

RESEARCH ARTICLE

Independence of The Central Bank of The Republic of Uzbekistan, Confidence in Monetary Policy and The Effects of Increasing Foreign Direct Investment and Analysis

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Abstract

This paper examines the relationship between central bank independence, monetary policy credibility, and foreign direct investment (FDI) inflows in Uzbekistan over the period 2010–2023. Drawing on inflation trajectory data, UNCTAD FDI statistics, and a comparative analysis with Georgia, this paper argues that the CBU's institutional transition functioned as a macroeconomic credibility signal to foreign investors, contributing to a sustained increase in FDI inflows in the post-reform period. The analysis is descriptive and narrative in nature; no causal claims are advanced. The paper concludes that deepening CBU independence and communication transparency remain investment climate priorities, and calls for future panel econometric research to establish more rigorous causal identification.

KEY WORDS

Central bank independence, monetary policy credibility, foreign direct investment, inflation targeting, Uzbekistan, transition economy, macroeconomic reform.

INTRODUCTION

For the country's economy to function properly and be stable, the factors affecting it (inflation, unemployment, etc.) must be managed and controlled by some policy. To implement such control, a certain institution must be in the position of a monetary policy maker. As for Uzbekistan, the post-2017 era, the second president of Uzbekistan Sh. Mirziyoyev has changed the monetary policy of the state from rigid, state-controlled system to a market-oriented, inflation-targeting framework. Pre-2017 policies prioritized exchange rate stability and growth at the expense of inflation control, while post-2017 reforms emphasized price stability, independence, and liberalization. Monetary policy subordinated to a fixed exchange rate peg, with multiple official and black-market rates creating distortions, making it harder for the economy to function clearly. The CBU used monetary targeting but

maintained loose policy, leading to negative real policy rates and high reserve money growth exceeding 50% year-on-year by mid-2017. Refinancing rate stayed low at 9% until June 2017, supporting credit to state enterprises at preferential rates amid segmented markets and limited independence. This created a huge loss, often not mentioned in formal statistics, creating a gap between the real economy and the version existed before this time. By the time the second president came, the policy changed from fixed, state-controlled to open-market and more "capitalistic" policy. In September 2017, the CBU unified exchange rates (devaluing sum from ~4,200 to 8,100 UZS/USD), liberalized currency access, and shifted focus to price stability with greater operational independence by removing itself from direct government control. Policy rate hiked to 14%, turning real

rates positive (2-3% since 2019), enabling phased inflation targeting from 2020 targeting 5% by 2023. Free-floating exchange rate adopted, with transparent decisions based on forecasts.

The state's Central Bank or Federal Reserve (or whatever institution responsible for monetary policy) is responsible for this very thing and controls the proper functioning of the overall economy. If governments control fiscal policy, why not control monetary policy as well, can be seen in the example of Zimbabwe in the 2000s. In the early 2000s, the Zimbabwean government demanded that the Reserve Bank of Zimbabwe print money for military spending and land acquisition. The lack of transparency in the government and the involvement in the Second Congo War have left Zimbabweans exhausted. The government, in turn, is spending \$22 million a month on the war, forcing the Reserve Bank to print more money. As a result, inflation has risen to such an extent that even a single bus fare is not enough for 1 trillion Zimbabwean dollars. According to information reported by The Sunday Times on March 1, 2008, the Munich company Giesecke & Devrient received \$500,000 more for the monthly supply of \$170 trillion Zimbabwean dollars. At that time, the inflation rate in Zimbabwe was 79.6 billion. percent per month, and by the end of 2008 it was 89.7 sextillion (8.97* 10^{22}) per year, a record.

This shows that the independence of the Central Bank is relatively crucial to the decent monetary policy. The credibility of monetary policy, thus, can be as important as the big macro factors of country's economy. To understand the importance of the independency of Central Bank, we need to understand literal evidence supporting the idea of why government should not govern monetary policy, and instead it should give the policy control to Central Bank.

Barro and Gordon (1983) argue that discretionary monetary policy generates an inflation bias, by saying "In particular, if people expect zero inflation, as occurs under the rule, then the policymaker would like to implement a positive inflation rate in order to secure some benefits from an inflation shock. Further, this desire does not stem from a peculiarity in a policymaker's tastes. Rather, it reflects the distortions that make inflation shocks desirable in the first place". That saying, the policymaker (the government) may implement some rules which are optimal today, but these rules may not be optimal tomorrow. This creates a proof that the monetary system should be taken control by an institution which is not fully

government-controlled.

Yet some scholars, most notably Posen (1993) suggest that the legal status of a central bank is actually a reflection of deeper societal forces. It claims that the observed relationship between central bank independence and inflation can be explained by the third factor, the effective financial opposition to inflation (FOI). Thus the more effective the opposition of the financial sector against inflation is the greater central

bank independence will be. That means, in countries where the financial sector is politically strong and organized, they will pressure the government to make the Central Bank independent. According to this view, in countries where private banks and investors have significant influence, they will demand an independent central bank to protect the value of their assets from being eroded by inflation. Therefore, central bank independence may be the result of a strong financial lobby rather than the sole cause of price stability. However, we may not argue that was the real case in Uzbekistan as at this time (2017) the investment rates and privatization of economy was low or at a reasonable rate. Investment as unit of GDP averaged around 25-30% in the early 2010s but dipped to a low of 17.3-17.4% in late 2016-Q3 2017 amid economic slowdown. FDI was minimal, often under \$200-300 million annually, hampered by currency controls, corruption, and closed markets. Gross fixed capital formation relied heavily on state-directed projects with limited private participation. But in the post – 2017 era, this figures changed reasonable to positive side, averaging 30-35% post-2017, peaking at 42.6% in quarter 3 of 2024, with 39.01% in Q1 2025. FDI inflows surged, reaching \$1.1 billion peak in December 2024 and \$2.2 billion in 2023 alone. If we look closely, we can see that through the implementation of right tools and policies, the system of monetary policy and investment inflows changed dramatically through years after 2017. Subsequently, leading to the affirming Presidential Decree No. UP - 5877 to be signed on November 18, 2019, to mandate the shift. Later, on January 1, 2020, The Central Bank of Uzbekistan officially declared its phased transition to an inflation targeting (IT) regime. This itself explains the Posen claim was correct and the Republic of Uzbekistan used this way systematically.

Prior to Uzbekistan's monetary reforms, the Central Bank of the Republic of Uzbekistan (CBU) operated under significant political influence, with exchange rate management and inflation control subordinated to broader fiscal objectives. This

lack of institutional independence created persistent policy uncertainty, raising the perceived risk of investment in the Uzbek economy. Following the adoption of an inflation targeting framework in 2019 and the formal strengthening of CBU operational independence, the monetary policy environment shifted substantially. When a central bank credibly commits to price stability through transparent, rule-based policy, inflation uncertainty declines and exchange rate volatility is reduced — two factors that directly lower the risk premium foreign investors attach to a destination country. As Mishkin (2004) argues, credible monetary frameworks are particularly consequential in emerging markets, where inflation expectations are less anchored and institutional trust must be actively built. For Uzbekistan, the CBU's transition toward credible commitment thus represents not merely a

technical monetary reform, but a structural signal to foreign investors that the macroeconomic environment has become more stable and predictable.

Through the analysis of Uzbekistan's economy, it is clear that the movement from govern-ruled system to inflation-targeting one for Central Bank has improved the country's credibility for investors. When there's a little chance that inflation might affect the investment project, the investors eventually find it safer and much profitable to invest in Uzbekistan rather than other places. To see whether the inflation-targeting policy and open-market strategies really worked, we will discuss the foreign direct investment rates to Uzbekistan within the recent years.

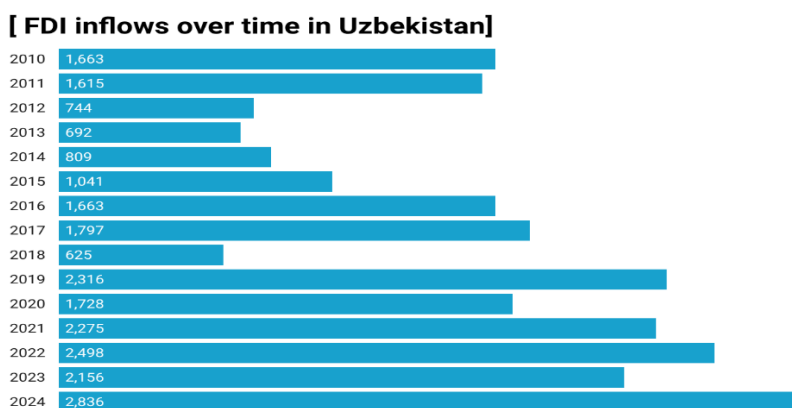


Chart: Salimbek Mamasodiqov · Created with Datawrapper

Figure 1. Uzbekistan's inflows of FDI over the years 2010-2024.

It is clear that the inflows of foreign direct investments fluctuated severely in pre-2017 phase, from \$692 million to \$1,797 million by 2017. The data is consistent with an increase in FDI inflows within the post-2017 phase. Starting at \$625 million in 2018, and reaching its peak at \$2,836 million by 2024. This data suggests a relationship between how the changes made in monetary policy influenced positive FDI inflows to the country. This allowed the economy to run even faster via transparent and fair policies, and most importantly the independency (at least to some extent) of Central Bank played a crucial role in this case of foreign direct investments.

As we know, the privatization of economy is highly linked to the overflow of FDI and the credibility of monetary policy of any given country. One of the major macro-level variable that, investors usually look for is a low rate of inflation or stability of inflation rates. Therefore, if the country wants to gain more FDI flows into their economy and subfields of economy, the monetary policy of country should focus more on inflation-targeting than other areas of policies. Here we will provide the information figure 2. inflation rates in Uzbekistan from 2010 to 2024.

Inflation trajectory of Uzbekistan

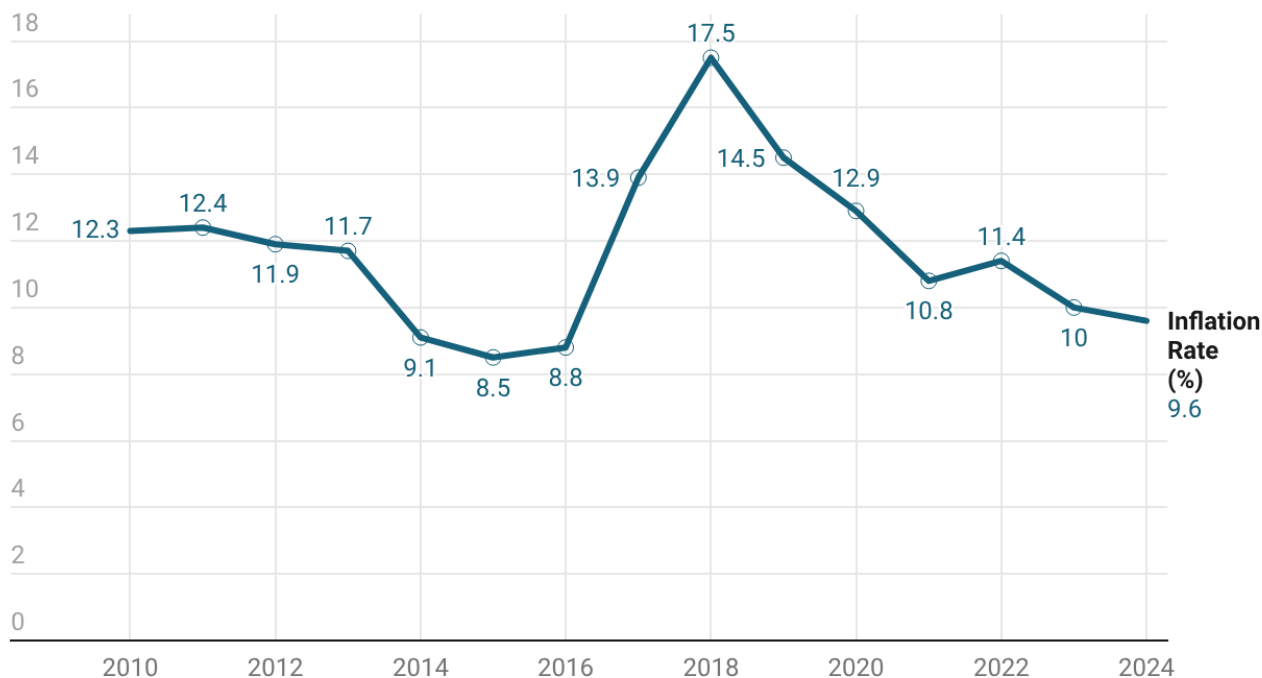


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Figure 2. inflation rates in Uzbekistan from 2010 to 2024.

As shown in the chart, Uzbekistan's inflation trajectory between 2010 and 2023 reflects three analytically distinct phases that closely correspond to the CBU's evolving institutional framework. In the pre-reform period spanning 2010 to 2016, inflation remained persistently elevated, fluctuating between 8.5% and 12.4% without a clear downward anchor, consistent with a monetary authority operating under political constraints rather than a credible price stability mandate. A sharp spike to 17.5% in 2018 followed the 2017 exchange rate liberalization - a reform that unified the official and black market exchange rates, producing a one-time upward adjustment in measured prices rather than representing a deterioration in monetary control. Critically, the post-inflation targeting period from 2019 onward tells a different story: inflation declined consistently from 14.5% in 2019 to 9.6% by 2023, and the sharp year-to-year volatility

characteristic of the earlier period largely disappeared. This stabilization pattern is consistent with the theoretical expectation that credible institutional commitment reduces inflation uncertainty - the precise channel through which monetary policy credibility is argued to influence foreign investor confidence. This clearly indicates that the credibility of CBU is rising due to the constant downward trajectory from 2019 onwards. That might suggest that the phase of surge (2017-2018) can be the result reforming from the new liberalization of monetary policy.

Following the inflation rate, we will be discussing the FDI comparison between Uzbekistan and Georgia (almost same-level economy), to see what clearly happened in Uzbekistan during this period, and what predictions can we assume for further period.

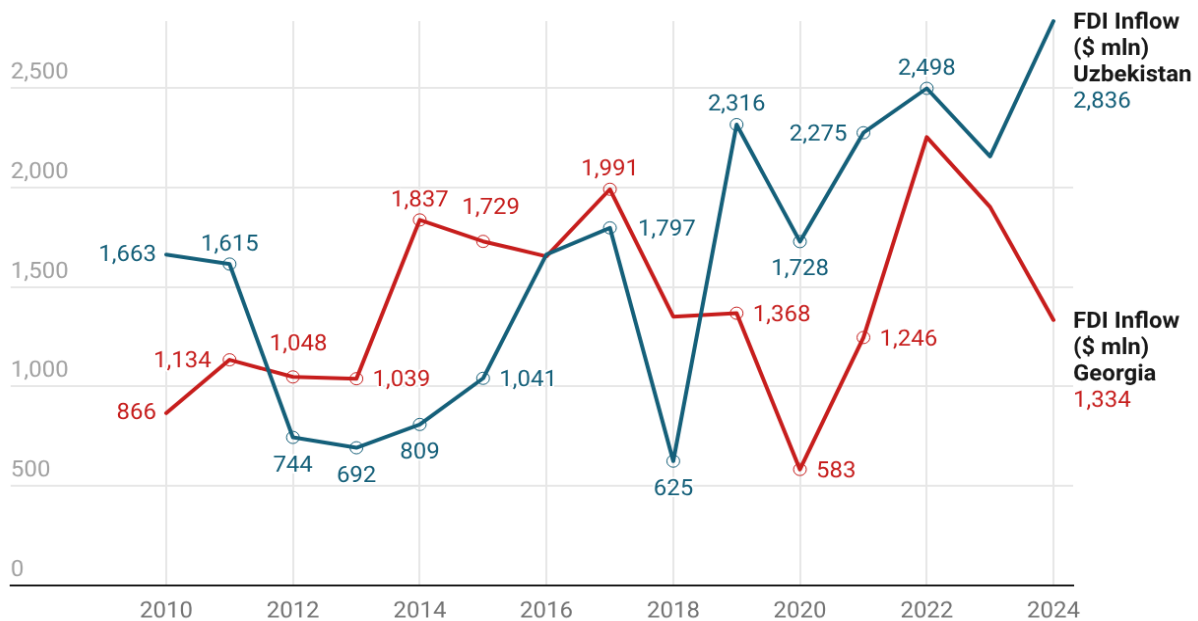


Chart: Salimbek Mamasodiqov • Created with Datawrapper

Figure 3. the FDI inflows comparison between Uzbekistan and Georgia.

A comparison of FDI inflows between Uzbekistan and Georgia between 2010 and 2023 provides additional context for evaluating the reform period's impact. Prior to Uzbekistan's structural reforms, Georgia - a smaller but more institutionally mature transition economy - consistently attracted higher absolute FDI inflows, reflecting its earlier completion of macroeconomic stabilization and a more established investment environment. This pattern reversed markedly after 2017. Following the exchange rate liberalization and subsequent adoption of inflation targeting, Uzbekistan's FDI inflows surpassed Georgia's and continued on an upward trajectory, reaching \$2,836 million by 2023 compared to Georgia's \$1,334 million. Equally notable is the difference in trajectory stability: while Georgia's inflows remained volatile in the post-2020 period, Uzbekistan's followed a more consistent upward path, suggesting an improvement in the quality and durability of investor confidence rather than merely a cyclical uptick. While this comparison cannot isolate monetary credibility as the sole driver - Uzbekistan's broader reform package, market size, and resource base all play a role - the timing and pattern of the divergence is consistent with the argument that credible macroeconomic policy contributes meaningfully to FDI attraction in transition economies.

The empirical patterns presented earlier in the paper are broadly consistent with the theoretical framework outlined

earlier. Following the adoption of inflation-targeting regime in 2019 and the exchange liberalization in 2017, both key indications moved in the direction predicted by credibility theory: inflation became progressively slower and more stable, while FDI inflows grew substantially. This gave an incredible example of earlier methodologies suggested by different scholars. The convergence of these trends suggests that institutional monetary reform, beyond its direct macroeconomic effects, may have functioned as a credibility signal to foreign investors — reducing perceived policy uncertainty and lowering the risk premium associated with long-term investment in Uzbekistan.

The Georgia comparison reinforces this interpretation. The fact that Uzbekistan's FDI trajectory improved relative to a peer economy during the post-reform period reduces the likelihood that the observed growth simply reflects broader regional or global investment trends. Instead, it points toward country-specific factors — of which monetary reform was a significant component — as a meaningful driver of the change. That probably assure the government and the other responsible institutions that the monetary system plays a huge role in attracting foreign direct investments. That said, other macro-factors such as market size, work force opportunity and the value of resources are also vital elements of this trend.

Other several important limitations must be acknowledged,

however. Uzbekistan's post-2016 reform agenda was broad and simultaneous: trade liberalization, privatization, and improvements in the business climate all occurred alongside monetary reform, making it difficult to isolate the independent contribution of CBU credibility to FDI growth. Additionally, the relatively short post-IT time series — spanning only 2019 to 2023 — limits the strength of any conclusions drawn. Global disruptions, particularly the COVID-19 shock in 2020 and regional instability, further complicate the picture. This analysis therefore makes no claim of causation; rather, it argues that the data is consistent with the credibility-FDI mechanism and that the Uzbekistan case warrants more rigorous empirical investigation with longer data and a formal econometric framework.

There can be no further direct and specific directions or suggestions to make it clear that the independency of CBU itself played the major role in this role play, rather it assumes that this trajectory also contributed to the stable growth of FDI inflows in Uzbekistan alongside other major economic factors.

This paper examined whether the CBU's transition toward a credible, rule-based monetary framework — marked by the 2017 exchange rate liberalization and the 2019 adoption of inflation targeting — is associated with improved foreign direct investment inflows into Uzbekistan. Drawing on inflation trajectory data and UNCTAD FDI statistics, the analysis finds that both indicators shifted favorably in the post-reform period, with inflation stabilizing and FDI growing substantially, a pattern not fully explained by regional trends as suggested by the Georgia comparison. These findings are consistent with the theoretical prediction that credible monetary commitment reduces investor uncertainty and lowers the risk premium on long-term capital allocation. For policymakers, the implication is direct: deepening CBU independence, improving forward guidance, and maintaining transparency around the inflation targeting framework are not merely technical monetary priorities — they are investment climate priorities. Future research would benefit from a panel econometric approach across Central Asian economies with a longer post-IT time series, which would allow for a more rigorous causal identification of the credibility-FDI relationship.

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