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# CONTENTS

The role and prospects of innovations in uzbekistan’s strategy for transition to a green economy .....	4
<b>Abdurakhmanova Gulnora Kalandarovna</b>	
Evaluation of the vape category among e-cigarette smokers in Uzbekistan.....	9
<b>S.M. Mirzaliev, G.K. Abdurakhmanova, M.O. Kurolov, Judy Smetana, Krissy Lewis</b>	
Features of the south korean education system and possibilities of their application in Uzbekistan .....	23
<b>Mukhamadjanov Shakhriyor Solijon ugli</b>	
Exploring the directions of sustainable development of tourism in uzbekistan.....	28
<b>Khusniddin Egamnazarov</b>	
Influence of the number of workers on the profitability of enterprises.....	35
<b>Gafurova Azizaxon Fatixovna</b>	
Strategies for differentiating teaching instructions in the esp classroom .....	39
<b>Shahnoza Berdiyeva Xolmaxmatovna</b>	
Factors affecting remote services of banking .....	43
<b>Khudoyorov O.O.</b>	
Digital transformation of manufacturing .....	48
<b>Kudaynazarova Dilnaz Koshkarbaevna</b>	
Forming important methods for nurturing students’ educational initiatives based on national-cultural approaches .....	54
<b>Azimova Nilufar Nuriddinovna</b>	
The multifaceted dimensions of poverty in Asia: a comprehensive analysis.....	61
<b>Amirdjanova Sitara Sunnat kizi</b>	
Spiral models of innovative development: triple, quadruple and five helix models.....	66
<b>Sultanova Munisa Samat kizi</b>	
Strategic development of mice tourism in Spain: trends and implications.....	72
<b>Bahromov Behzod, Egamnazarov Husniddin</b>	
Development of food market infrastructure .....	77
<b>Daminova Ugiloy Mirzakul kizi</b>	
The mechanisms for developing students’ motivation for independent learning through educational project technology .....	83
<b>Kasimova (Mulladjanova) Nasiba Azimdjanovna</b>	
Program-based budgeting and its application potential in Uzbekistan.....	89
<b>Ganieva Malika Maksudovna</b>	
Management of integrated manufacturing enterprises .....	92
<b>Tursunova Zarnigor Rustamovna</b>	
Building a sustainable workforce: the role of green hrm in driving corporate environmental responsibility.....	96
<b>Omanova Nargiza Rustam kizi</b>	
The main features of e-commerce dynamics in world countries.....	105
<b>Dilafruz Sodikova</b>	
Theoretical foundations and macroeconomic impact of foreign direct investment: insights and implications for developing economies .....	113
<b>Ibragimov Ganijon Gayratovich</b>	

# THEORETICAL FOUNDATIONS AND MACROECONOMIC IMPACT OF FOREIGN DIRECT INVESTMENT: INSIGHTS AND IMPLICATIONS FOR DEVELOPING ECONOMIES



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**Abstract:** Foreign Direct Investment (FDI) serves as a pivotal catalyst for economic growth and sustainable development, especially in developing nations. This study examines the theoretical foundations of FDI and its multifaceted influence on macroeconomic indicators. It highlights key channels through which FDI contributes to economic development, including technology transfer, human capital enhancement, and integration into global value chains.

Using Uzbekistan as a case study, the paper explores recent trends, challenges, and opportunities in attracting FDI, with a focus on institutional reforms and policy measures. Findings reveal that while FDI plays a crucial role in fostering innovation, creating employment, and boosting economic output, significant barriers such as regulatory inefficiencies, political instability, and inadequate infrastructure persist. Addressing these challenges requires comprehensive strategies, including the establishment of a transparent investment climate, targeted reforms, and leveraging global best practices.

This research provides actionable recommendations for policymakers to optimize FDI inflows and align them with long-term development goals.

**Key words:** Foreign Direct Investment (FDI), economic growth, technology transfer, human capital, macroeconomic indicators, institutional reforms, investment climate, developing economies, Uzbekistan, global value chains, sustainable development, policy measures, regulatory inefficiencies, infrastructure development.

## INTRODUCTION

The impact of foreign direct investment (FDI) on the economy has become one of the most debated issues among economists and policymakers in both developed and developing countries in recent years. This debate is intensifying as FDI flows to the least developed countries (LDCs) continue to grow rapidly. Economists and policymakers argue that FDI can contribute to the growth and development of host LDCs through various channels, including the transfer of modern technology and management skills, human capital development, and the expansion of export markets. While the potential role of FDI in the development process of developed economies has once again come under the spotlight, some fundamental questions remain unresolved.

Among these issues, the impact of FDI on income inequality in host countries is perhaps the most complex and controversial. While the least developed countries have experienced rising inequality in recent decades, they have also witnessed rapid globalization of economic activity through international trade and investment, particularly direct investment.

According to the 2024 World Investment Report, "foreign direct investment fell by 2 percent to US\$1.3 trillion in 2023 amid the economic downturn and rising geopolitical tensions. Project finance flows in several European economies have declined, affecting sustainable development. New financing for Sustainable Development Goals (SDGs) sectors has fallen by more than 10 percent, particularly in rural food and water" [1]. This hampers efforts to achieve the 2030 Agenda and calls for urgent policy action to rethink financing for sustainable development. The report notes that improving the ease of doing business and expanding

digital government solutions can help overcome underinvestment by creating a transparent and streamlined environment. It highlights the significant growth of online services and information portals, which support the broader development of digital governance especially benefiting developing countries.

The flow of direct investment to developing countries decreased by 7 percent to US\$867 billion [2]. Tight financing conditions have led to a 26 percent decline in international project finance deals, which are crucial for infrastructure investment. Given that international project finance is a key driver of economic development in developing countries, these nations remain highly vulnerable to the global downturn in this type of investment. Crises, protectionist policies, and regional shifts are disrupting the global economy, trade networks, regulatory environments, and supply chains. This undermines the stability and predictability of global investment flows, creating both obstacles and unique opportunities. While the outlook for 2025 remains challenging, the report suggests that modest growth is possible, supported by efforts to ease financial conditions and facilitate investment through national policies and international agreements.

Investments in global value chain-intensive industries, such as automotive and electronics, are increasing in regions and countries with easy access to large markets. However, many developing countries continue to struggle to attract foreign investment and integrate into global production networks.

Clause 49 of the Decree of the President of the Republic of Uzbekistan “On the Strategy “Uzbekistan — 2030”” No. DP-158<sup>1</sup>, dated September 11, 2023, in the section “Further Increasing the Investment Attractiveness of Our Country and Accelerating the Development of the Securities Market”, sets the task of “conducting an investment rating of regions and further increasing their attractiveness for investors based on the capabilities of each region” [3]. To implement these tasks, US\$43 billion is planned to be invested in 2025. This is expected to lead to the implementation of more than 300 major projects and the production of 662 new import-substituting products [4].

## LITERATURE REVIEW

Numerous studies have been conducted on the theoretical foundations of attracting foreign investment into the economy. Economists in Uzbekistan have concluded that “Foreign direct investment (FDI) is a form of capital investment that grants the investor direct rights to securities or property. FDI involves the placement of investments by the investing state or its economic entities in the economy of the recipient state” [5]. Upon closer examination, this viewpoint is well-justified, as it primarily emphasizes capital formation.

Some researchers have highlighted institutional barriers as key obstacles to attracting foreign direct investment in Uzbekistan. They have proposed various institutional reforms to address these challenges. Specifically, one study notes that “Despite the increasing volume of foreign direct investment entering Uzbekistan’s economy in recent years, the country still ranks low as a recipient of foreign investment. The main reason for this can be attributed to the low efficiency of state institutions in Uzbekistan” [6].

A favorable investment climate is widely considered the most critical factor in attracting FDI. Scholars emphasize that “Investment activity plays a crucial role in the socio-economic development of the regions of our country. Their sustainable development largely depends on the level of investment potential and its rational utilization” [7].

Foreign scholars have identified FDI as a fundamental driver of economic development. They argue that “A synthesized analysis of the impact of foreign direct investment on the economic growth of developing countries—struggling with poverty, illiteracy, disease, and the debt crisis—reveals that FDI serves as an effective solution to many of these challenges. It aligns with the Sustainable Development Goals, focusing on people, the planet, and overall well-being” [8].

Keynesian economic theory underscores the principle of macroeconomic equilibrium, specifically the balance between savings and investments. According to Keynesian thought, when this equilibrium is disrupted, capital tends to flow beyond national borders. An excess of savings over investments can lead to economic recession. Furthermore, “J. Keynes argued that if a country maintains a positive balance of payments, it can become a capital exporter. At the same time, Keynesian economists advocate for regulatory mechanisms to oversee international capital flows” [9].

Foreign capital generally exerts diverse effects on the host country’s economy. One key advantage is that “Foreign direct investment is typically long-term in nature and does not incur maintenance costs, unlike commercial loans. Consequently, it does not contribute to an increase in the host country’s external debt, making it a favorable investment source under certain conditions” [10]. Empirical research further supports the notion that “The presence of foreign direct investment positively impacts the economic development of the host country” [11]. Moreover, “FDI is distinct from foreign portfolio investment or foreign indirect investment due to the aspect of direct control” [12].

<sup>1</sup> <https://lex.uz/docs/6991208>

Foreign direct investment is generally defined as “the practice of international businesses investing in countries other than their own” [13]. Recent studies and modern theoretical approaches define FDI as follows: “Foreign direct investment (FDI) is a type of capital flow in which investors from outside a country invest in its productive assets” [14]. Investors may be corporations or individuals, and companies engaging in FDI often transform into multinational enterprises as they expand their operations across multiple geographic regions.

## RESEARCH METHODOLOGY

Foreign direct investment (FDI) is a major catalyst for economic growth and development in countries around the world. As globalization deepens, FDI has emerged as an important vehicle for transferring capital, technology, and management skills from one country to another. Its economic impact is profound and multifaceted, spanning sectors such as employment, infrastructure development, technology transfer, and international trade.

FDI not only injects much-needed capital into the host country but also helps increase competitiveness, innovation, and productivity in local industries. It serves as a vehicle for knowledge exchange and skills development, contributing to the overall development of the economy. However, the impact of FDI depends on many factors, including the host country’s institutional framework, policy environment, and the nature of the investment. Understanding the dynamics of FDI and its implications is crucial for policymakers, investors, and other stakeholders seeking to harness its potential for sustainable economic growth and prosperity.

## ANALYSIS AND RESULTS

Foreign direct investment is an important component of the global economy. Its impact is not limited to specific sectors or regions but resonates globally. Direct investment acts as a catalyst for economic growth, innovation, job creation, and the exchange of ideas. It is a powerful tool that helps countries achieve their economic goals and improve the living standards of their citizens.

Direct investment can also contribute to sustainable development by encouraging investment in environmentally friendly technologies and practices. As we examine the various aspects of direct investment, it becomes clear that its impact goes beyond financial indicators and shapes the socio-economic landscape of host and local countries. The benefits of direct investment are numerous and wide-ranging, and countries should encourage this important form of investment.

Global direct investment flows are expected to decline by 2% in 2023 to \$1.3 trillion as trade and geopolitical tensions weigh on the slowing global economy. The report notes that excluding several European channel economies that have seen major shifts in investment flows, the headline figure would be more than -10% [15, 17–18].

Undoubtedly, developing countries face major economic shocks, such as high levels of poverty, low-capacity utilization, high unemployment, debt, and the increasingly difficult achievement of other sustainable development goals by 2030. Foreign direct investment has enabled economic recovery and growth, supported by policymakers at the national, regional, and international levels. This investment helps bridge the technology and resource gap in developing countries and prevents further accumulation of debt crises.

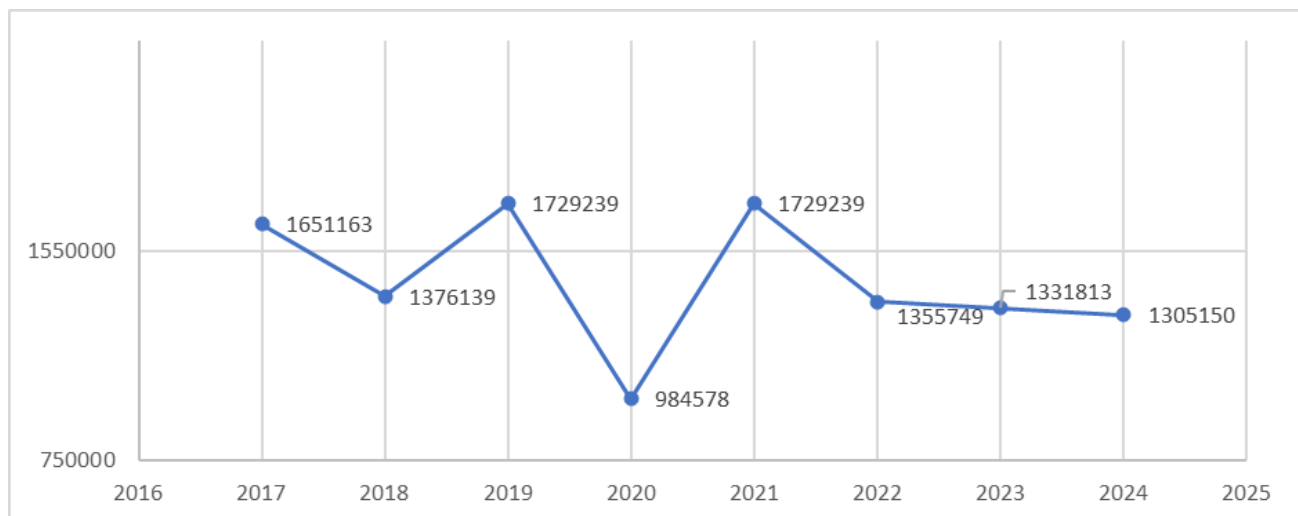


Figure 1. The volume of foreign direct investments in the world (billion US dollars) [16].

According to the *World Investment Report 2024*, “foreign direct investment in 2023 fell by 2% to US\$1.3 trillion amid economic slowdown and rising geopolitical tensions. In several European economies, project finance flows have slowed, affecting sustainable development [16].

The Chinese economy, which is one of the fastest-growing in the world, is also regarded as one of the top destinations for FDI. The increase in direct investment in China has shifted focus from manufacturing for export to catering to China’s vast domestic market. In other words, while direct investment in China may continue, the value chain may also continue to shift as manufacturing direct investment explores other directions, particularly in labor-intensive sectors.

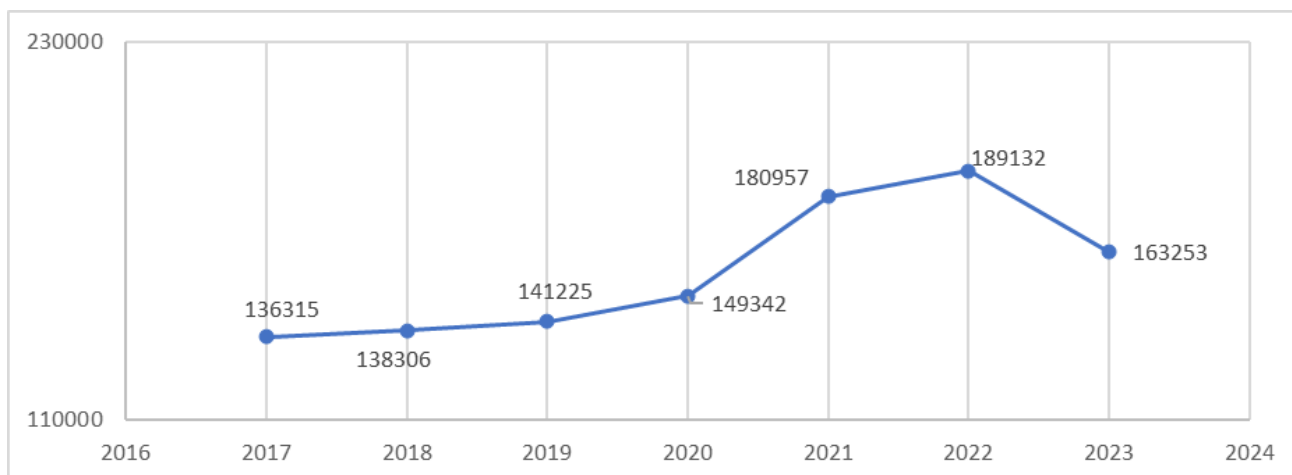


Figure 2. Total foreign direct investment attracted to China (million US dollars) [16].

In particular, the volume of mutual trade with China has doubled in recent years, reaching a record \$14 billion in 2023. The head of state has once again emphasized the opportunity to increase this figure to \$20 billion in the coming years. This can be achieved by expanding mutual supplies of agricultural and industrial products and concluding a new intergovernmental agreement on preferential trade for certain types of products.

The total volume of Chinese investments in Uzbekistan has exceeded \$14 billion, while the number of enterprises with Chinese investment has tripled.

## CONCLUSION AND RECOMMENDATIONS

In conclusion, it is appropriate to define the general concept of foreign direct investment (FDI) as follows: FDI is a form of capital investment that grants the investor direct ownership rights over securities or property. In other words, FDI refers to investments placed by a foreign state or its economic entities in the economy of the host country.

Developing countries and transition economies utilize direct investment as a key source of economic development and technological modernization. It contributes to income growth, job creation, and increased overall economic productivity. To attract direct investment, many countries have implemented privatization policies for state-owned enterprises and sought to improve their domestic investment climate to appeal to foreign investors. FDI fosters growth in host economies by enhancing total factor productivity and optimizing resource efficiency.

It has been substantiated that FDI will serve as the foundation for the further work of state bodies in developing a new strategy for attracting foreign direct investment until 2026. This includes not only securing these investments within the country but also ensuring their effective distribution across sectors and regions.

Thus, FDI can be theoretically defined as a form of capital investment that grants the investor direct rights over securities or property, enabling them to participate actively in the economy of the host country.

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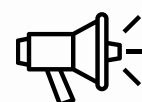
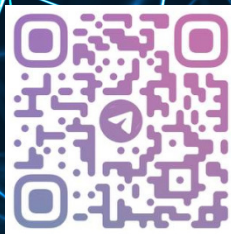
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