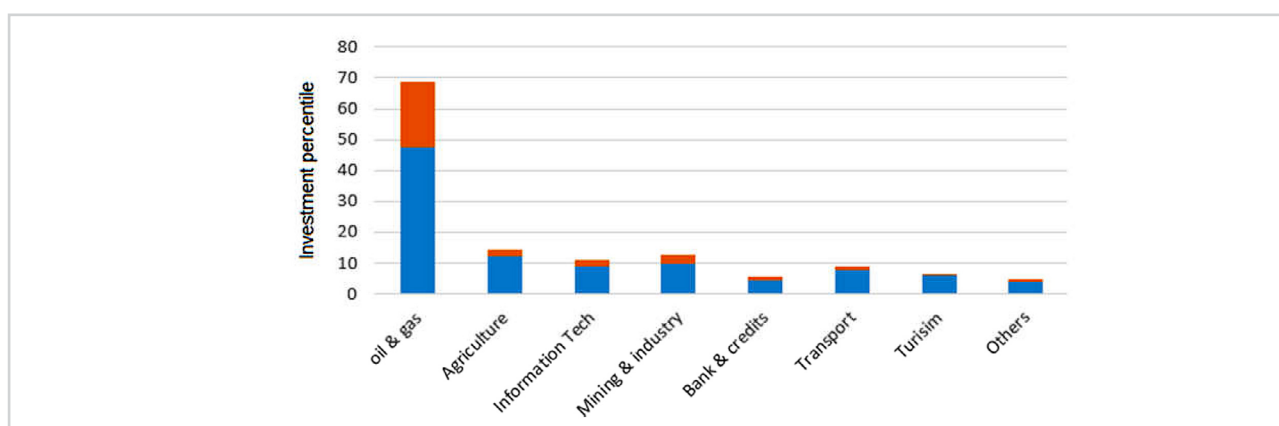


Figure 1:

Amount of foreign investment in different economic sectors of Uzbekistan

Source: World bank: <https://www.worldbank.org/en/news/press-release/2022/10/07/new-world-bank-study-contributes-to-development-of-uzbekistan-s-strategy-for-foreign-direct-investment>

Table 1:
Fisher's exact test results at the level of model variables

Variable	Fisher test statistics	Probability	Results
GDP	30.93	0.001	permanent
FDI	32.56	0.052	permanent
Tax	28.11	0.001	permanent
GP	30.48	0.001	permanent

Source: Authors' own findings

Table 2:
Results from model estimation

Variable	Coefficient	SD	T-value	Prob.
GDP	0.072	0.342	5.77	0.01
FDI	0.078	0.118	3.45	0.00
Tax	-0.031	0.034	-2.11	0.04
GP	0.124	0.089	7.45	0.00

Notes: Coefficient of Determination $R^2 = 0.89$; Adjusted $R^2 = 0.85$; F -Statistic = 23.67; Probability of $F = 0.00$; Durbin-Watson = 2.02.

Source: Authors' own findings

investment variable has a positive and significant effect on the growth of gross domestic product. In other words, considering the value of the T-statistic, which is equal to 5.77 and is greater than the critical statistic in the table, and also considering the significance level of this variable, which is equal to 0.05, it shows that this variable has the necessary significance at the 95% confidence level. On the other hand, considering the coefficient obtained for this variable, which is equal to 0.072, it is concluded that with a one percent increase in foreign direct investment, economic growth increases by 0.072%.

The tax on foreign capital has a negative and significant effect on economic growth. That is, considering the value of the T-statistic in this variable and also the value of its significance level which is equal to 0.04, it can be stated that this variable is significant at the 95% confidence level. In addition, considering the coefficient of this variable which is -0.031, it is concluded that with a one percent increase in the tax on foreign capital, economic growth is expected to decrease by 0.031.

4. Conclusion

Political and economic uncertainty and instability are one of the main reasons for the failure of countries to attract foreign direct investment. When appropriate cultural, social, political, and other conditions are not provided, countries and foreign companies will not show much interest in investing in their own countries. Considering the positive and significant effect of the degree of trade openness on attracting foreign direct investment, it is proposed that economic policies in the host country should be aimed at creating an open and economically stable environment, so that level of investment risk is reduced, consequently, flow of foreign direct investment increases.

The results of the model estimation have shown that reducing taxes and creating facilities for attracting foreign direct investment have a direct and positive effect. Also, by increasing the attraction of foreign investment, it can lead to higher economic growth. Success in attracting foreign direct investment can potentially create many benefits for the host country. In addition to increasing direct employment and domestic output, it has increasing effects on the purchase of domestic goods and services, wage and salary costs, even includes broader effects such as technology transfer, improving productivity of suppliers, competitors and customers, and improving infrastructure and skills of workforce, but these benefits will not be achieved automatically.

In addition, in order to improve the effect of attracting foreign direct investment, it is also very important to adapt policies to improve the quality of FDI attracted, which is achieved through better targeting of marketing, promotion, incentive regulations and improvement of the quality of the business environment in terms of regional skills, infrastructure, and technology base. It is increasingly recommended that in order to achieve reinvestment, technology transfer, regional linkages and retention of foreign invested businesses, governments need to encourage and promote greater embedding of foreign investment in the regional economy. On the other hand, enhancing the linkages between FDI and the network of companies and organizations in the host regions will not only strengthen domestic industries and provide links to global markets and technologies, but also help foreign investors to experience a more conducive environment with higher productivity to sustain themselves in the region. It is suggested that the exchange rate policies in the country should be stable because if the exchange rate is stable, more confidence will be created in the economic space and consequently decision-making will be simpler for foreign investors. By increasing the customs exemptions on intermediate and capital inputs required by foreign investors, the flow of foreign direct investment will be more.

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