European Journal of Business and Management
ISSN 2222-1905 (Paper) ISSN 2222-2839 (Online)
Vol.8, No.3, 2016

Effects of Foreign Direct Investment and Firm Export in Economic Growth: Evidence from Uzbekistan

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Abstract

Uzbekistan's economy has been enjoying a progressive economic growth thanks to diversified export structure, attracted foreign direct investment (FDI), more sophisticated industries and open economic policy. Impact of inward FDI and export has become more significant due to their rapid shift and extension across all industries. This article examines the impact of FDI based firms on economic growth through export capacity and effect analysis, and provides recommendation for further improvement of export-oriented performance of FDI-based firms.

Keywords: foreign direct investment, export capacity, FDI-based firm, economic growth, Uzbekistan

1.Introduction. An empirical assessment of the role of foreign direct investment (FDI) in a host country's export performance is important, since exports have been for a long time viewed as an engine of economic growth (Zhang, 2004). Export capacity is a major indicator of international economic relations of any economy, no matter they are centrally planned or market economy. However, export capacity is built on different elements of foreign trade, business environment, extent of liberalization and absence of barriers, customs levy structure and foreign demand level for exported products. Closer ties of foreign trade enable exporter grow and penetrate international markets, which, in turn, increase the volume of receipts from foreign trade. Interestingly, the growing body of observations proves that developing and developed economies are building a new structure of firm export through multinational enterprises. Multinational enterprises are forwarding their capital to developing economies in the form of foreign direct investments by establishing their affiliates and joint ventures. Affiliates produce products and goods, and saturating international market in line with meeting the local demand. As foreign direct investment flows increase, export volume of an economy also shifts upward. In practice of many developing economies, FDI gains the central position in ensuring economic growth through facilitating capital mobility, production and employment opportunities. In case of Uzbekistan, as a post-Soviet and transition economy, FDI attraction and absorption has multilateral effect in country-wide economic performance. Large-scale privatization and liberalization policy conducted in Uzbekistan lays a solid foundation for directing the FDI flows, enhancing economic sectors which need transfer of technology, innovative management structure and professional skills from advanced economies, and enabling economic growth in both short and long term perspective. Patterning to internationally admitted experience in enlarging the scale of FDI-based enterprises and deriving from specific features of national economy, Uzbekistan is running a policy framework of export capacity development and business environment sophistication with a special focus on FDI support scheme in all aspects. This paper studies the export performance of FDI-based enterprises and their rle in economic growth at large through practical approach.

2. Literature review. There has been a growing literature on the FDI-export link by Lardy, Nauthgton, UNCTAD, Zhang, and Song. In some literature, coexisting effect of FDI and export are defined as a powerful engine of growth for developing economies, who are in need of external funding for new capacities in production and technology, capital mobility and funding source. Theoretically, the simulative effects of FDI on exports of the host country derive from the additional capital, technology, and managerial know-how the foreign investors bring with them, along with access to global, regional, and especially home-country, markets (UNCTAD, 2002).According to Dunning (1977, 1981), an multinational enterprises choose FDI over export and licensing if there are ownership advantage, location advantage, and internalization advantage, because these factors vary from country to country and from industry to industry. As seen in China's case, found by Zhang and Song in 2000, FDI provides host economy with competitive assets for export-oriented production in technology-intensive and dynamic products in the world trade. Direct and indirect effects of FDI and consequent export growth stimulate import substitution and reduction of exporting raw materials at macro-level. However, in macro level, FDI and export effects are proven in internationalization, innovativeness and human capital sophistication.

3. FDI and Export Dilemma: How They Interact?

Impact of FDI on host economy's export is a highly controversial issue among both economists and academia. However, they proposed diverse models and theories of FDI-export relations by taking the orientation and aims of invested FDI. Dunning (1998) argued that the relationship between trade and FDI was conditional on the motivation of the FDI in question. Market-seeking FDI can displace exports from the home to the host country, while efficiency-seeking FDI will increase the volume of trade (Gray, 1998; Kojima, 1978; Buckley, 1983). While firms from developed countries may prefer to export their products to the unexplored markets, developing countries attempt to use their market potential to attract foreign direct investment FDI (Qui and Tao, 2001). However, injected foreign direct investment has a double-edged effect in terms of mode they interact with foreign trade performance of the host economy. The first mode, local-market oriented FDI, is aimed at saturating the local markets at national level and substituting the imports by producing the imported goods based on natural and human resources through introduction of new technologies and capital. It is commonly encountered in many developed countries with significantly less developed or underdeveloped particular sectors. Because some sectors, at the modern age of technological development, need sophisticated technologies and R &D facilities to keep pace with international trend. The second mode, export-oriented FDI, is the most widespread and attractive one often highly welcomed and supported by host economies. Availability of cheap labor, easy access to relevant raw materials and governmental support for foreign investors attracts FDI to mobilize capital through foreign trade and external capital, and to ensure employment opportunities, introduction to new technologies and stimulation of local manufacture with the excess of natural resources. Host economies support export of FDI-based enterprises due to high level market saturation and partial protection of local industries in the same field.

Table 1. FDI, international trade and production in selected years of 1990-2014, billion USD

Indicators	1990	2005-2007 (average)	2012	2013	2014
FDI inflows	205	1397	1403	1467	1228
FDI outflows	244	1423	1284	1306	1354
FDI inwardstock	2198	13894	22073	26035	26039
FDI outwardstock	2254	14883	22527	25975	25875
Cross-border M & As	98	729	328	313	399
Export of foreign affiliates	1444	4976	7469	7688	7803
Employment by foreign affiliaties (000 people)	20625	53306	69359	71297	75075
Memorandum					
GDP	22327	51799	73457	75453	77283
Gross fixed capital formation	5592	12219	17650	18279	18784
Exports of goods and services	4332	14927	22407	23063	23409

Source: UNCTAD, 2015

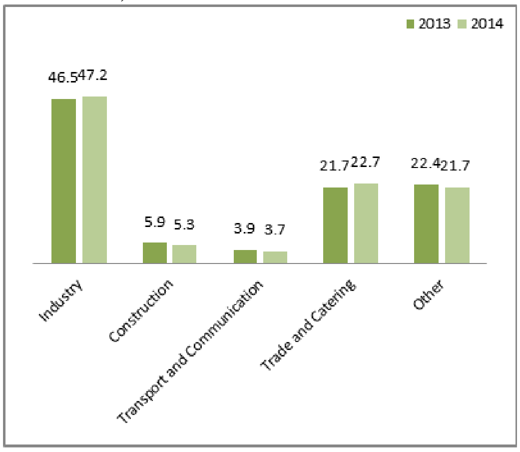
Global investment environment is working on export-facilitation regime. Highly competitive markets and growth in the number of suppliers from emerging and developing economies pose higher risk of exiting from market for playing ones and difficulties in market access for new suppliers. Export opportunities are limited by not only market-related barriers but also unsound stance of global financial system since 2008. International financial profile is not sufficiently stable to support export: most countries are in recovery process and financial system is still vulnerable to any systemic or hidden shocks. As UNCTAD found (2015), countries' investment policy measures continue to be geared predominantly towards investment liberalization, promotion and facilitation through international investment agreements targeted to boost export capacity by development of new production facilities. Therefore, recent trends proved that most multinational corporations have invested extensively in low-cost export locations, as well as in developed countries, in industries where proximity to markets matters.

4. FDI-Export Linkages in Uzbekistan: Impact on Economic Growth

In the global economy, international trade and foreign direct investment (FDI) have become increasingly important. Both of them are known as key elements that drive an increase in economic integration and the economic development process (Virakul, 2009). Attracting inward FDI generates direct and indirect impacts that possibly benefit the host economy. The direct benefit is through an increase in capital inflows and employment. At the same time, the indirect benefits are spillovers such as productivity and export spillovers to domestic firms. One of the similar concepts of FDI-export relations explains that FDI influences on host economy's export under two potential tools: supply-increasing tool (capacity tools) and FDI-specific tools. The supply-increasing tools arise when FDI inflows induce increases in the host country's production capacity, which, in turn, increases export supply capacity. The FDI-specific tools arise because foreign capital inflows may incorporate different competitive advantages, such as superior knowledge and technology and thus, higher productivity, or better information about export markets as compared to local firms. It is often argued that successful FDI-promoting policies should lead to, among other things, a significant increase in the host country's exports.

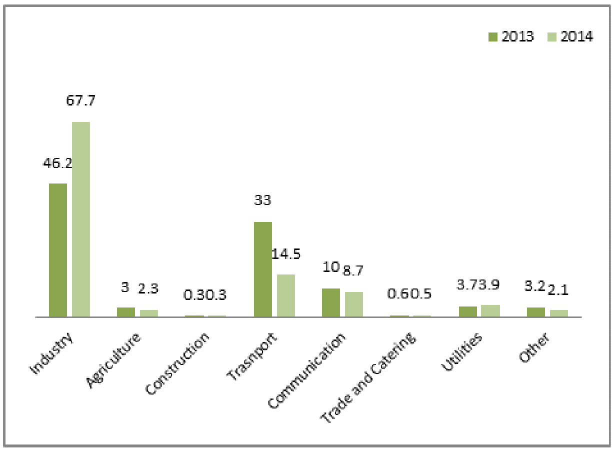
Since the early independence Uzbekistan switched from a centrally planned economic system to one based on market forces following the development path of advanced economies. Freely determined price system, private ownership and permission to run a private business totally diversified socio-economic condition (Abdullaeva, 2015). Deepening of economic reforms opened new ways of development which can be seen in continuous economic growth, economic diversification and progressive foreign economic relations. Especially, foreign economic linkages of Uzbekistan strengthened with high FDI attractiveness and growing volume and outreach of foreign trade. The last decade remained remarkable with inflow of FDI to different sectors of national economy and sustainable increase in gross production due to effective organization of investment environment and public policy framework created to support it. As a result, number of FDI-based firms increased, their share and spread among sectors optimized (Figure 1and Figure 2).

Figure 1. Sectoral share of FDI-based enterprises in 2013-14, %



Source: State Statistics Committee of Uzbekistan, 2015

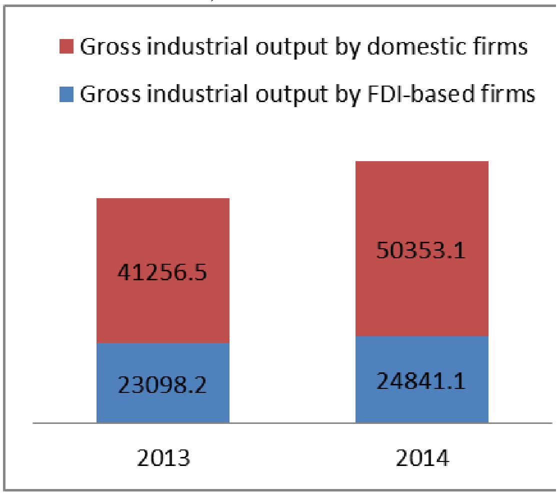
Figure 2. Sectoral share of FDI inflow in 2013-14, %



Source: State Statistics Committee of Uzbekistan, 2015

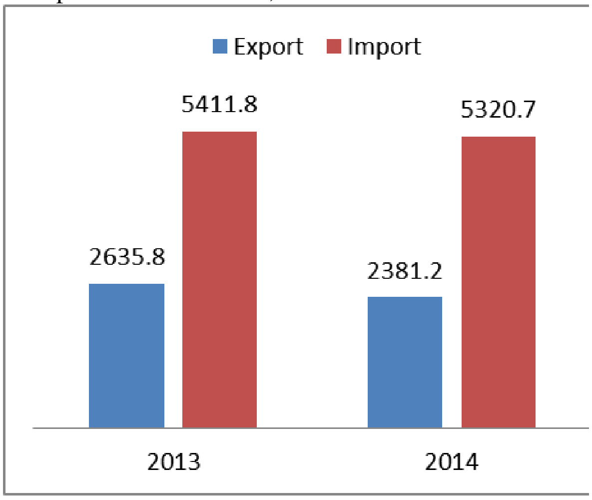
It is often argued that successful FDI-promoting policies should lead to, among other things, a significant increase in the host country's exports (Kutan and Vukšić, 2007). As a policy response to positive effect, Uzbekistan signed a law amending foreign investment regulations, including the introduction of a one-stop shop for foreign businesses, the easing of migration regulations for foreign investors, a guarantee of investors' rights to repatriate funds and a pledge of stable tax legislation and customs tariffs for foreign investors for a decade after a firm is registered (UNCTAD, 2015). Consequently, number and share of FDI-based enterprises in gross export increased further despite the poor economic condition in international markets owing to recovery period from global financial crisis and its long-term implications (Figure 4 and Figure 5). Considering current condition in global markets, expansion and performance of FDI-based firms, their position in foreign trade are inherent in terms of Uzbekistan's integration to global economic community and competitiveness. Therefore, trade and FDI are the principal strategies for firms to access foreign markets. As the world becomes increasingly interdependent through international trade and investment flows, the linkages between these two strategies become increasingly important.

Figure 3. Gross industrial output by FDI-based firms in 2013-2014, billion UZS



Source: State Statistics Committee of Uzbekistan, 2015

Figure 4. Foreign trade indicators of FDI-based enterprises in 2013-2014, million USD



Source: State Statistics Committee of Uzbekistan, 2015

Export and FDI linkages sometimes lead to reviewing the tax and customs policy depending on the government's attitude and national development priorities. In case of Uzbekistan, as shown above, FDI attraction is one of the focus areas on economic development policy as a driving force of export facilitation and technological modernization. Business environment in the economy totally changed due to introduction of international market players and healthier competition among local and FDI-based enterprises in terms of quality and price.

5. Conclusion and Recommendations

A standard outcomes in studies of export-FDI linkages are that an increase in FDI volume may cause firms export more products and goods through earned efficiencies from vertical and horizontal technology transfer, market competition, supply quality, welfare effects, corporate management skills and advancement of professional skills of employees. Governmental support tools for attracting foreign capital and stimulating exporter enterprises gain the key importance in ensuring continuous economic growth and socio-economic wellbeing. Deriving from the main findings, two export and investment promotion measures are proposed for further widening of impact area of FDI-export relations. Firstly, Uzbekistan should further support export promotion measures like export finance, credit guarantees, trade fairs which have positive effect on export-oriented investment by reducing the cost of multiple border crossings on the import and export. Secondly, the government should keep the current effective condition of inward investment promotion, particularly for export-oriented FDI, including existing the longevity of financial, fiscal, and other incentives subsidized infrastructure, market access preferences and regulatory concessions in three special economic zones.

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