

ASIAN DEVELOPMENT BANK

TAR:UZB 37558

TECHNICAL ASSISTANCE

TO THE

REPUBLIC OF UZBEKISTAN

FOR

STRENGTHENING THE POLICY AND LEGAL FRAMEWORK FOR

FOREIGN DIRECT INVESTMENT

December 2003

CURRENCY EQUIVALENTS

(as of 30 November 2003)

Currency Unit	–	sum (SUM)
SUM1.00	=	\$0.001
\$1.00	=	SUM977.06

ABBREVIATIONS

ADB	–	Asian Development Bank
DLP	–	Department of Legal Protection
FDI	–	foreign direct investment
FIL	–	Foreign Investment Laws
GDP	–	gross domestic product
IPA	–	investment promotion agency
MOJ	–	Ministry of Justice
TA	–	technical assistance

NOTES

In this report, "\$" refers to US dollars.

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I. INTRODUCTION

1. The Government of Uzbekistan requested the Asian Development Bank (ADB) to provide technical assistance (TA) to strengthen the policy and legal framework for foreign direct investment (FDI) in order to establish a more favorable environment to attract FDI. In response to the request, the fact-finding mission visited Tashkent in August 2003 and reached an understanding with the Government on the TA.¹ The logical framework is in Appendix 1.

II. ISSUES

2. **Foreign Direct Investment.** It is widely recognized that FDI has played an increasingly important role in the economic development in recipient countries as FDI offers a number of advantages. Besides providing financial resources, FDI facilitates the transfer of intangible assets such as technology, skills, and management know-how, thereby helping directly boost productivity, job creation, and economic growth. FDI can also help secure foreign market access and improve domestic producers' competitiveness.

3. The Government has long recognized the importance of FDI and started to promote FDI from the early period of the transition from a centrally planned to market-based economy. However, Uzbekistan has yet to successfully attract much of FDI compared to other former Soviet Union republics in spite of the country's abundant natural resources (e.g., oil and gas, gold and other raw materials, cotton and other agricultural products); skilled labor force; and a potentially large domestic market. To date, FDI to Uzbekistan has amounted only to \$850.0 million compared to \$14.5 billion to Kazakhstan. For the last few years, FDI inflow has decreased further, with an estimated disbursement of only \$65 million in 2002, down by about 10% year on year according to the International Monetary Fund (IMF). Uzbekistan now has the lowest ratio of FDI to gross domestic product (GDP) in the former Soviet Union republics, and FDI per head is only about \$6.

4. **Privatization.** FDI is not only crucial for employment generation and economic growth in Uzbekistan but would also help accelerate privatization of state-owned enterprises. Government data show that the private sector accounts for about 35% of GDP, and exports from small and medium-sized enterprises contributed only about 5% of total export volume in 2002. Recently, the Government published a new resolution on privatization to jump-start the process of selling state assets in line with private sector development. Considering that domestic financial institutions remain underdeveloped and are unable to mobilize savings to support the privatization program, the success of the Government's renewed privatization efforts largely depends on FDI.

5. **Foreign Direct Investment Promotion Strategy.** As developed and developing economies increasingly recognize the importance of FDI, they progressively compete for FDI. Recipient countries have thus switched from a regulatory to a promotional approach to attract FDI. As of today, most recipient countries have already moved from the first generation of investment promotion (mainly opening up their economies to FDI) to the second generation (the recipient countries actively "market" their location). The establishment of investment promotion agencies (IPAs) in many recipient countries reflects this trend.² However, Uzbekistan has yet to

¹ The TA is first appeared in *ADB Business Opportunities* (Internet edition) on 27 August 2003.

² A 2001 survey by United Nation Conference on Trade and Development showed that there are currently 164 national level investment promotion agencies.

establish such an agency. Crucial information needed by foreign investors to make investment decisions and establish businesses is not readily available.

6. The Government's efforts have been limited only to advertising potential areas of FDI, mainly through publications. In order to considerably improve FDI promotion, there is a need to develop a strategy accommodating investment requirements and conditions. An investment promotion strategy should use a range of promotional activities such as image building, investment generation, and investor servicing. Following international practice, the Government will need to explore the establishment of an IPA as a part of the strategy.

7. **Legal and Regulatory Framework.** Another constraint on FDI promotion is weak legal framework. The Law on Foreign Investments and on Guarantees and Measures for the Protection of Rights of Foreign Investors³, the "Foreign Investment Laws (FIL)", provides the legal framework for FDI. FIL defines the types of entities in which foreigners are allowed to invest, conditions governing repatriation of profits and earnings, and general rights of foreign investors and guarantees on their investment. The significant guarantee for an entity with foreign investment is contained in the FIL that provides for protection against adverse changes in the law for 10 years following registration. To supplement FIL, a number of decrees have been issued. However, these are discretionary and often have no effective date. In fact, a number of these decrees apply only to individual firms. As a result, many decrees are often conflicting and create confusion both to firms and tax authorities.

8. To address the weaknesses of the regulatory framework and ensure appropriate protection for foreign investors, the Government created the Department for Legal Protection (DLP) of Foreign Investments and Entities with Foreign Investment under the Ministry of Justice (MOJ) in 2003. However, DLP has experienced difficulties in effectively fulfilling its tasks due to weak capacity of its staff and the complexity of regulations and decrees. Assistance is needed to develop a consistent and comprehensive legal framework for FDI in the context of long-term private sector development and to improve MOJ's capacity to strengthen the legal framework.

9. This TA will help the Government foster and sustain economic growth through enhanced resource mobilization by promoting greater capital inflows and better FDI management. This will improve the country's integration into world finance and trade and eventually reduce the country's dependency on foreign assistance. This TA is consistent with ADB's strategic objectives of private sector development and good governance. No other development partner has been involved in promoting FDI in Uzbekistan, however, care will be taken to ensure extensive consultation with major development partners including the World Bank, International Finance Corporation, and European Bank for Reconstruction and Development, to address concerns they may have regarding constraints in FDI in the country.

THE TECHNICAL ASSISTANCE

A. Purpose and Output

10. The purpose of the TA is to assist the Government in its efforts to effectively promote FDI by (i) creating a conducive policy environment for FDI, (ii) establishing a legal framework to ensure protection of foreign investors, and (iii) strengthening capacity of government agencies concerned.

³ Adopted on 30 April 1998.

11. The output will include the following:

- (i) FDI-related policy assessment and recommendations,
- (ii) establishment of legal protection for foreign investments and entities with foreign investment,
- (iii) medium-term strategy to promote FDI,
- (iv) upgraded repository of FDI regulatory acts, and
- (v) officials trained in FDI promotion and protection.

B. Methodology and Key Activities

12. The TA will provide for extensive consultation with the private sector and other development institutions. In the course of developing recommendations, a workshop with high-level government officials and international experts will be conducted to facilitate government ownership. The TA will organize a 1-day conference to disseminate TA output. The TA activities are summarized below.

13. **Policy and Institutional Framework.** The TA will assess current institutional arrangements, policies, and practices to identify major impediments to FDI. Since a number of government agencies are involved with FDI-related policy, a thorough assessment of roles and relations among them will provide recommendations on operational aspects of facilitating FDI. Based on the study results, the TA will provide recommendation on overall foreign investment policy situations and procedures to create a conducive environment for FDI with a medium-term strategy to proactively promote FDI. The recommended strategy will include the schemes to establish an IPA for FDI.

14. **Legal and Regulatory Framework.** The TA will analyze existing legal and regulatory frameworks to identify weaknesses (including gaps and contradictions) and other potential legal constraints on FDI. The assessment will be made on constitutional and legislative framework on foreign investment to determine whether amendments are necessary. The TA will identify the critical legal impediments to protecting and attracting FDI; evaluate various options to remove them; and recommend changes such as revision of laws, regulations, and decrees to harmonize them.

15. **Improving Capacity of the Department for Legal Protection.** Based on the results of the institutional and legal assessment, the TA will provide in-country trainings, and overseas training to improve DLP's capacity. The trainings will provide government officials with international best practices and practical solutions identified by the assessment. The TA will make FDI-related legal case studies from key legal cases related to the FDI in Uzbekistan in order to develop domestically applicable reference materials. Together with case studies, the preparation and implementation of trainings will produce a repository of international best practices and reference materials on FDI.

C. Cost and Financing

16. The total cost of the TA is estimated to be \$430,000 equivalent, including foreign exchange cost of \$242,000, and local currency cost of \$188,000 equivalent. The Government has requested ADB to finance \$300,000 equivalent, covering the entire foreign exchange cost of \$242,000 and \$58,000 equivalent of the local currency cost. The Government will contribute \$130,000 in kind for office space, counterpart staff, transportation, and other services. The TA

will be financed on a grant basis by ADB's TA funding program. Details of the cost estimates are in Appendix 2.

D. Implementation Arrangement

17. MOJ will be the Executing Agency for the TA. DLP under MOJ and the Agency for Foreign Economic Relations will be the implementing agencies. The MOJ will also provide office space, counterpart staff, transportation, and other services to consultants and will arrange appointments for them with relevant agencies and organizations.

18. The TA will engage a team of two international consultants for a total of 6 person-months: one team leader—an economist and FDI specialist (3 person-months); and a legal specialist (3 person-months). The domestic consultants (18 person-months) will have the same set of expertise as the international consultants and information technology areas. The consultants' terms of reference are in Appendix 3. The consultants will be recruited individually and engaged in accordance with ADB's *Guidelines on the Use of Consulting Services* and other arrangements satisfactory to ADB on the engagement of domestic consultants. Equipment will be procured by ADB in accordance with its *Guidelines for Procurement*.

19. The consultants will submit (i) inception reports 2 weeks after services start; (ii) interim progress reports at appropriate stages of TA implementation; (iii) draft final reports before conclusion of the contract; and (iv) final reports 2 weeks after incorporating MOJ's and ADB's comments. The TA is expected to commence in March 2004 and be completed by August 2004. A 1-day conference will be organized near the end of implementation to invite comments from international and domestic experts in the field and disseminate the report findings.

III. THE PRESIDENT'S DECISION

20. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$300,000 on a grant basis to the Government of Uzbekistan for Strengthening the Policy and Legal Framework for Foreign Direct Investment, and hereby reports this action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Goal</p> <p>Increase FDI flow</p>	<ul style="list-style-type: none"> • Increased amount of foreign direct investment 	<ul style="list-style-type: none"> • Report of investment flow from the Central Bank 	
<p>Purpose</p> <p>Promote FDI by (i) creating a conducive policy environment, (ii) establishing a legal framework to ensure protection of foreign investors, and (iii) strengthening capacity of government agencies concerned</p>	<ul style="list-style-type: none"> • Establishment of IPA • Increased number of enterprises with foreign investment • Decreased number of FDI related legal cases appealed 	<ul style="list-style-type: none"> • Government structure • Registry of foreign investors • Court registry 	<ul style="list-style-type: none"> • Progress of general economic reform • Resources allocated to the IPA • Well-functioning court system
<p>Outputs</p> <ul style="list-style-type: none"> • FDI-related policy assessment and recommendation • Recommendations on legal and regulatory frameworks • Medium-term strategy to promote FDI • Upgraded repository of FDI regulatory acts • Trained officials in FDI 	<ul style="list-style-type: none"> • Interim recommendations formulated, finalized, and adopted by MOJ before completion of the TA • Number of case studies used • Frequency of use of the references and repository • Number of training participants 	<ul style="list-style-type: none"> • Consultation with the Government • Registry in the MOJ library • Training report and evaluation • Consultation with the Government 	<ul style="list-style-type: none"> • Adoption of policy recommendations • MOJ to adopt the recommendations to enhance the legal framework • Application of case studies • Trained officials given adequate incentives to apply the trainings

<p>Activities/Inputs</p> <ul style="list-style-type: none"> • Training for local authorities • Intensive training abroad • Workshop for strategy formulation • Establishing references and collection of international good practices • Conducting case studies • 24 person-months of consulting services, comprising 6 person-months of international and 18 person-months of domestic consultants • Equipment 	<ul style="list-style-type: none"> • Number of participants • Intensive training abroad, completed successfully • Level of workshop participants • Increased volume of reference materials • Number of case studies • Consultants—\$193,000 • Equipment and software—\$20,000 	<ul style="list-style-type: none"> • Training evaluation report submitted by the participating officials • Completion report on training abroad • List of workshop participants • List of library materials • Case study report • Final review meeting • Project account 	<ul style="list-style-type: none"> • Motivation of training participants • Availability of counterpart support and full cooperation between all the relevant government agencies • Competent consultants
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COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
A. Asian Development Bank Financing^a			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	150	0	150
ii. Domestic Consultants	0	27	27
b. International and Local Travel	10	2	12
c. Reports and Communications	2	2	4
2. Equipment ^b	20	0	20
3. Training, Seminars, and Conferences			
a. In country Training Program	0	15	15
b. Oversea Intensive Training ^c	20	0	20
c. Translators and Interpreters	0	2	2
4. Miscellaneous Administration and Support Costs	10	5	15
5. Contingencies	30	5	35
Subtotal (A)	242	58	300
B. Government Financing			
1. Office Accommodation and Transport	0	45	45
2. Remuneration and Per Diem of Counterpart Staff	0	30	30
3. Facility for Training	0	25	25
4. Miscellaneous Administration	0	15	15
5. Contingencies	0	15	15
Subtotal (B)	0	130	130
Total	242	188	430

^a Financed by Asian Development Bank's TA funding program.

^b Equipment consists of computers and accessories, and office equipment such as copier, facsimile machine, etc. Upon TA completion, the equipment will be donated to the Ministry of Justice.

^c This component provides for government officials higher than director level to study abroad for up to 2 weeks to learn and update their skills in foreign direct investment (FDI) promotion. The visit will be made to an ADB developing member country that has successfully attracted FDI.

Source: ADB estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. International Consultants (6 person-months)

1. Team Leader, Economist, and Foreign Investment Specialist (3 person-months)

1. The specialist will have extensive working knowledge of foreign direct investment (FDI) in Developing Member Countries and, preferably, have work experience in the countries of the former Soviet Union. The specialist will be responsible for the overall management of technical assistance implementation and the timely delivery of quality interim and final reports. The specialist will develop a work plan for efficient team management. In particular, the consultant will do the following, related to assessment, recommendation, and strategy:

- (i) Review studies and information related to FDI promotion in Uzbekistan available at the Asian Development Bank (ADB).
- (ii) Review and assess major difficulties facing investors, including economic, financial, and administrative constraints.
- (iii) Review and assess investment promotion plans.
- (iv) Elaborate a logical framework highlighting promotional and investment mobilization strategies, including multiplier effects for the economy given the country's resource endowment, existing infrastructure, domestic market, and international agreements.
- (v) Recommend establishment of an investment Promotion Agency (IPA) for foreign investors, and on its location, governance, operational role, scope, and relations with other government agencies, in line with international best practices. Consult knowledgeable experts in Uzbekistan, ADB, and elsewhere.
- (vi) Develop a policy recommendation to create a conducive environment for FDI, and a medium-term strategy to promote it. Consolidate findings and recommendations in the reports submitted to the Government and ADB.

2. The consultant will also do the following, related to training, workshop, web site, and conference:

- (i) Develop and implement a workshop for high-level government officials to discuss major issues in creating a conducive policy environment for foreign investment.
- (ii) Design and arrange a training program abroad for high-level government officials to provide practical knowledge and experience from foreign government agencies.
- (iii) Strategize public information campaign to promote FDI and information dissemination.
- (iv) Organize and implement a 1-day conference to disseminate the results of the studies and demonstrate the improved government policies and services.

2. **Legal Specialist** (3 person-months)

3. The specialist will have extensive working knowledge of legal aspects of FDI in DMCs and, preferably, have work experience in countries of the former Soviet Union. The specialist will work closely with the team leader and share the responsibilities as needed. In particular, the specialist will do the following, related to assessment and recommendation:

- (i) Based on international experience and in consultation with the Ministry of Justice (MOJ), review the Law on Foreign Investments and on Guarantees and Measures for the Protection of Rights of Foreign Investors and propose amendments to make the law progressive, simple, and clear.
- (ii) Review related laws, codes, regulations, and administrative procedures that may have a direct or indirect bearing on FDI, and harmonize them by identifying incompatibilities and proposing amendments.
- (iii) Review implementing decrees and regulations in support of laws with direct and indirect bearing on FDI, and propose new implementing decrees to help clarify and implement these laws.
- (iv) Review and propose legal amendments to delegate power to IPA.
- (v) Consolidate findings and recommendations in the reports submitted to the Government and ADB.

4. The specialist will also do the following, related to case studies, training, workshop and conference:

- (i) Coordinate domestic legal experts to develop best practices and/or case studies on key legal cases related to FDI to develop more domestically applicable reference materials.
- (ii) Identify international best practices to protect foreign investors' rights.
- (iii) Prepare and conduct training programs for DLP officials and other legal professionals involved in foreign investment or its protection.
- (iv) Develop and implement a workshop for high-level government officials to discuss formulating recommendations for the legal framework.
- (v) Help the team leader organize and implement a 1-day conference to disseminate results of the studies and demonstrate the improved government services.

B. **Domestic Consultants** (18 person-months)

1. **Coordinator** (4 person-months)

5. The consultants will have extensive, in-depth knowledge of the country and economics, and good contacts with the Government and enterprises. The consultants will help the international consultants quickly become familiar with their tasks by translating various documents into English; researching and compiling the set of government policies, regulations,

and procedures adopted; and ensuring that the international consultants' output is appropriate. The domestic consultants are expected to possess sufficient experience in their relevant fields. In particular, the consultant will do the following:

- (i) Help the team leader and legal specialist in all aspects of their tasks within the terms of reference.
- (ii) Prepare and translate background materials for efficient engagement of international consultants.
- (iii) Under the guidance of the team leader, collect and analyze required information and data, and make these available in English and in an organized, readable form.
- (iv) Conduct research on specific topics as required by the team leader.
- (v) Arrange and organize discussions, trainings, workshops, and conference; and help the team leader prepare materials for them, including translation of documents and interpretation of discussions.

2. Legal Experts (4 persons, 12 person-months)⁴

6. The consultants will have extensive in-depth country and sector knowledge, and good contacts with the Government and enterprises. The consultants will make case studies under the guidance of the legal specialist. The consultants are expected to possess sufficient experience in their relevant fields. In particular, the consultants will do the following:

- (i) Help the international legal specialist in all aspects of their tasks within the terms of reference.
- (ii) Under the guidance of the legal specialist, develop best practices and case studies from key legal cases.
- (vi) Under the guidance of the legal specialist, collect and analyze required information and data, and make them available in English and in an organized, readable form.
- (iii) Conduct research on specific topics as required by the legal specialist.
- (iv) Arrange and organize trainings in legal areas, a workshop, and a conference, and help the legal specialist prepare materials for them, including by translating documents, interpreting discussions, and arranging logistics.

C. Reporting Arrangements

8. The TA will start upon engagement of the domestic coordinator 2 weeks before engagement of the international consultants. They will submit the following:

⁴ Several consultants will be hired for the same terms of reference due to the volume of case studies, after consultation with the Government.

- (i) an inception report 4 weeks after the TA starts,
- (ii) a draft training program on six weeks after the TA starts,
- (iii) an interim progress report eight weeks after the TA starts,
- (iv) a conference outline and budget eight weeks after the TA starts,
- (v) a draft final reports twelve weeks after the TA starts, and
- (vi) a final report two weeks after receiving comments from MOJ and ADB.