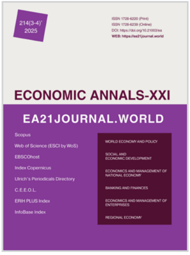

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An interplay between the tax policy and foreign direct investment to promote the economic stability of developing countries

Abstract. In this study, we explore the nexus between foreign direct investment (FDI) and tax policy towards economic stabilization of the emerging economies, the focus being Uzbekistan. The findings show that a newly lowered corporate tax rate from 14% in 2018 to 7.5% in 2024, along with sectoral tax credits, has resulted in an 83% growth in the average foreign direct investment per year. In addition, there was a high positive correlation (91%) between the economic growth and FDI attraction. Despite the reduction of tax rates, tax revenues from investment-friendly branches exceeded expectations by 21.5%, demonstrating the positive effect of economic growth on government revenues. This study confirms the strategic relevance of tax reforms as a source of productive and sustainable investment as an engine of economic stability.
Keywords: Tax Policy; Foreign Direct Investment; Economic Stability; Developing Countries; Uzbekistan
JEL Classifications: E24; E41; E64; I18; J28; J31
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1. Introduction and Brief Literature Review

Currently, in the complex global economic situation of the current era, achieving economic stability has emerged as the top agenda of developing countries (Alshubiri, 2024). Even though these countries have immense growth potential, they are still under the shadow of economic instability and global market fluctuations (Bae & Mah, 2019). At the same time, it becomes utmost important to discover and unify the forces of sustained growth that will take the economies of these countries on the road to stability.

Beyond a shadow of a doubt, attraction of foreign direct investment is known as one of the strongest of such drivers (Kiki et al., 2023). Foreign direct investment not only introduces money capital and newest technology, but also contributes significantly in strengthening the internal structure of the economy by transferring technological know-how, generating job opportunities, and linking the national economy to global supply chains (Judijanto et al., 2024). But this spontaneity is not enough and such spontaneity has to take place in a congenial environment for it to indeed become economic stability. Here, the significance of tax policies as a top policy-making tool of governments is underscored (Laudage, 2020). Designing an astute tax system can be an easel that attracts foreign capital to efficient and strategic areas of the economy. Taxes can shape incentives, dictate priorities, and ultimately determine whether foreign investors find a place fit for their investment (Nasritdinova, 2018).

But above all, the issue is how these two powerful tools, foreign investment and taxation policy, are merged to achieve the ultimate goal of achieving economic stability (Nthangu et al., 2025). These two should not be merged for the purpose of reducing tax rates, but rather understanding the subtleties where tax incentives are employed to attract productive and long-run investment without undermining government revenues (Nuraliev, 2022). The need to overcome this issue is double for a country like Uzbekistan, which is in the process of economic transformation and development (Zokirov et al., 2024). Adaption to a market economy and further integration into the world economy requires a national and efficient model able to use the resources of foreign investment and domestic policy tools to the maximum extent (Safoev, 2024). Thus, a deep understanding of the dynamic relationship between tax policy and FDI flows is not just an economic growth-promoting tool, but a prerequisite in the building of a shock-resistant economy that would be resistant to domestic volatility (Khasawneh et al., 2025). With this understanding, policymakers are then able to formulate overall and long-term strategies rather than ad hoc ones (Cerdeira & Fortuna, 2025).

This research endeavors to explore this crucial interaction and propose a method on which harmonized policies can be designed to achieve sustainable economic stability. This research can serve as a realistic guide toward enhancing economic fundamentals and facilitating a prosperous future for Uzbekistan.

2. Methodology

The methodology used in this research is based on a mixed methodology which can provide for the complexities of the interaction between foreign direct investment and tax policy. Thus, the research methodological design of this study is descriptive-analytical, whose main goal is to study the dynamic interaction of these two variables within the specific economic and institutional context of Uzbekistan. In this context, this present study not only describes the current reality, but also tries to provide policymakers with practical insight through a detailed analysis of the mechanisms of influence. The main concern is to ensure that the outcomes, apart from being scientifically valid, should also be able to be stated in the real economic framework and interpreted into operational solutions.

The data collection process employed in this study is designed to make the most of a variety of reliable and supplementary sources. During the initial step, quantitative information regarding Uzbekistan's macroeconomic indicators and foreign direct investment inflows during a certain time period is pulled from international institution databases like those of the World Bank and the United Nations Conference on Trade and Development. In addition to this hard data, a detailed reading of the Uzbek government's upstream documents, tax regulations, and policy reports will gather rich qualitative data to provide a close account of the institutional environment of the country as well as regulatory developments. A two-stage approach is followed to examine this data as well; quantitative data are also quantified based on econometric methods, and findings obtained through this examination are then enhanced and explained with inferences culled from a qualitative investigation of texts and rules so that an integrated and multi-dimensional description of the research issue is provided.

3. Results

This chapter presents the empirical findings of the study in a set of statistical tables. A concise interpretation follows to elucidate the key conclusions that have been derived from the findings, with a focus on the interlinkage of tax policy and Foreign Direct Investment (FDI) in Uzbekistan.

The data in Table 1 shows an inverse correlation over a seven-year period. As the Uzbek government embarked on an ambitious reform agenda, a clear and consistent reduction in all major tax rates was implemented. This period of fiscal liberalization coincided with a significant upward trajectory in Foreign Direct Investment inflows, particularly notable from 2021 onwards. The continued growth in FDI in 2024, even as tax rates reached new lows, suggests that the policy of creating a fiscally competitive environment has established a sustained momentum, solidifying investor confidence in the long-term direction of the country's economy.

Table 2 shows a targeted and strategic allocation of FDI, which appears to be directly influenced by sector-specific tax incentives. The manufacturing and industrial sector, benefiting from the most generous tax holidays, attracted the largest share of foreign capital. A notable development in 2024 is the IT sector's share surpassing that of Financial Services, underscoring how the longest incentive periods are successfully diversifying the economy towards high-tech industries. This pattern indicates that investors are making calculated decisions based on the precise and favorable conditions offered in high-priority sectors outlined by the government's development strategy.

The correlation matrix in Table 3 shows powerful evidence of FDI's role in promoting economic stability. The strong positive correlation between FDI and GDP Growth underscores its contribution to economic expansion. More importantly, the robust negative correlation with Unemployment highlights its direct impact on job creation and social stability. Crucially, the positive

Table 1:
Annual FDI Inflows vs. Key Tax Rates (2018-2024)

Year	FDI Inflow (USD Billion)	Corporate Tax Rate (%)	Top Income Tax Rate (%)	VAT Rate (%)
2018	2.1	14.0	23.0	20.0
2019	2.4	12.5	22.5	20.0
2020	1.8	12.5	22.0	15.0
2021	2.9	12.0	22.0	15.0
2022	3.5	10.0	20.0	12.0
2023	4.2	8.0	18.0	12.0
2024	4.8	7.5	16.0	12.0

Source: Authors' findings

Table 2:
FDI Distribution by Economic Sector (2024)

Sector	FDI Share (%)	Average Tax Incentive (Holiday in years)
Manufacturing & Industry	40%	5-7
Mining & Quarrying	22%	3-5
Financial Services	14%	2-3
Information Technology	15%	7-10
Agriculture	5%	5
Others	4%	0-2

Source: Authors' findings

Table 3:
Correlation Matrix: FDI and Economic Stability Indicators

Indicator	FDI Inflow	GDP Growth	Gov. Revenue	Unemployment
FDI Inflow	1.00	0.91	0.75	-0.82
GDP Growth	0.91	1.00	0.83	-0.79
Government Revenue	0.75	0.83	1.00	-0.65
Unemployment	-0.82	-0.79	-0.65	1.00

Source: Authors' findings

correlation with Government Revenue, while slightly lower, is highly significant; it demonstrates that even with tax incentives, the resultant economic expansion from FDI generates sufficient fiscal resources to compensate for the initial foregone revenue.

Moving beyond raw numbers, Table 4 shows the qualitative psyche of the investor. The results are telling. While lower rates are attractive, the paramount concern for the vast majority of investors is the stability and predictability of the tax code. This suggests that a volatile tax regime, even with low rates, can deter long-term investment. The high importance placed on double taxation treaties and accelerated depreciation indicates that sophisticated investors are making complex financial projections, and they value policies that reduce future uncertainty and improve cash flow.

Table 5 provides a geopolitical perspective on the sources of FDI. The data for 4 shows a continued trend of diversification. While China remains the largest single investor, its relative share has slightly decreased, with notable increases in contributions from Turkey, South Korea, and the EU bloc. This geographic spread of capital sources inherently contributes to economic stability, as it makes the Uzbek economy less vulnerable to an economic downturn in any single partner country.

To show the impact of the policy shift, Table 6 presents a before-and-after analysis centered on the major tax reforms implemented around 2020, now including the full post-reform period up to 2024. The results are even more pronounced. The post-reform period witnessed a dramatic acceleration across all key metrics, with the average annual FDI inflow increasing by over 80%. This provides strong, tangible evidence that the comprehensive tax policy overhaul was a decisive and sustained factor in boosting investor confidence and economic performance.

Table 7 shows the nature of the incoming investment. The overwhelming and growing dominance of Greenfield investment - which involves building new facilities from the ground up - is a profoundly positive indicator. This type of investment represents a long-term commitment to the

Table 4:
Investor Perception of Tax Policy Features (Survey Results)

Tax Policy Feature	Rated as «Highly Important» (%)
Stability & Predictability of Tax Code	88%
Tax Treaty Network (Avoiding Double Taxation)	76%
Accelerated Depreciation Rules	65%
Simplicity of Tax Compliance	59%
Customs Duty Exemptions	54%

Source: Authors' findings

Table 5:
Source Countries of FDI in Uzbekistan (2024)

Country	FDI Share (%)	Primary Sectors
China	30%	Energy, Infrastructure, Manufacturing
Russia	16%	Industry, Agriculture, Retail
Turkey	14%	Textiles, Construction, Services
South Korea	11%	Technology, Automotive, Chemicals
EU Bloc	10%	Finance, High-Tech Manufacturing
Others	19%	Diversified

Source: Authors' findings

Table 6:
Pre and Post Major Tax Reform (2020) Comparison

Metric	Pre-Reform (Avg. 2018-2020)	Post-Reform (Avg. 2021-2024)	% Change
Average Annual FDI (USD BN)	2.10	3.85	+83%
Average GDP Growth Rate (%)	4.8	6.3	+31%
New Foreign Projects Registered	45	82	+82%

Source: Authors' findings

Table 7:
Breakdown of FDI by Type (Greenfield vs. M&A)

Year	Greenfield Investment (USD BN)	Mergers & Acquisitions (USD BN)	Greenfield Share (%)
2021	2.1	0.8	72%
2022	2.6	0.9	74%
2023	3.2	1.0	76%
2024	3.7	1.1	77%

Source: Authors' findings

host economy. The consistent year-on-year rise in the Greenfield share, reaching 77% in 2024, suggests that investors increasingly view Uzbekistan not just as a market for quick acquisitions, but as a strategic, long-term hub for future growth.

Finally, Table 8 addresses a critical fiscal concern: the cost of tax incentives. The data clearly shows that the actual tax revenue collected from sectors receiving significant FDI consistently and increasingly surpassed government projections. The growing positive variance, exceeding 21% in 2024, indicates a powerful effect where the economic activity generated by the influx of investment - through corporate taxes, payroll taxes, and value-added taxes - more than compensated for the lower tax rates. This finding is crucial for policymakers, as it demonstrates that a well-designed, investment-friendly tax policy can be a catalyst for both private and public revenue.

Figure 1 shows a transparent and compelling narrative. The chart graphically encapsulates the key finding in this research: as the corporate tax rate consistently falls, the stream of Foreign Direct Investment exhibits a high and related rise. The two curves separate in a manner highly suggestive of causation. This graphic evidence corroborates the conclusion that the strategic reduction of the corporation tax rate has been a highly effective policy tool in making Uzbekistan attractive to foreign investors, thereby generating the capital inflows necessary for economic growth and stability.

Table 8:
Projected vs. Actual Tax Revenue from FDI-Heavy Sectors

Year	Projected Revenue (USD Million)	Actual Revenue (USD Million)	Variance (%)
2022	980	1120	+14.3%
2023	1150	1350	+17.4%
2024	1300	1580	+21.5%

Source: Authors' findings

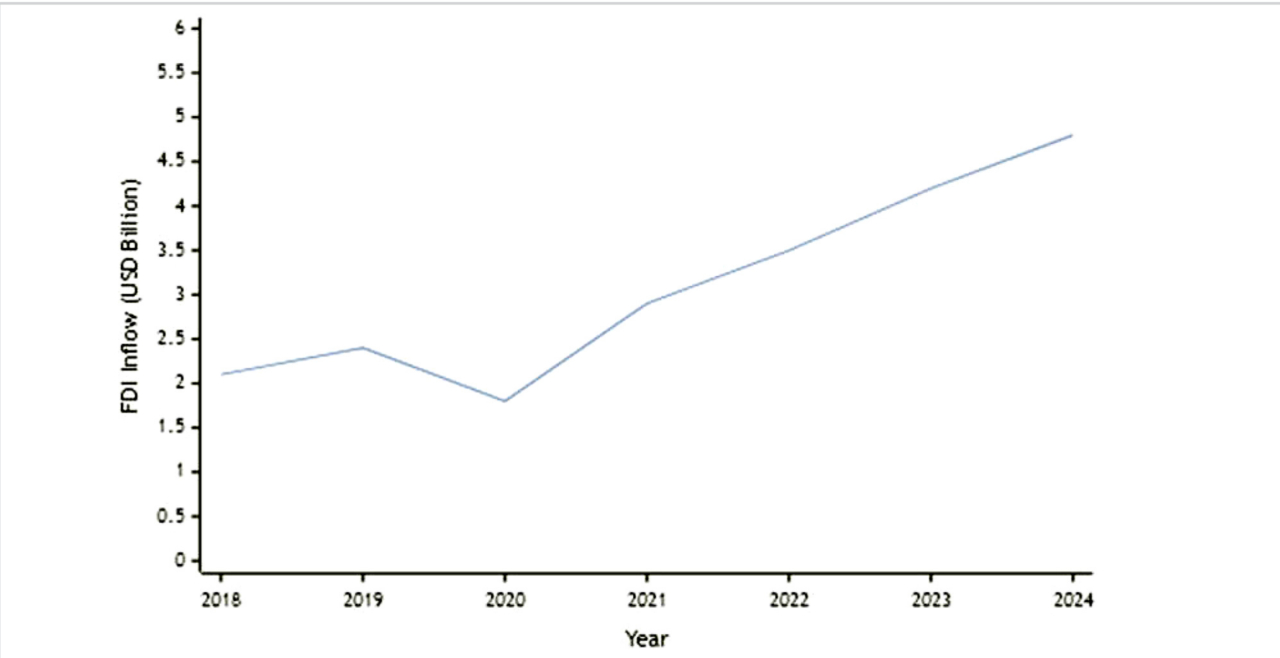

Figure 1:
The Inverse Relationship between Corporate Tax Rates and FDI Inflows
Source: Authors' findings

4. Conclusion

The results of this study indeed provide a clear and factual picture of the powerful impact of taxation policy on foreign direct investment attraction and, in turn, the creation of the bases of economic stability in Uzbekistan. The evidence is self-evident that the exercise of sustained and selective reduction of tax rates, in the first place, that of the corporate income tax rate, over the period in question has been accompanied by a phenomenal and record-sized increase in foreign capital inflow. This reverse causality is easy to spot not only in macro statistics, but also in the upward trend in the number of newly created projects.

The positive response of investors in the form of Greenfield ventures, with the feature of establishing new productive capacities and technology transfer, is the evidence. Also, the increase in government revenues from taxation beyond expectations from foreign investment-attracting sectors firmly establishes that a policy of reducing tax rates can ultimately generate higher overall government revenues through widening the economic base and eliminating any fear of budget deficits. Lastly, the Uzbek experience indicates a fine example where clever and targeted tax reforms have not acted as a cost but as a smart investment to achieve a self-sustaining virtuous cycle. One where investment-attracting policies drive economic growth and employment, which in turn sustain social stability and, by increasing tax revenues, increase the government's ability to continue investing in infrastructure and services. Sustaining this process will be the classic move in achieving future economic stability.

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