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INTRODUCTION

Reasoning and relevance of the topic. Almost all types of economic activity of enterprises are related to the need to invest in real assets. In modern conditions at most enterprises this investment is the only direction of investment activity. This determines the high role of management of real investments and sources of their financing in the system of investment activity of the enterprise.

To what extent the company's management can correctly and accurately determines the sources of their investment activity, the efficiency of the enterprise as a whole depends. After all, it's not just to decide the question “where to find money”, but also to structure the sources of investments. The forms of sources inevitably affect the nature of enterprise management associated with the liquidity and profitability of the enterprise. And the ratio of own and borrowed sources in many respects determines relations with subjects of economic relations in which the enterprise enters in the course of its activity.

The President of the Republic of Uzbekistan Sh.M.Mirziyoyev has paid special attention to the issues of financing investment projects: “... it is necessary to pay special attention to issues of introduction of significant investments into the regions of our country. Therefore, as an experimental project, I will propose to implement the following system on the example of the National Bank. The Bank has to take measures to attract investment sources, along with its own funds, in investment activity”¹, which is directly related to the improvement of investment projects in our country.

The problem of investment in our country is so urgent that talk about them does not cease. This problem is urgent, first of all, by the fact that it is possible to make a huge fortune on investments in the world, but at the same time, the fear of losing the invested funds stops investors.

¹ O'zbekiston Respublikasi Prezidenti Shavkat Mirziyoevning mamlakatimizni 2016-yilda ijtimoiy-iqtisodiy rivojlantirishning asosiy yakunlari va 2017-yilga mo'ljallangan iqtisodiy dasturning eng muhim ustuvor yo'nalishlariga bag'ishlangan Vazirlar Mahkamasining kengaytirilgan majlisidagi ma'ruzasi: Tanqidiy tahlil, qat'iy tartib-intizom va shaxsiy javobgarlik – har bir rahbar faoliyatining kundalik qoidasi bo'lishi kerak

In a market economy, making profits is the driving motive of investment activity. This goal is mediated by the production of specific goods; the provision of services that are recognized in the market without this investment will be useless.

In a world economy, the development of investment activities is very crucial, because investments are necessary to achieve several objectives such as an increase and expand the scope of activities, reduction of production costs and sales of products, creation of the necessary raw materials base, increase and improve the structure of export, etc.

Therefore, the most important task of scientific and theoretical study of the development and future prospects of investment activities in a world economy is the complex process of modern and evolving forms and methods of ownership and management. The above facts determine the relevance of this Master's degree thesis.

Object and subject of the research. The subject of the research is the financial and economic and legal relations that arise in the process of development of investment activities in a world economy. Object of the research is considered as basis of Foreign Direct Investment and Foreign Portfolio Investment activities in a globe.

Objectives and tasks of the research. The main objective of the research is to show the relevance of the chosen theme of the dissertation work, using the accumulated theoretical experience of foreign scientists. The basic aim of this paper is to reinvestigate the development and future prospects of investment activity in a world economy by stating that investment spending makes direct contribution to economic activity because investment is the most volatile component of GDP. Investment plays vital role in the long run and short run growth. It links the present with the future. Dissertation works with below given tasks:

- describes the content and theoretical foundations of investment activity;
- justifies the role and importance of investment activities in a global flow;

- determines the main features of investment activity in the development of the world countries' economy;
- illustrates main figures of Foreign Direct Investment and Foreign Portfolio Investment;
- displays the modern scene of attracting foreign investments to Uzbekistan's economy;
- gives several prospects in terms of futures of Foreign Direct Investment and Foreign Portfolio Investment.

Scientific novelty. Scientific novelty of this dissertation work can be seen in following cases:

- the nature and significance of the investment activity, and described and classified sources and methods of financing the investment projects;
- the main features are illustrated by utilizing real case examples;
- tendencies of Foreign Direct Investment inflow and outflows are described and explained by using latest available data source by UNCTAD World Investment Report;
- modern trends of Foreign Portfolio Investment are illustrated by using latest available figures and table;
- weak and strong points of Uzbekistan's economy in terms of attracting Foreign investments are justified by utilizing available data figures.

Main research topics and assumptions. The practical application of scientific recommendations and recommendations in the research work will help to see the current and future state of the investment flow in the world.

Explanation of literature on the topic of the research. Problems related to investing activities, investment financing, are investigated by foreign economists such as Bocharov V.V., Igoshina L.L., Ivashenko A.G., Igonina L.L., Morozov D.S., Nashville A.S., Rodionov I., Nikkonen A., Romash V. M., Shevchuk V. I. and other scientists. Also in the Republic of Uzbekistan economic scientists such as Abdullaeva Sh.Z., Vakhobov A.V., Khajibakiev Sh.X., Muminov N.G., Vakhobov A.V., Malikov T.S., Karimov N.G., Gazibekov D.G.,

Angelidi M.S., Mamatov B.S., Khujamkulov D.Yu., Nasirov E.I.². were conducted research in some areas of investment activities in major fields of country's economy.

Description of the method used in the study. Systematic approach, grouping, comparison, economic analysis and comparisons were used in the research.

Theoretical and practical significance of the research results. The theoretical significance of the results of dissertation is that it can be used in future special research works aimed at effective financing of investment projects. The practical significance of the work is that the formulated suggestions and recommendations will further deepen the research work aimed at improving the investment projects modernization methods, also it can be used to teach investment courses students of high and secondary special educational institutions in the field of finance and banking.

Description of structure of research work. The research paper consists of the introduction, three chapters, conclusions and recommendations and a list of publications. The dissertation text consists of 91 pages, contains 3 tables and 23 pictures.

The introduction of dissertation covers the substantiation and relevance of the topic of dissertation, the subject and object of research, the purpose and tasks of the study, methods of research, summary of the literature on the subject, theoretical and practical significance of scientific work and scientific novelty.

Chapter I talks about the scientific-theoretical basis of investment activities, illustrates the development of investment activity tendencies in the global economy, and describes the main features of investment activity.

² Бочарев В.В. Методы финансирования инвестиционной деятельности предприятий. – М.: «Финансы и статистика», 1998. – 160 с.; Игошина Л.Л. Инвестиции. Уч. пос. – М.: «Экономист», 2005. – 216 с.; Ивасенко А.Г. Инвестиции: источники и методы финансирования / 3-е изд. перераб. и доп. – М.: «Омега-Л», 2009. – 261 с.; Игонина Л.Л. Инвестиции: учебное пособие / под ред. д-ра экон. наук, проф. В.А.Слепова. – М.: «Экономистъ», 2005. – 478 с.; Морозов Д.С. Проектное финансирование: управление рисками и страхование. – М.: «Анкил». 1999. – 196 с.; Нешитой А.С. Инвестиции: Учебник. – М.: «Дашков и К⁰», 2006. – 328 с.; Родионов И., Никконен А. Венчурный капитал и прямые инвестиции в инновационной экономике. Курс лекций, Лекции 1-2. – СПб.: «РАВИ», 2012. – 173 с.; Ромаш В. М., Шевчук В. И. Финансирование и кредитование инвестиций. Учеб. пос. – Минск: «КНИЖНИЙ ДОМ», «МИСАНТА», 2004. – 160 с

Chapter II devoted to tendencies and analytical analysis of Foreign Direct Investment and Foreign Portfolio Investment in the global flow. In addition, the scene of attracting foreign investments in case of home country – Uzbekistan is illustrated in this chapter.

Chapter III obtains with general information about future picture of Foreign Direct Investments and Foreign Portfolio Investments in a world economy.

At the dissertation section, general conclusions on the development and futures of investment activities in the world economy have been developed and proposals have been illustrated to improve it.

CHAPTER I. THE THEORITICAL BASES AND FEATURES OF DEVELOPMENT INVESTMENT ACTIVITIES IN THE WORLD ECONOMY

1.1 The scientific-theoretical basis of investment activities

The word “investment” can be defined in many ways according to different theories and principles. It is a term that can be used in a number of contexts. However, the different meanings of “investment” are more alike than dissimilar. The term ‘investment activities’ is considered as a new expression than other economical phrases. The first signs of investment can be observed in the scientific works of Australian economists such as Bem-Baveri³. The authors such as Edwin J.Dolan, Colin D.Kempbell, Rosemary J.Kempbell testifies that the expression “investment” derived from the term which is called as “savings”. They says that the portion of disposable income not spent on consumption of consumer goods but accumulated or invested directly in capital equipment is called as “savings”⁴. Hence, scientists continued their researches by stating that when the scenario is investigated in a case of big sphere such as among huge entities the word “savings” releases its place to the term of “investment”. However, the researchers separately pointed the difference between those two phrases by stating that “the savings” are the amount of money which is directed for the usage. Hence, “Investment is the commitment of money or capital to purchase financial instruments or other assets in order to gain profitable returns in the form of interest, income, or appreciation of the value of the instrument”⁵. Investment is related to saving or deferring consumption.

Generally, investment is the application of money or other assets in the hope that in the future it would appreciate or generate more income. According to

³Аладьин В.В. Инвестиционная деятельность субъектов Российской федерации. /В.В. Аладьин. – М.: Социум, 2002. -С.17.

⁴Долан Э.Дж. и др. Деньги, банковское дело и денежно-кредитная политика. /Пер. с англ. В.Лукашевича и др. под общ. ред. В Лукашевича. – Л., 1991. -С.15-16.

⁵Вахрин П.И., Нешиной А.С. Инвестиции: Учебник. – 3-е изд., перераб. и доп. – М.: Издательско-торговая корпорация «Дашков и К», 2005. -С.13.

economics, investment is the utilization of resources in order to increase income or production output in the future. An amount deposited into a bank or machinery that is purchased in anticipation of earning income in the long run are both examples of investments.

Furthermore, it should be said that foreign economists such as W. Sharpe, Campbell R. MacDonnell, Stanley L. Brue, Igoshin L.L., Neshitoy A.S. defined the term of investment in different ways. As for illustration, the author of a work “Investments” William Sharpe said that: “Investments are to reject certain amount of current value in order to obtain certain value in future”⁶. Another point of view by Campbell R. McConnell, Stanley L. Brue is that: “Investments are an increase of material resources, accumulation of means of production and expenses for manufacturing”⁷.

For further information, below is given meaning of investment activity from different perspectives. Investment activity is a term frequently used in the fields of economics, business management and finance. It can mean savings alone, or savings made through delayed consumption. Investment can be divided into different types according to various theories and principles. While dealing with the various options of investment, the defining terms of investment need to be kept in mind.

According to economic theories, investment is defined as the per-unit production of goods, which have not been consumed, but will however, be used for the purpose of future production. Samuelson P.A. said that: “Investments – to reject present utilization in order to get an upgraded future underwritten asset”⁸. Examples of this type of investment are tangible goods like construction of a factory or bridge and intangible goods like 6 months of on-the-job training. In terms of national production and income, Gross Domestic Product (GDP) has an essential constituent, known as gross investment.

⁶Sharpe W. Investments. M.: Infra-M, 1997. P.-16,

⁷Campbell R. McConnell, Stanley L. Brue. Economics, principles, problems and politics. Volume2. M.: Republic, 1992. P.-388 .

⁸Samuelson P.S.Economics. M: BINOM, 1997. P. -783.

According to business management theories, investment refers to tangible assets like machinery and equipment and buildings and intangible assets like copyrights or patents and goodwill. Tkachenko I. U. said that: “Investments can be defined as allocating capital resources into several diversified different forms in order to get a shifted profit in future”⁹. The decision for investment is also known as capital budgeting decision, which is regarded as one of the key decisions.

In finance, investment refers to the purchasing of securities or other financial assets from the capital market. Margolin A.M. told that “Investments are to produce cash flows, objected bank savings, financial securities, technologies, manufacturing machine and vehicles due to investor’s purposes and to reintroduce them into different operating financial fields”¹⁰. It also means buying money market or real properties with high market liquidity. Some examples are gold, silver, real properties, and precious items. Financial investments are in stocks, bonds, and other types of security investments. Indirect financial investments can also be done with the help of mediators or third parties, such as pension funds, mutual funds, commercial banks, and insurance companies.

According to personal finance theories, an investment is the implementation of money for buying shares, mutual funds or assets with capital risk.

The investment activities are such activities of legal entities, state and local investments for a total sum of practical actions to implement. According to Russian economists, scientists Bocharov V.V.: “The investment activities are the sum of the actions of practical realization of investments by the state, citizens and legal persons”¹¹. Authors of “Big Economical Dictionary” Arzimiyan A. and others described the investment activities in this way: “Investment activities are the sum of activities which are related to putting and realization of investments”¹². Economic scientists Angelidi M.S. and Gazibekov D.G. also represented investment activities to the descriptions given above¹³. All of these explanations are the same as the content of the activities of the investment approach, which

⁹Tkachenko I. U. Investments. M.: Academy, 2009. P. 6.

¹⁰Margolin A. M. Investments. M.: RAGS, 2006. P. 464.

¹¹Bocharov V.V. Methods of the financing of investment activity enterprises. M.: Finance and Statistics, 1998. P. 7.

¹²Arzimiyan and others. Big Economical Dictionary. M.: ‘Legal culture’, 1994. P.-157.

¹³ Газибеков Д.Г., Ангелиди М.С. Инвестиционная деятельность до вступления в рыночную экономику. Т.: ТФИ, 1994. С.-7.

reflected in the actions related to the implementation of the investments of investors.

Investments and investment activities are very similar concepts. In accordance with the definition given to investment, investment activity primarily consists of two stages. The first phase of the movement of investment resources for investing in investment facilities, that investment activity will occur. The second stage of the investment objectives of the investment income, the result will be displayed.

Investment activity can be described as narrow and broad sense. The narrow sense of investment or investment activity to redirect resources as an investment that reflects the recovery process. In other words, keeping the value of the current capital, and will be restoring funds. The high degree of investment income (effect) in order to get involved with the object of investment funds. That is, the value of the capital increase savings of resources or that an investment object. This process can be become the investment or the investment cycle framework. It should be noted here that despite investment in themselves as an object of investment activity. Investment is calculated according to their economic nature is an abstract concept, the planned investment activity in real economic, social objects for specific actions to achieve activity levels.

Furthermore, it should be mentioned that in recent years Uzbek scientists such as Gazibekov D. G., Khaydarov N. Kh., Vakhobov A.V. and others also have made several scientific researches in terms of issues of investment activity.

D.G. Gozibekov interpreted as the essence of the economic content of investment and financial category, clear and unknown risks, the mobilized capital and capitalization aspects of the present value of investments reached to give attention to the following definition: “visible and invisible, but there are risks as well as the possibility to evaluate the results as intended On the basis of the capitalization of the value of their funds and other savings and financial and real assets in order to provide a bond”¹⁴. These opinions testifies ones are really not

¹⁴ Gozibekov D.G. Investitsiya loyihalarini moliyalashtirish masalalari. M.: “Moliya” Publication, 2003. P.14-15.

only toward capital investment, but is also the formation of circulating assets. In addition, the author of this scientific work in the conditions of globalization and economic transformation of the theoretical and practical study focused on the issues of investment activity. The most essential quality characteristics of the investment are risks, funding sources and a close link between the justification of the methods to achieve the goals. The impact of the investments depends on the nature of their content, quality and characteristics, based on the origin of the reliability of sources of financing. The current value of the investment, increasing the value of the future, capitalization and ways to achieve results in a systematic manner based on the modern concept of value for money basis. Author investment in content and essence of the concept of 'investment' as a financial category, and it is clear and ambiguous risks, the mobilized capital and the capitalization of the present value of emphasis on those aspects. Khaydarov N. Kh. in his scientific work about enterprises investment activity devoted to improve relations between financial and tax issues in case of enterprises' investment activity, and he gave the following description: "Investment is a type of business activity where any physical or juridical person (entity and individual) who is operating on the basis of law can direct his free financial, material and intellectual resources to any business object despite of its type of property"¹⁵.

Moreover, in the period of independence, in Uzbekistan the law of the Republic of Uzbekistan "On Investment Activity" (24th of December, 1998) has been edited the second time (9th of December 2014) and there the term "investment" is described as following: "Investments are tangible and intangible assets which are directed to economical and other activity objects and rights which are linked with them". Due to sources, this description defines clearly the term's economical concept and fits for modern usage.

As for the summary it can be said that the terms 'investment' and 'investment activity' are much more broaden terms than 'capital' or 'source' or

¹⁵Haydarov N.H. Iqtisodiyotni erkinlashtirish sharoitida korxonalar investitsion faoliyatidagi moliya-soliq munosabatlarini takomillashtirish masalalari. Iqtisod fanlari doktori ilmiy darajasini olish uchun yozilgan dissertatsiya. –T. 2003. B.-29.

‘credit’ and these terms are clearly theoretically based by native and foreign scientists.

1.2. The development of investment trends in the global economy

As it mentioned above, the first signs of investment was observed in the scientific works of Australian economists in the second half of XX century. Time by time the world’s financial and economic situation has affected on everything and the term “investment activity” has also basically improved. The term has also found its simple definition.

The investment activity of the enterprise is a purposefully carried out process of finding the necessary investment resources, selecting effective investment objects, forming a balanced investment program (investment portfolio) and ensuring its implementation. The term “investment activity” can be given a broad and narrow definition. In a broad sense, investment activity is an activity connected with investing funds in investment objects in order to generate income (effect). In a narrow sense, investment activity, or actual investment, is a process of converting investment resources into investments. Investment activity can be defined as the unity of the processes of investing resources and generating revenues in the future.

In a narrow sense, two types of investments have been identified. Due to sources, there are real (capital-forming) investments - investments in the creation of new ones, reconstruction or technical re-equipment of existing enterprises and financial (portfolio) investments in the purchase of shares and securities of the state, other enterprises, investment funds. In the first case, the investor enterprise, investing means, increases its production capital - the basic production assets and the working capital necessary for their operation.

In the second case, the investor increases his financial capital, receiving dividends income on securities. Investments in the creation of production in this

case are carried out by other enterprises and organizations that have issued shares to attract financial resources for the implementation of their investment projects.

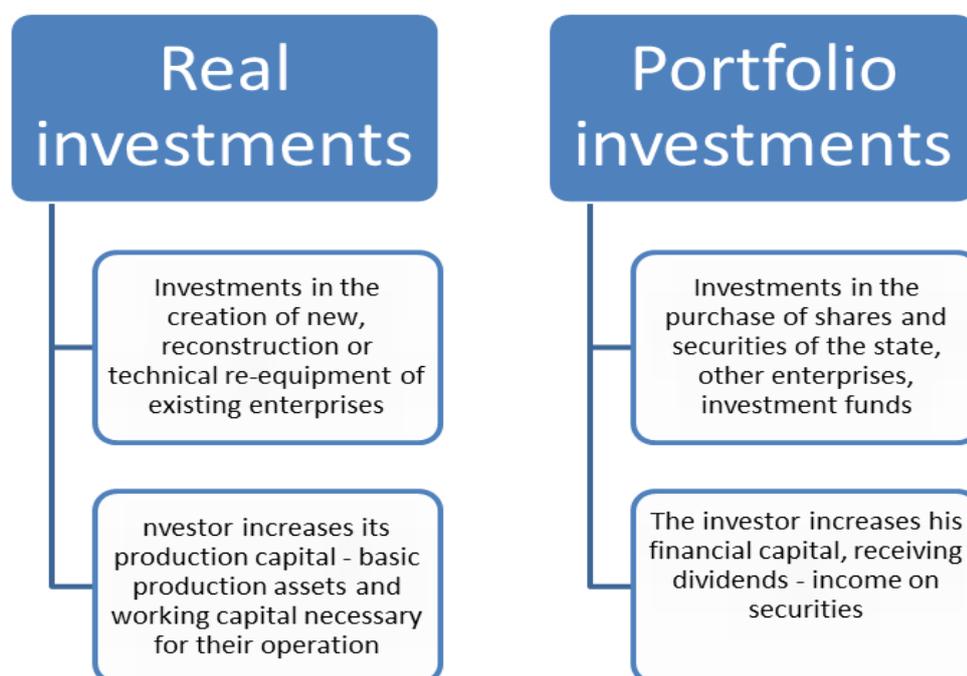


Figure-1.1. Types of investments¹⁶

When people think about globalization, they often first think of the increasing volume of trade in goods and services. Trade flows are indeed one of the most visible aspects of globalization. But many analysts argue that international investment is a much more powerful force in propelling the world toward closer economic integration. Investment can alter entire methods of production through transfers of knowledge, technology, and management techniques, and thereby can initiate much more change than the simple trading of goods. Over the past years, foreign investment has grown at a significantly more rapid pace than either international trade or world economic production generally. In fact, foreign direct investment in the United States in 2012 equaled roughly \$174.7 billion (down from its peak \$325 billion in 2008) (Organization for International Investment).

¹⁶Summarized by the student herself.

The tremendous growth in levels of foreign direct investment is a recent phenomenon and is one of the most powerful effects and causes of globalization. In 1982, the global total of Foreign Direct Investment (FDI) flows was \$57 billion. According to UNCTAD 2013), by the end of 2012, FDI flows reached an estimated \$1.35 trillion, a 14 percent decline since 2011 (OECD). Global international investment has still not yet returned to pre-crisis levels.

International investment or capital flows fall into four principal categories: commercial loans, official flows, foreign direct investment (FDI), and foreign portfolio investment (FPI). Commercial loans, which primarily take the form of bank loans issued to foreign businesses or governments. Official flows, which refer generally to the forms of development assistance that developed nations provide to developing ones. Foreign direct investment (FDI) pertains to international investment in which the investor obtains a lasting interest in an enterprise in another country. Most concretely, it may take the form of buying or constructing a factory in a foreign country or adding improvements to such a facility, in the form of property, plants, or equipment. FDI is calculated to include all kinds of capital contributions, such as the purchases of stocks, as well as the reinvestment of earnings by a wholly owned company incorporated abroad (subsidiary), and the lending of funds to a foreign subsidiary or branch. The reinvestment of earnings and transfer of assets between a parent company and its subsidiary often constitutes a significant part of FDI calculations.

Foreign portfolio investment (FPI), on the other hand, is a category of investment instruments that is more easily traded, may be less permanent, and do not represent a controlling stake in an enterprise. These include investments via equity instruments (stocks) or debt (bonds) of a foreign enterprise that does not necessarily represent a long-term interest.

Until the 1980s, commercial loans from banks were the largest source of foreign investment in developing countries. However, since that time, the levels of lending through commercial loans have remained relatively constant, while the levels of global FDI and FPI have increased dramatically. Over the period 1991-

1998, FDI and FPI comprised 90 percent of the total capital flows to developing countries. Over the period of 1996-2006, FDI and FPI outflows from the United States more than doubled. Global FDI flows decreased significantly from 2007-2009 due to the Financial Crisis and finally started rising again in 2010, though have still not reached pre-crisis levels. Similarly, when viewed against the tremendous and growing volume of FDI and FPI, the funds provided in the past by governments through official development assistance, or lending by commercial banks, the World Bank, or International Monetary Fund (IMF), are diminishing in importance with each passing year. Therefore, when one talks about the recent phenomenon of globalization, one is referring in large part to the effects of FDI and FPI, and these two instruments will therefore be the primary focus of this Issue in Depth. When we look at the global scene in a case of FDI indicators, the picture will be as following (Figure-1.2).

Global foreign direct investment (FDI) flows jumped by 38 per cent to \$1,762 billion, their highest level since the global economic and financial crisis of 2008–2009 (Figure 2). A surge in cross-border mergers and acquisitions (M&As) to \$721 billion, from \$432 billion in 2014, was the principal factor behind the global rebound. These acquisitions were partly driven by corporate reconfigurations, including tax inversions. Discounting these large-scale corporate reconfigurations implies a more moderate increase of about 15 per cent in global FDI flows. The value of announced greenfield investment remained at a high level, at \$766 billion.

Flows to developed economies nearly doubled (up 84 per cent) to \$962 billion, up from \$522 billion in 2014. Strong growth in inflows was reported in Europe. In the United States FDI almost quadrupled, albeit from a historically low level in 2014. The share of developed economies in world FDI inflows therefore leapt from 41 per cent in 2014 to 55 per cent in 2015 (Figure-1.2), reversing a five-year trend during which developing and transition regions had become the main recipients of global FDI.

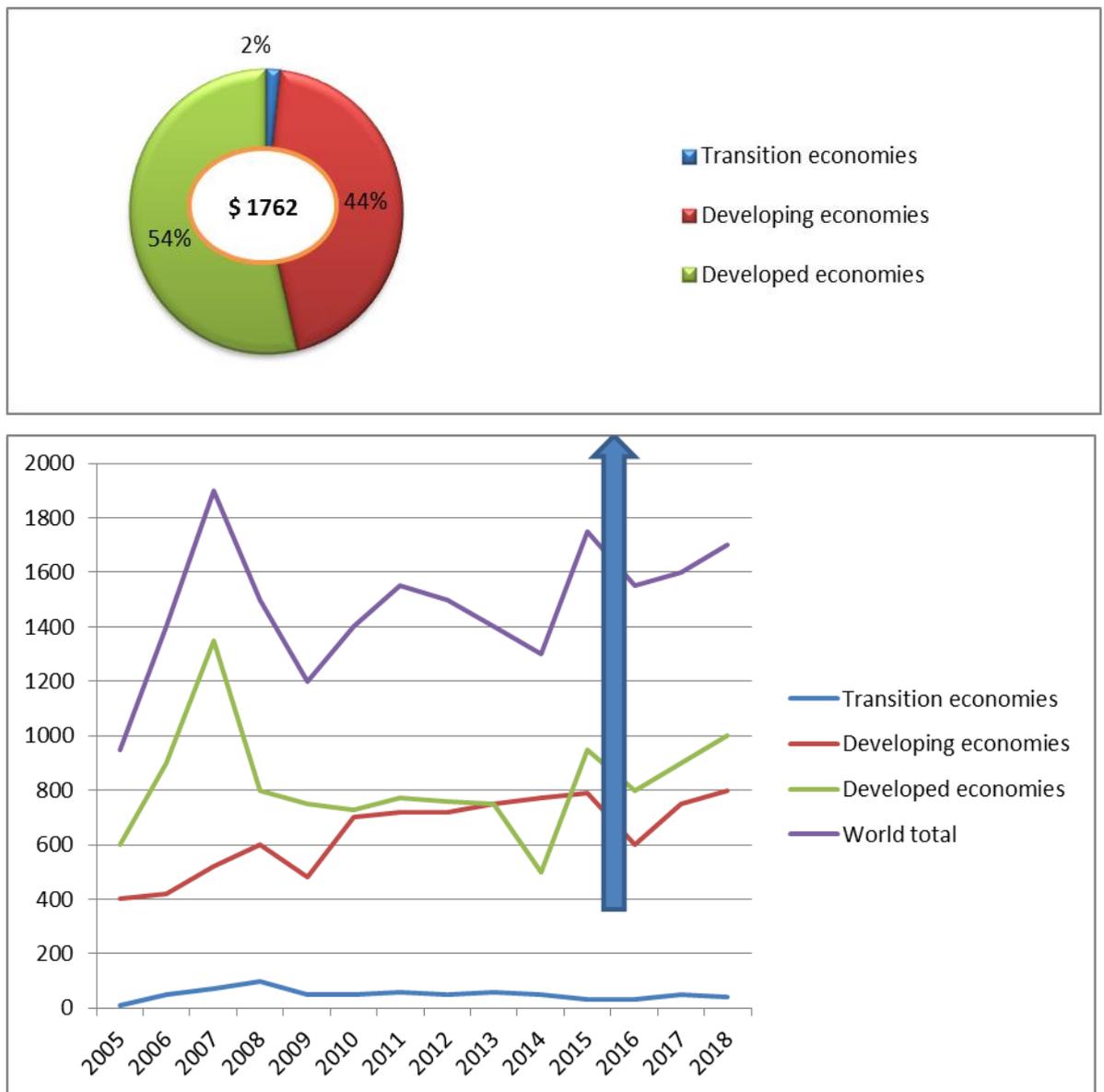


Figure-1.2. Global FDI inflows by group of economies, 2005-2015¹⁷

Much of this shift to developed economies was due to cross-border M&A activity, which recorded a 67 per cent increase in value to \$721 billion – the highest level since 2007. Activity was particularly pronounced in the United States where net sales rose from \$17 billion in 2014 to \$299 billion. Deal making in Europe also rose significantly (up 36 per cent). While FDI through cross-border M&As can contribute to productive investments, a number of deals concluded in 2015 can be attributed to corporate reconfigurations, including tax inversions. This trend was especially apparent in the United States and Europe, with several mega-

¹⁷ World Investment Report 2016 by UNCTAD, Chapter 1 p.2 (www.unctad.org/fdistatistics)

deals concluded to transfer the tax domicile of an MNE to jurisdictions that offer lower corporate tax rates, and do not levy tax on global earnings.

FDI to developing economies – excluding Caribbean financial centres – increased to a new high of \$765 billion (up 9 per cent). Developing Asia, with its FDI inflows surpassing half a trillion dollars remained the largest FDI recipient region in the world (Figure-1.3).

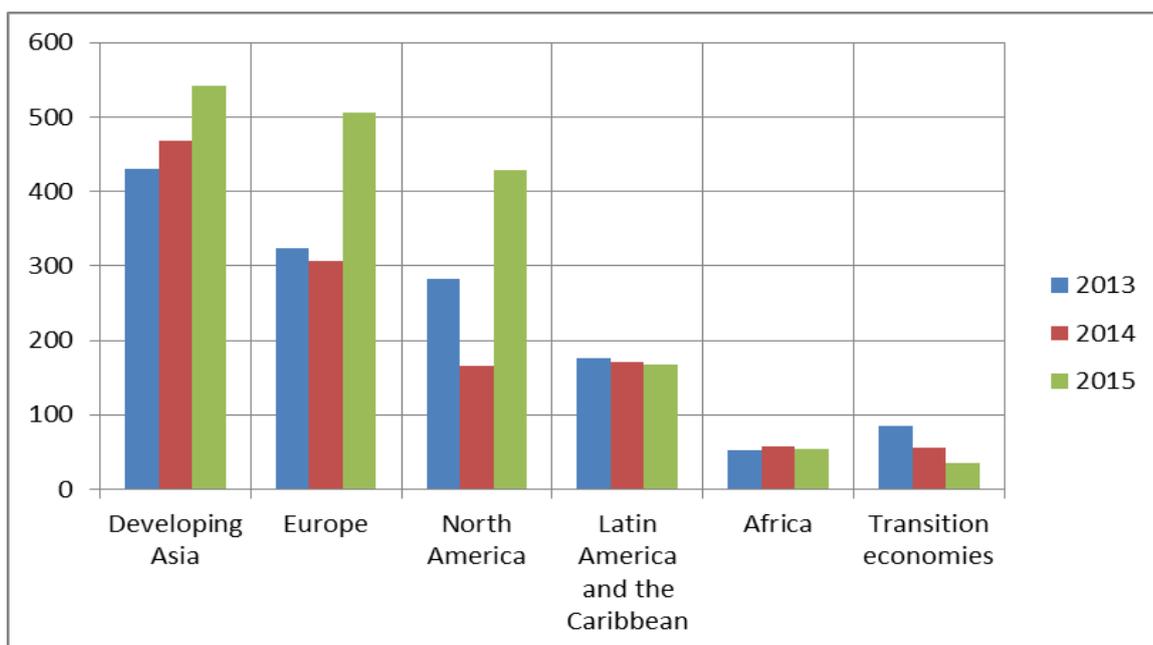


Figure 1.3. FDI inflows, by region, 2013-2015 (Billions of dollars)¹⁸

Due to UNCTAD’s World Investment Report 2016, FDI outflows from developed economies increased by 33 per cent to \$1.1 trillion. As a result, developed countries accounted for 72 per cent of global FDI outflows in 2015, up from 61 per cent in 2014. This 11 percentage point increase broke the nearly uninterrupted decline that began in 2007. The increase notwithstanding, the level of outward FDI from developed economies remained 40 per cent short of its 2007 peak. Europe became the world’s largest investing region in 2015, with FDI outflows of \$576 billion. Foreign investment by North American MNEs, in contrast, remained flat, with a significant gain in Canada being offset by a moderate decline in the United States. Furthermore, the biggest owner of FDI Outflow indicators was United States of America with 300 billions of dollars to

¹⁸ UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

developed economies and 317 billions of dollars to developing or transition economies during the period from 2013 to 2015. The second stage was booked by Japan with 129 and 114 billions of dollars to developed and developing industries respectively. In addition, China is considered as the third largest world investor in the globe with indicators which is 128 billions of dollars to developed countries and 123 billions of dollars to the developing industries.

Hence, why has foreign investment increased so dramatically in recent decades?

As stated earlier in this brief, international investment levels have exploded in recent decades. These increases in the flows of foreign investment have themselves marked a new and distinct phenomenon in the era of globalization. Several factors have helped drive this growth:

1) Technology. Telecommunications and transportation advances have simply made it easier to do business across large distances. As former American President William Jefferson Clinton once pointed out, in the 1960s, transatlantic telephone lines could only accommodate 80 simultaneous calls between Europe and the United States. Today, satellites and other telecommunications infrastructure can handle one million calls at one time. Fax machines, email and the drop in the cost of air travel have also contributed significantly to the growth of FDI. A business owner might think twice about trying to run an affiliate in a foreign country if communication with that office were not both easy and cheap. Changes in practices tend to be driven by changes in capabilities, and these new methods to communicate have unquestionably helped drive much of the subsequent desire to promote economic integration. The 21st century has brought even greater changes with the development of Bluetooth technology, better satellite reception, and increased flexibility in telecommuting and teleconferencing.

2) The lure of higher profits. In the 1980s and early 1990s, a number of countries in East Asia (Hong Kong, Indonesia, Japan, South Korea, Malaysia, Singapore, Taiwan, and Thailand) began to experience enormous economic growth rates— in some cases piling up double-digit expansions in their GDP per capita

year after year. These countries had built their phenomenal growth on a foundation based on greater integration into the international economy. In particular, they began emphasizing export-led growth. Investors from around the world realized that access to East Asian markets and their trading partners might help them attain much higher returns on their investments than they could obtain at home.

3) The fall of the Berlin Wall. The end of the Cold War had an important impact on international financial liberalization. First, many developing countries that had previously been committed to socialist models of economic planning began to turn toward market economies. The resulting efforts to privatize state-owned enterprises and changes in economic policies that were more favorable to capital investment made these economies much more attractive to potential investors. In addition, the demise of the Soviet Union also gave many investors much more confidence in the political stability of developing countries in general. Fears that a government might be overthrown or voted out in favor of one that might expropriate foreign assets declined.

4) Financial liberalization. Prior to the 1970s, many countries, including the United States, imposed strict limits on the rights of companies and individuals to invest overseas, to purchase foreign securities, or even to hold foreign currencies.

Many of these restrictions were put in place following the Great Depression of the 1930s, which had produced volatile movements of capital, triggering financial panics in some cases. However, in the early 1970s, the United States went off the gold standard and the previous system of fixed exchange rates between foreign currencies was abandoned. In addition, many restrictions were lifted on the flows of international capital, making it much easier for investors to purchase foreign securities. Since that time, the United States has been in the forefront of efforts to remove remaining controls on the movement of international capital. The Reagan and Clinton Administrations in particular made de-regulation of capital movement a high priority on their international economic policy agendas.

Financial liberalization has been the most direct, and probably the single biggest, factor accounting for the growth of international investment flows over the past several decades.

1.3. The features of investment activity in the development of the world country's economy

The investment activity of the enterprise is a purposefully carried out process of finding the necessary investment resources, selecting effective investment objects (tools), forming an investment program (investment portfolio) balanced according to selected parameters and ensuring its implementation.

Practical implementation of investments is ensured by the investment activity of the enterprise, which is one of its economic activities and the most important form of realizing its economic interests.

The investment activity of the enterprise is a purposefully carried out process of finding the necessary investment resources, selecting effective investment objects, forming a balanced investment program (investment portfolio) and ensuring its implementation.

The term “investment activity” can be given a broad and narrow definition. In a broad sense, investment activity is an activity connected with investing funds in investment objects in order to generate income (effect). In a narrow sense, investment activity, or actual investment, is a process of converting investment resources into investments.

The investment activity of the enterprise consists of the following components: investment strategy, strategic planning, investment design, and analysis of projects and actual efficiency of investments. The investment strategy is the choice of ways for the development of the cumulative assets:

- Strategic planning involves clarifying the investment strategy, aligning with the list of investment projects and a long-term investment financing plan.

- The investment project can be presented in the form of a feasibility study or business plan.

- Feasibility study of the investment project is a study of technical, economic, environmental and financial feasibility of investment with a specified profitability. Feasibility study includes geological studies, technical designs of buildings and structures, technical preparation of production, environmental impact studies on environmental conditions, marketing studies, calculation of financial and economic indicators.

- The business plan of the investment project is a standard form of investment presentation, common to all developed countries.

Planning methods and criteria for assessing the effectiveness of investment projects is the economic language of business communication, ensuring mutual understanding of owners, entrepreneurs, investors, bankers, employees of state institutions and international financial organizations. For large investment projects, the feasibility study and the business plan differ in the degree of detail of the studies and the set of accompanying documents. For a small investment, a feasibility study and a business plan can be identified.

The analysis of the effectiveness of investment projects consists of three parts: general economic, technical and economic-financial.

A general economic analysis is a description of a favorable or unfavorable economic situation and criteria for the economic importance of investments. The main criteria for the expediency of investments in the social and market economy is the saturation of the national market with goods and services (formation of a competitive environment); Creating jobs and meeting consumer demand; Receipt of taxes in the state and local budget.

Feasibility analysis refers to the technical part of the project, demonstrating the economic advantages of a particular technical solution.

Financial analysis of investments is based on the study of cash flows of capital and current value. The capital value is calculated in the draft investment balance sheet (assets and liabilities). The current value is the revenue from the sale

of goods (services), prime cost and taxes. Cash flows and financial analysis are reflected in the financial part of the business plan of the investment project.

There are certain features of the investment activity of the enterprise. They are as follows:

1. The investment activity of the enterprise is an integral part of the overall economic development strategy of the enterprise. Volumes of investment activity of the enterprise allow to estimate rates of its economic development. They are characterized by two indicators: the amount of gross investment and the amount of net investment of the enterprise.

- Gross investment is the total amount of investment of funds in a certain period of the enterprise's activity aimed at creating, expanding and renewing the productive capacity.

- Net investment is the amount of gross investment for a certain period, reduced by the amount of depreciation for the same period. The dynamics of this indicator determines the nature of the economic development of the enterprise.

2. The cyclical nature of investment activity, which is caused by the need to compensate for the moral and physical depreciation of fixed assets, as well as expansion of production occurring at regular intervals. For this period there is a preliminary accumulation of financial resources.

3. The timing of investment costs and results. The value of this period depends on the form of the investment process carried out by the enterprise. There are three main forms of the investment process: sequential, parallel, interval.

- With a parallel flow of the investment process, the formation of investment profit usually begins before the full completion of the capital investment process.

- When the investment process proceeds sequentially, the investment profit is formed immediately after the end of the investment.

- In the case of an interval flow of the investment process between the period of completion of investment of capital and the formation of the investment profit of the enterprise, there is a certain time interval.

4. Possibility of occurrence of investment risks. These risks are connected, first of all, with the changes occurring in the external environment (tax system, market conditions, currency regulation, etc.).

5. The investment activity of the enterprise is the main form of ensuring the growth of its production (operational) activity and is subordinate in relation to its purposes and tasks. Investment activity contributes to the growth of its operating profit in two directions:

- Increase in operating income due to an increase in the volume of production and marketing activities (construction of new branches, organization of new industries, etc.);

- Decrease in specific operating costs (timely replacement of physically worn out equipment, renewal of obsolete fixed assets, etc.).

6. The forms and methods of investment activity depend to a lesser extent on the branch characteristics of the enterprise than the production activity. This is determined by the fact that the investment activity of the enterprise is carried out in close connection with the financial market, the sectoral segmentation of which is practically non-existent.

7. Volumes of investment activity of the enterprise are characterized by unevenness for certain periods. This is determined by a number of conditions, in particular, the need for preliminary accumulation of financial resources to start the implementation of projects, the use of favorable external conditions for investment activities.

Investment activity is a necessary condition for the circulation of the funds of the economic entity. In turn, production activity creates the prerequisites for new investments.

Summary based on Chapter I

As for the summary it can be said that the terms “investment” and “investment activity” are much more broader terms than “capital” or “source of finance” or “credit” and these terms are clearly theoretically based by native and foreign scientists.

Investment is the commitment of money or capital to purchase financial instruments or other assets in order to gain profitable returns in the form of interest, income, or appreciation of the value of the instrument.

In a narrow sense, two types of investments have been identified. Due to sources, there are real (capital-forming) investments - investments in the creation of new ones, reconstruction or technical re-equipment of existing enterprises and financial (portfolio) investments in the purchase of shares and securities of the state, other enterprises, investment funds.

The tremendous growth in levels of foreign direct investment is a recent phenomenon and is one of the most powerful effects – and causes – of globalization.

UNCTAD report figures say that foreign investment’s flow is owned by Developing Asia, whereas Transition economies display the tiniest figures in terms of FDI and FPI inflow & outflow.

In recent decades, foreign investment increased dramatically due to several factors such as development of technology, the lure of higher profits, financial liberalization and etc.

CHAPTER II. MODERN ANALYSIS OF INVESTMENT ACTIVITIES IN WORLD'S ECONOMY

2.1. Foreign Direct Investment's global flow

International investment or capital flows fall into four principal categories: commercial loans, official flows, foreign direct investment (FDI), and foreign portfolio investment (FPI). Commercial loans, which primarily take the form of bank loans issued to foreign businesses or governments. Official flows, which refer generally to the forms of development assistance that developed nations provide to developing ones.

Foreign direct investment (FDI) pertains to international investment in which the investor obtains a lasting interest in an enterprise in another country. Most concretely, it may take the form of buying or constructing a factory in a foreign country or adding improvements to such a facility, in the form of property, plants, or equipment. FDI is calculated to include all kinds of capital contributions, such as the purchases of stocks, as well as the reinvestment of earnings by a wholly owned company incorporated abroad (subsidiary), and the lending of funds to a foreign subsidiary or branch. The reinvestment of earnings and transfer of assets between a parent company and its subsidiary often constitutes a significant part of FDI calculations.

According to the United Nations Conference on Trade and Development (UNCTAD), the global expansion of FDI is currently being driven by over 65,000 transnational corporations with more than 850,000 foreign affiliates. An investor's earnings on FDI take the form of profits such as dividends, retained earnings, management fees, and royalty payments.

Companies choose to invest in foreign markets for a number of reasons, often the same reasons for expanding their operations within their home country. The economist John Dunning has identified four primary reasons for corporate foreign investments:

- **Market seeking:** Firms may go overseas to find new buyers for their goods and services. The top executives or owners of a company may realize that their product is unique or superior to the competition in foreign markets and seek to take advantage of this opportunity. Another motivation for market seeking occurs when producers have saturated sales in their home market, or when they believe investments overseas will bring higher returns than additional investments at home. This is often the case with high technology goods. As one analyst noted, "The minimum size of market needed to support technological development in certain industries is now larger than the largest national market" (Sutherland, 1998).

- **Resource seeking:** Put simply, a company may find it cheaper to produce its product in a foreign subsidiary—for the purpose of selling it either at home or in foreign markets. The foreign facility may be able to obtain superior or less costly access to the inputs of production (land, labor, capital, and natural resources) than at home.

- **Strategic asset seeking:** Firms may seek to invest in other companies abroad to help build strategic assets, such as distribution networks or new technology. This may involve the establishment of partnerships with other existing foreign firms that specialize in certain aspects of production.

- **Efficiency seeking:** Multinational companies may also seek to reorganize their overseas holdings in response to broader economic changes. For example, the creation of a new free trade agreement among a group of countries may suddenly make a facility located in one of those countries more competitive, because of access for the facility to lower tariff rates within the group. Fluctuations in exchange rates may also change the profit calculations of a firm, leading the firm to shift the allocation of its resources.

Now, if we look at the global scene of FDI flow tendencies, the overall picture will be as following. Global foreign direct investment (FDI) inflows fell by 16 per cent in 2014 to \$1.23 trillion, down from \$1.47 trillion in 2013 (figure 1). This is mostly explained by the fragility of the global economy, policy

uncertainty for investors and elevated geopolitical risks. New investments were also offset by some large divestments.

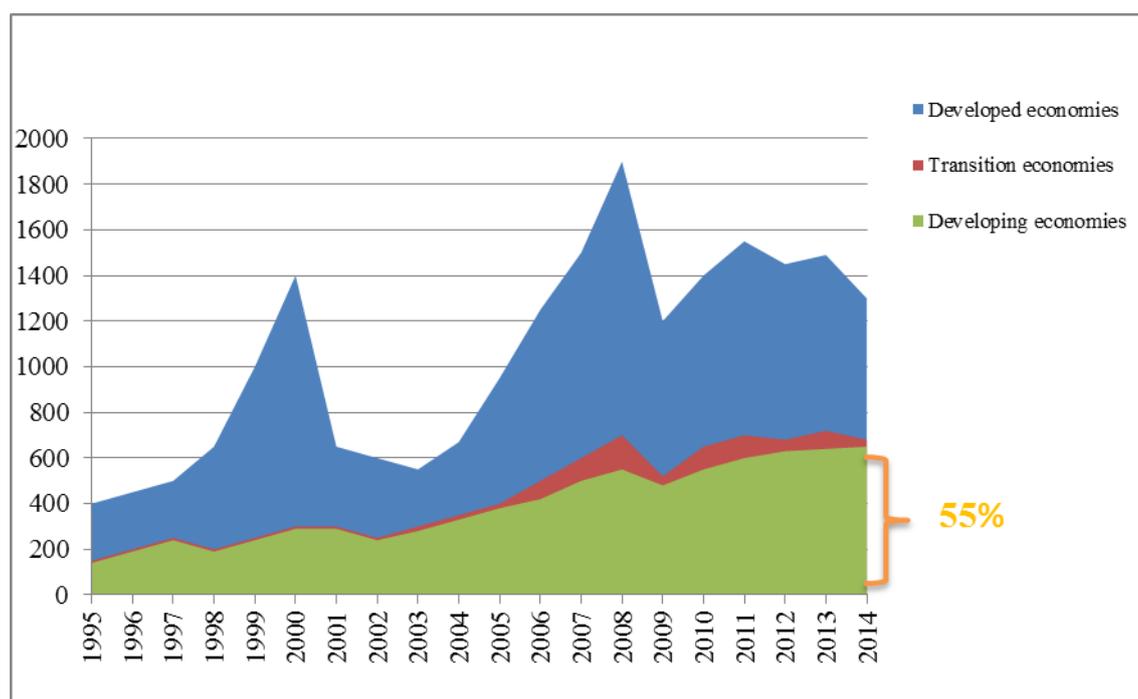


Figure 2.1. FDI inflows, global and by group of economies 1995-2014 (billions of dollars)¹⁹

Hence, if we take the above given indicators and discuss in regional aspect, the overall scene in developing Asia can be described as following: hindered by the current global and regional economic slowdown, FDI inflows to Asia are expected to decline in 2016 by about 15 per cent, reverting to their 2014 level. Data on cross-border M&A sales and announced Greenfield investment projects support the expected decline. For instance, cross-border M&As in the region announced in the first quarter of 2016 were \$5 billion, only 40 per cent of the same period in 2015. In addition, the number of Greenfield projects announced in 2015 was 5 per cent lower than in 2014. There are indications that intraregional investments are rising: 53 per cent of announced Greenfield projects in developing Asia by value in 2015 were intraregional, especially from China, India, the Republic of Korea and Singapore. Among the most important industries driving this intraregional

¹⁹ UNCTAD, FDI/MNE database (www.org/fdistatistics)

development are infrastructure and electronics. The rise of investments from Singapore to India exemplify this trend.

FDI flows to some Asian economies such as China, India, Myanmar and Viet Nam are likely to see a moderate increase in inflows in 2016. During the first four months of 2016, FDI inflows in non-financial sectors in China amounted to \$45 billion, 5 per cent up from the same period in 2015. In India, the large increase of announced Greenfield investments in manufacturing industries may provide further impetus to FDI into the country. Viet Nam is expected to continue strengthening its position in regional production networks in industries such as electronics, while Myanmar is likely to receive increasing levels of FDI inflows in infrastructure, labour-intensive manufacturing and extractive industries. Announced Greenfield projects in Myanmar totalled \$11 billion in 2015 and \$2 billion in the first quarter of 2016, pointing to sustained FDI inflows in the near future.

The recovery of FDI in developed countries is unlikely to be sustained in 2016. UNCTAD forecasts indicate that FDI flows to developed countries will be in the range of \$830–880 billion, with the median falling by 11 per cent.

The third wave of administrative action against tax inversions by the United States Treasury Department in 2016 should make it harder for companies to move their tax domiciles out of the United States and shift profits to low-tax countries. For instance, the \$160 billion merger of drug maker Pfizer (United States) with Ireland-based Allergan was dropped in April 2016.

Although announced Greenfield investment projects in developed countries in 2015 were up across many industries and from a range of source countries, especially Europe, cross-border M&A data on deals announced over the period January–April 2016 probably provide a better indication of prospects for 2016 as a whole. In this period, \$292 billion worth of M&A deals targeting assets in developed countries were announced; compared with the year before, cross-border M&A deals made a much slower start. In the same period in 2015, the value of announced deals amounted to \$423 billion. The decline would have been much more pronounced had it not been for a flurry of deals announced by Chinese MNEs

which were worth \$93 billion, representing 32 per cent of the total. The largest announced deal was the proposed takeover of the agribusiness MNE Syngenta (Switzerland) by ChemChina (China) for \$44 billion. Agribusiness might see further consolidation with the German pharmaceutical MNE Bayer launching a \$62 billion bid for Monsanto (United States) in May 2016.

In addition to announced deals, the transactions completed in the first four months of 2016 provide some pointers. In Europe, M&As will be boosted by Royal Dutch Shell (Netherlands/United Kingdom) takeover of the gas exploration and production company BG Group (United Kingdom) for \$69 billion. However, the subdued 2015 level of M&A sales in telecommunications in Europe might decline further in 2016. The merger of two mobile operators in the United Kingdom, BT and EE, resulted in divestments of stakes in EE by Orange (France) and Deutsche Telecom (Germany) amounting to –\$19 billion. By contrast, foreign investors may make substantial inroads into Japan in 2016, with high-profile deals such as the acquisition of the electronics group Sharp and a concession to operate airports in Kansai.

After the slump in 2015, FDI flows to transition economies are expected to increase in the range of \$37–47 billion in 2016, barring any further escalation of geopolitical conflicts in the region. In South-East Europe, the EU integration process and increasing regional cooperation will likely support FDI inflows. In the Commonwealth of Independent States (CIS), FDI is expected to increase, as some companies with hefty debt burdens and reduced access to the international capital market are forced to sell equity stakes; for example, Rosneft, the largest Russian oil producer, decided to sell 29.9 per cent of its Taas-Yuriakh subsidiary, which operates one of the largest oil and gas fields in eastern Siberia, to a consortium of three Indian companies: Oil India, Indian Oil and Bharat PetroResources. Furthermore, several countries, including Kazakhstan, the Russian Federation and Uzbekistan, have announced large privatization plans in response to ballooning current account deficits and depleted foreign exchange reserves, resulting from the depreciation of their currencies and low energy prices.

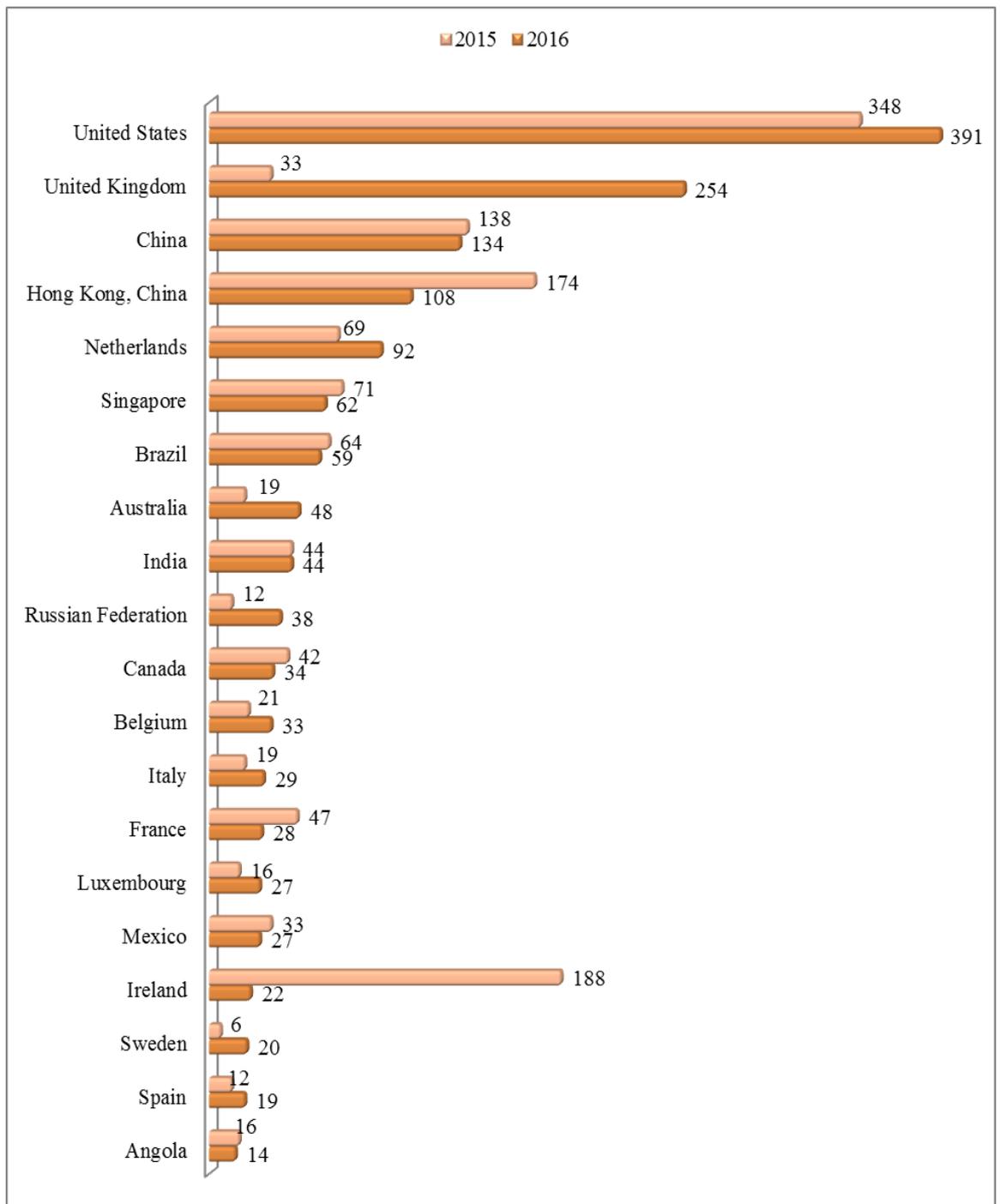


Figure-2.2. FDI inflows, top 20 host economies, 2015 and 2016 (billions of dollars)²⁰

Developing economies continued to account for half of the top 10 host economies. The United States remained the largest recipient of FDI, attracting \$391 billion in inflows, followed by the United Kingdom with \$254 billion, vaulting from its 14th position in 2015 on the back of large cross-border M&A

²⁰ World Investment Report 2017 by UNCTAD, p.7

deals. China was in third position with inflows of \$134 billion – a 1 per cent decrease from the previous year.

Hence, we think, for each investor it is interesting that how US economy is continuing being the world's largest receiver of global FDI inflow. So, there are several reasons for this, and some of them are given below.

Firstly, the economy is large and stable. While enthusiasm for the global economy is in relatively short supply these days, prospects for the US seem fairly good. Near term, economic experts expect US growth to stay close to its current moderate pace,²¹ and longer term, the US will likely remain a global economic powerhouse, despite faster growth across many emerging economies. The Economist, for example, predicts that by 2050, the US will be the second largest economy in the world, behind only China and considerably larger than Indonesia, Germany, Brazil and the UK combined.²² And in the interim, the US remains by far the largest economy in the world, exceeding China's by over 65%.²³

Secondly, the investment universe is vast. The US offers by far the largest investment market in the world. Both its stock and bond market are three times larger than the next biggest,²⁴ and US asset managers manage roughly half the world's total long term assets under management.²⁵ While bigger isn't always better, a larger base of investments and investors is generally positive, because it provides more opportunities and enhances market liquidity.

Thirdly, innovation thrives are booming the globe. The US is one of the most innovative countries in the world²⁶ and continues to take steps to ensure it remains that way.²⁷ It spends more on research and development than any other nation and more on a relative basis to GDP than most. It also benefits from highly

²¹ Bloomberg. Weighted average forecast for US real GDP. 89 professional organizations contributed to this forecast. 13 June 2016.

²² The Economist Intelligence Unit. Long-term macroeconomic forecasts: Key trends to 2050. Published in 2015.

²³ Worldbank estimates. As measured by annual gross domestic product at purchaser's prices. 31 December 2015.

²⁴ Bank for International Settlements. The bond market size for each country is measured by total debt securities outstanding as of 31 December 2015, and the stock market size for each country is measured by the market capitalization of listed domestic companies as of 30 June 2016.

²⁵ <https://www.selectusa.gov/financial-services-industry-united-states>. 31 December 2015.

²⁶ The Global Innovation Index 2015: Effective Innovation Policies for Development (the US ranks 5 out of 141 economies).

²⁷ National Economic Council and Office of Science and Technology Policy. Strategy for American Innovation. October 2015.

developed venture capital and angel investing industries as well as unrivaled academic research.²⁸ Innovation matters to investors, because it fuels economic progress and is a key determinant of a country's global competitiveness.

Next, the business environment is friendly. The US is a friendly place to do business. It ranks 7 of 189 on the World Bank's Ease of Doing Business Index, placing it among top global performers, which, according to the World Bank, have "good rules that allow efficient and transparent functioning of businesses and markets while protecting the public interest."²⁹ The index is calculated based on a number of corporate regulatory criteria, such as ease of complying with tax regulations, quality of legal proceedings, minority shareholders' rights, and the time and costs associated with miscellaneous red tape. All else held equal, a better ranking is good for businesses and their investors.

Furthermore, the benefits of diversification are real. Portfolio diversification can make a big difference by enhancing returns and reducing volatility.³⁰ For example, a 50/50 blend of Hong Kong and US equities has delivered 1.7% in extra annualized return with 26% less volatility than Hong Kong equities over the past 20 years.³¹ We don't intend to suggest the same will be true over the next 20 years or that a 50/50 blend is the ideal mix. But what this example highlights is that holding investments with different risk/return profiles can make a meaningful difference over the long-term.

As shown in Figure 6, the stock of FDI in the United States has come mostly from a small number of advanced economies, with the top 10 investor nations by location of the ultimate beneficial owner (UBO) collectively accounting for nearly 80 percent of FDI stock in the United States in 2015. The geographic distribution of the most recent FDI flows data, which is only measured based on the country from which the investment came (that is, it may measure investment from

²⁸ Council on Foreign Relations. *Renewing America Progress Report and Scorecard. Keeping the Edge: U.S. Innovation.* January 2016.

²⁹ World Bank. *Doing Business 2016: Measuring Regulatory Quality and Efficiency.*

³⁰ Diversification will not guarantee a profit or assure against losses. Past performance is not indicative of future performance.

³¹ Morningstar Direct as measured by the returns and standard deviations in Hong Kong Dollar terms of the Russell Hong Kong Index and a 50% blend of the Russell Hong Kong Index and Russell USA Index, rebalanced quarterly, from 1 July 1996 – 30 June 2016.

intermediary nations rather than the ultimate owner) and is subject to large year-to-year fluctuations, suggest that total FDI flows since 2010 have mostly come from a small number of advanced economies. The top 10 investors during the years 2013-2015 all accounted for at least 92 percent of FDI inflows, up from 2010-2012 top 10 that accounted for an average of just over 85 percent of total FDI.³²

In addition, top 10 investors in the United States can be given for further information.

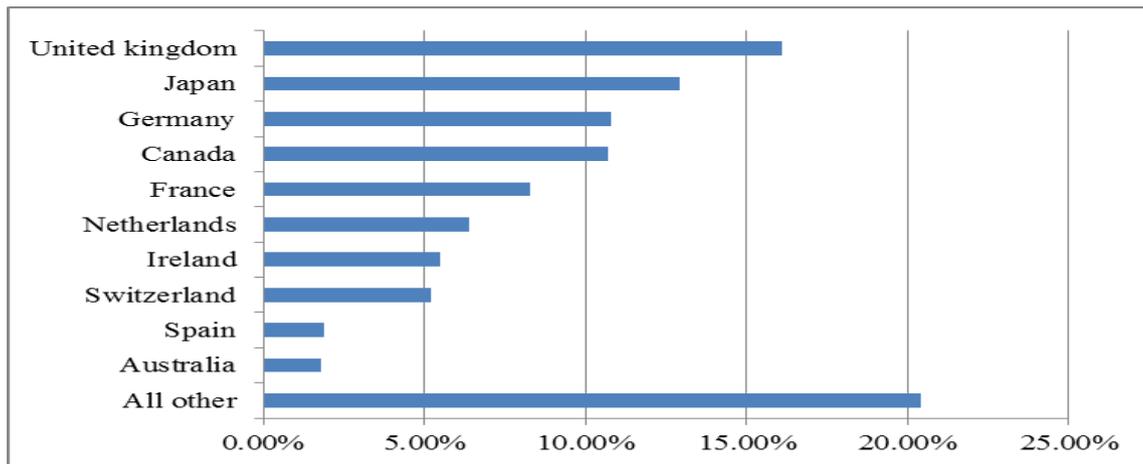


Figure 2.3. FDI in the U.S. Top 10 Investor Countries by Ultimate Beneficial Owner (UBO), 2015³³.

Next, question will be about FDIUS (Foreign Direct Investment in the United States) allocation by industry and sectors.

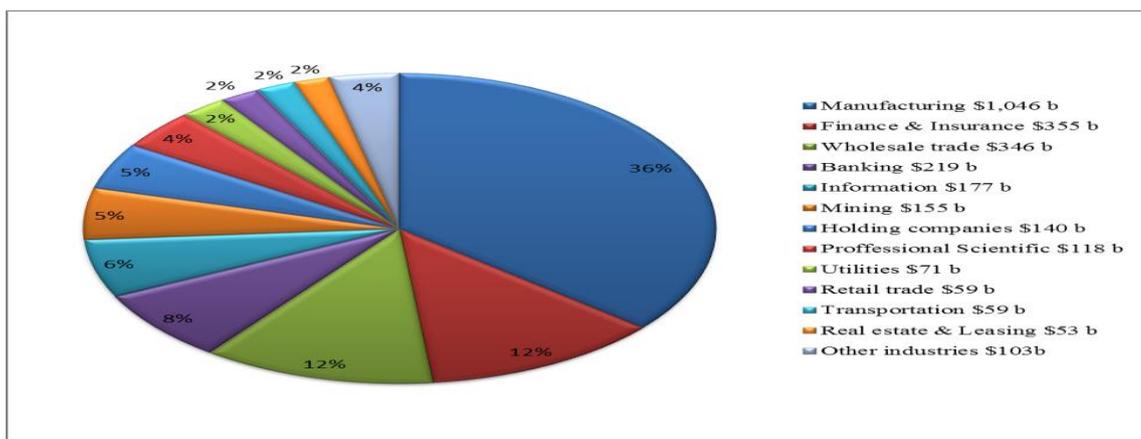


Figure-2.4. Cumulative FDIUS by industry, 2015³⁴

³² U.S. Department of Commerce Economics and Statistics Administration. Foreign Direct Investment in the United States 2016 Report.

³³ Department of Commerce, Bureau of Economic Analysis.

³⁴ Data are shown on a historical-cost basis, or cost at time of investment. Bureau of Economic Analysis.

All sectors of the U.S. economy represent significant business opportunities for foreign companies. Topping \$1 trillion in 2014, manufacturing accounted for more than one-third of cumulative foreign direct investment. Because the United States has the world's largest and most liquid financial markets, foreign companies, on a cumulative basis, have invested heavily in the U.S. finance and insurance industries, reaching \$355 billion by year-end 2014. International companies have spent nearly \$350 billion in wholesale trade over time. Banking, information, and mining each received more than \$150 billion in cumulative foreign direct investment through 2014. Inward investment in holding companies and professional, scientific, and technical services each exceeded \$100 billion cumulatively by 2014.³⁵

As it is illustrated above, according to the 2017 World Investment Report of the United Nations Conference on Trade and Development (UNCTAD), the United Kingdom is the world's second largest recipient of foreign direct investment (FDI). FDI influx, which markedly decreased following the international financial crisis of 2009, again resumed an upward trend in 2012. In 2015, FDI reached USD 40 billion. Furthermore, between 2015 to 2016, FDI has allowed the creation of a record number of jobs in the UK, with the number of projects financed by FDI reaching record levels. Despite Brexit, the UK economy still has some key strengths: London remains the financial capital of Europe, while Great Britain still has a strong currency, despite its recent devaluation, and is one of the most important European markets. The UK placed seventh of 190 economies in the 2017 Doing Business ranking established by the World Bank. So let's briefly define the reasons of the Kingdom's attractiveness in terms of foreign investments.

Firstly, the UK is the easiest place to establish and run a business in Europe: According to a World Bank study, it takes only 13 days to establish a business in the UK. The World Bank has ranked the UK first in Europe and sixth in the world to operate business.

³⁵ Bureau of Economic Analysis.

Secondly, an internationally competitive tax environment for foreign investors: the UK has the lowest corporate tax at 28 percent which is the lowest in the G7. The highest personal tax bond at 40 percent is also the lowest in the EU.

Thirdly, most flexible market in Europe: According to a World Bank report, the UK stands at second place to employ workers.

Next, least barriers to entrepreneurship: OECD has identified the UK as second in the world for Product Market Regulation. It also ranks second for the least barriers to entrepreneurship and third for the least barriers to trade investment in the world.

Moreover, top talent: the UK is home to the top six universities in Europe. Two of the top six best schools in the UK figure in top three global universities. The UK's governmental language – English is considered as the operational language when doing business globally.

Table-2.1.

UK FDI inflow by country and by sector³⁶

Main Investing countries	2015, %	Main Investing sectors	2015, %
USA	46.8	Financial services	46.0
Canada	8.5	Information & Communication	19.0
Spain	5.3	Transport & Logistics	8.0
Japan	6.1	Scientific Services	6.0
India	3.0	Electricity & Gas	5.0
Australia	2.7	-	-
Germany	12.9	-	-
Hong-Kong	2.3	-	-

As it is illustrated in Table-2.1 the most investing country is - The United States of America with 46.8 % share, and the second stage is followed by Canada with 8.5 %, Spain concluded the powerful third with its share 5.3% in terms of Foreign Direct Investment Inflows in territory of the Kingdom.

The largest share of FDI inflow into the UK goes to the financial services industry, and half of the UK's current investment stock of GBP 1 trillion comes

³⁶ [https://en.portal.santandertrade.com/establish-overseas/United Kingdom/foreign-investment](https://en.portal.santandertrade.com/establish-overseas/United%20Kingdom/foreign-investment)

from the EU member States. The next most widely broadened investment sector is considered as Information and Communication sector with its share 19.0 % and Transport and Logistics industry has booked third stage in the list with 8.0 % respectively.

As written above, we have already discussed the United States' and the United Kingdom's attractiveness in terms of FDI inflows, now turn to China which was in third position with inflows of \$134 billion.

Talking about emerging markets, China provides a strong platform for investments into its small cap funds. China has emerged as a strong player in the financial market due to the presence of its world class infrastructure and efficient and skilled manpower. There are various reasons for an investor to acquire funds in the China market.³⁷

Firstly, due to the high volume of population in China, and its sheer involvement towards spreading its dimensions in sectors such as IT, economic industry and its political stronghold in all spheres, many companies are reflecting immense growth opportunities. And as an investor one should always look for an industry which has better future growth prospects.

Secondly, unlike any other world markets, this market has lot of commodities which allow the investor to diversify his/her portfolio. Therefore, diversification caters to the investor's requirements and thus he can create better avenues for earning profits.

Thirdly, the Chinese currency Yuan is experiencing a positive trend in the currency appreciation market. Thus, the strengthening of Yuan during the inflationary cycle in comparison to dollar can give better chances of survival to an investor investing in this market.

Next, China is slowly and steadily emerging as a major global network which links various countries and thus reduces the geographical boundaries. Thus

³⁷ <https://www.globalbankingandfinance.com/top-10-reasons-to-invest-in-china/>

the Chinese transportation sector is another interesting area that can fetch good revenues to the investor investing in this zone.

In addition, the Chinese oil sector has shown a tremendous rise in its market pattern. The Chinese oil company (CNOOC) has a potential production rise forecast which might go hand-in-hand with China's manufacturing and transportation sectors (the other two profitable sectors of China).

The country's economy also ranked the second most attractive to multinational companies in 2016-2018, after the United States. The absorption of FDI is part of the policy of opening China to the outside world.

In 2016, FDI followed their upward trend and reached USD 139 billion, a new record level. FDI flows from China abroad, valued at USD 161 billion in 2016, outpaced FDI flows into the country. China has a large and rapidly expanding market, which was not overly affected by the financial crisis. With a strong potential, a wealth of employees and potential partners eager to learn and evolve, the country is a base for low cost production.

Table-2.2.

Chinese FDI distribution by countries and by sectors 2016³⁸

Main Investing countries	2016, in %	Main Investing sectors	2016, in %
Hong Kong	69.0	Manufacturing	43.2
Singapore	5.0	Real estate	20.9
South Korea	4.0	Business services	6.2
USA	3.0	Wholesale trading	5.7
Macao	3.0	Transport services	2.0
Taiwan	3.0	-	-
Japan	3.0	-	-
Germany	2.0	-	-

Nevertheless, certain factors can hinder investments, such as China's lack of transparency, legal uncertainty, low level of protection of intellectual property rights, corruption or protectionist measures which favour local businesses. Now let's look at FDI distribution by invested countries and by sectors in Table 2 below.

³⁸ <https://en.portal.santandertrade.com/establish-overseas/china/foreign-investment>

As it is illustrated in Table-2.2, the most investing country is – Hong Kong with 69.0 % share, and the second stage is followed by Singapore with 5.0 %, South Korea concluded the powerful third with its share 4.0 % in terms of Foreign Direct Investment Inflows in territory of China.

The largest share of FDI inflow into China goes to the manufacturing industry which books 43.2 % pie in a whole cake. The next most widely broadened investment sector is considered as real investment sector with its share 20.9 % and Business services and renting industry has booked third stage in the list with 6.2 % respectively.

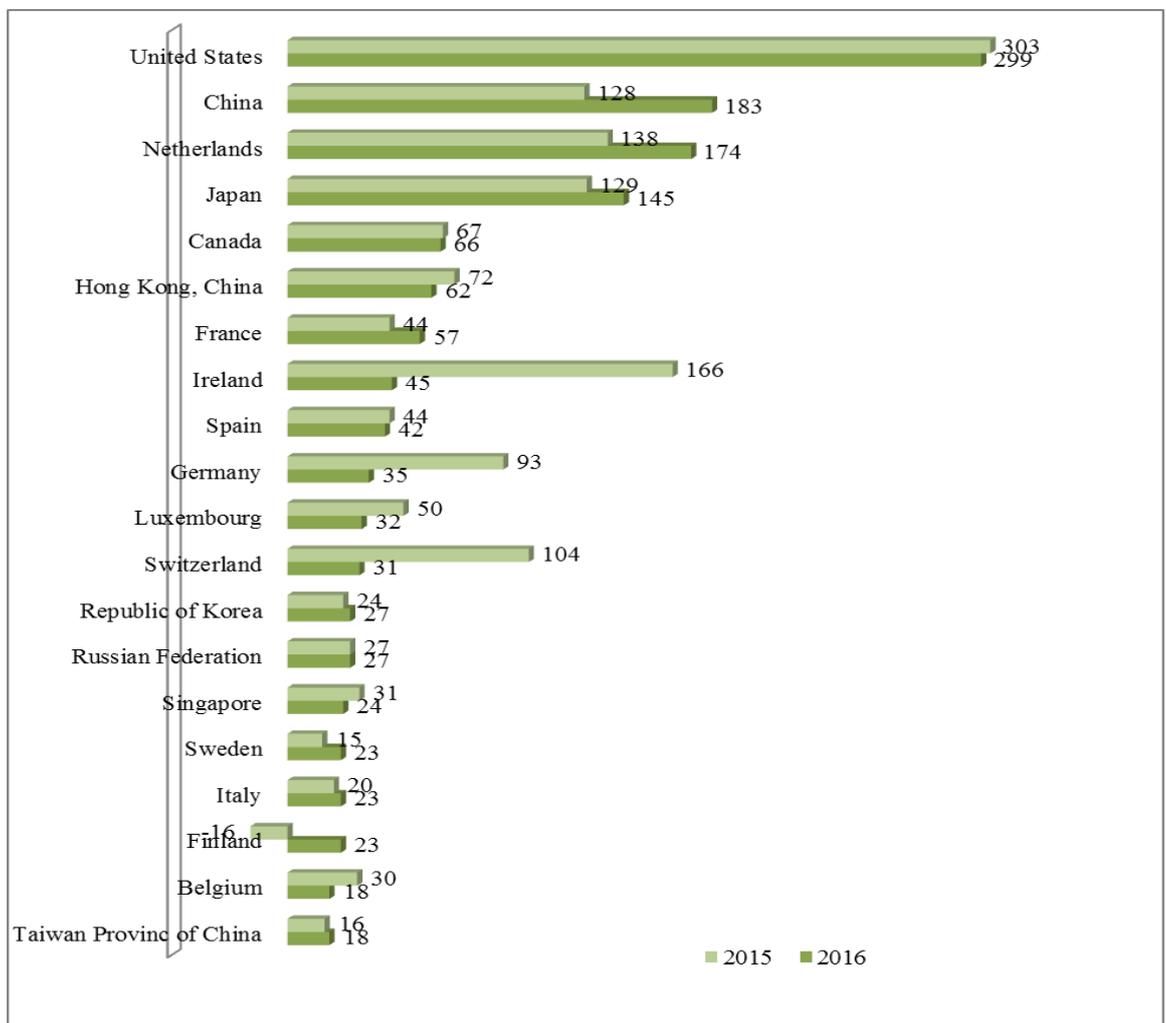


Figure 2.5. FDI outflows, top 20 host economies, 2015 and 2016 (billions of dollars)³⁹

Next topic will be devoted to FDI outflows and below given Figure-2.5 illustrates top 20 home economies in 2015 and 2016 due to World Investment Report 2017 by United Nations Conference on Trade and Development.

³⁹ World Investment Report 2017 by UNCTAD, p.9

Outward investment from developed economies declined by 11 per cent to \$1 trillion in 2016. Their share in global outward FDI flows remained stable – at just over 70 per cent – as outflows from developing economies remained flat, at \$383 billion, and those from transition economies contracted 22 per cent, to \$25 billion. Investment by European MNEs, which had surged in 2015, retreated significantly in 2016, falling 23 per cent to \$515 billion. This was driven by sharp reductions in outflows from Ireland, Switzerland and Germany. Investment by North American MNEs was roughly steady in 2016, despite a significant reduction in the value of their cross-border M&A purchases. The United States remained the world’s largest outward-investing country in 2016, although flows declined marginally (-1 per cent), to \$299 billion (Figure-2.5).

As it is displayed, in 2016 the biggest amount of invested money (299 billions of dollars) went out from the United States of America. So, below the data is given about the invested fund allocation by countries and by industries.

From the figure it can be said that Europe owned the biggest portion (57%) of US FDI outflow, Asia and Latin America countries reserved the second stage with 16% at the same time in terms of FDI outflows by the United States. Africa and Middle East possess a tiny pie in cake of US FDI outflow with 2% and 1% respectively.

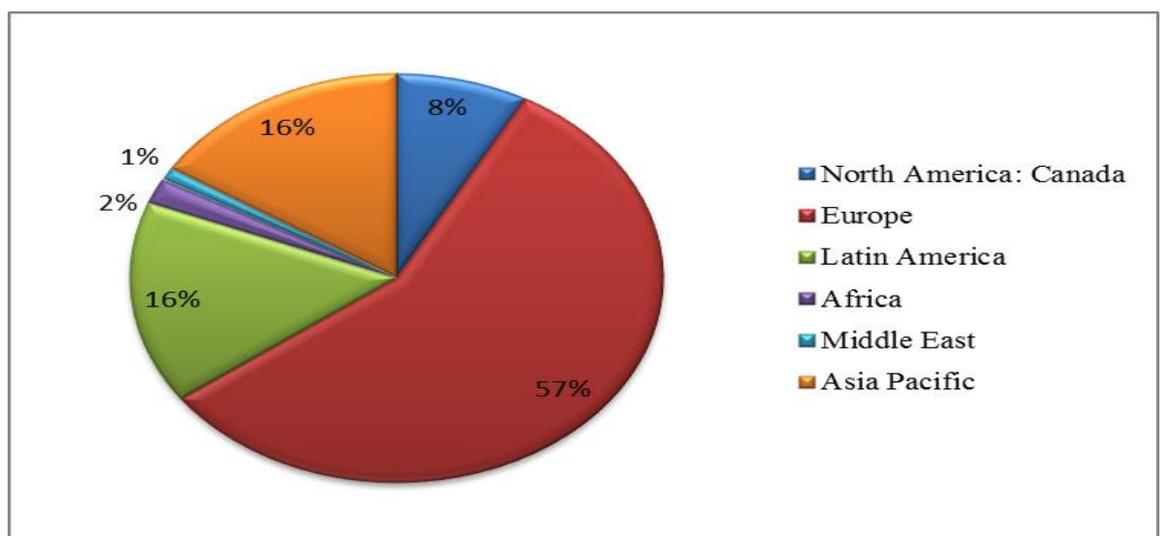


Figure-2.6. Geographical distribution of the U.S. FDI outflow, 2011-2016⁴⁰

⁴⁰ US Outward FDI Profile, Presentation Point by Lucyna Kornecki, PhD, Associate Professor in College of Business Embry Riddle Aeronautical University (ERAU), p.11

Due to latest data available, US economists found the holding companies as the most attractive sector to invest in and topping \$93 billions of dollars in 2011-2016 (on average), is accounted for this sector. On a cumulative basis, the U.S. investors have invested heavily in foreign manufacturing industries, reaching \$43 billion by year end 2016. American companies have spent nearly \$35 billion in overseas finance over time. Wholesale trading and mining each received more than \$15 billion in cumulative foreign direct investment through 2011-2016.

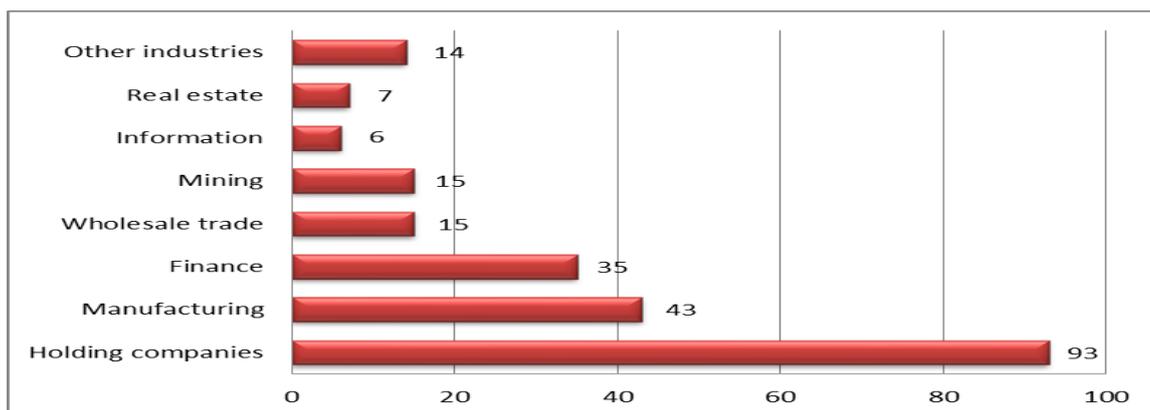


Figure-2.7. Sectoral Distribution of U.S. FDI outflows, 2011-2016 (average)⁴¹.

While the pace of global economic growth is slackening, Chinese enterprises are actively making outward foreign direct investments and expanding their businesses overseas. China is now one of the world’s leading sources of FDI, its outflows in 2015 ranking second globally only to the US. During the same period, China’s outward FDI exceeded its inbound FDI, making the country one of the world’s net capital exporters.⁴²

According to figures released in 2017 by UNCTAD, China’s outward FDI flows in 2016 reached US\$183 billion (up 18.3% year on year), for the first time ranking as the world’s second-largest source of FDI. Its investment amount, second only to the US (US\$299 billion) but higher than third placed Netherlands (US\$174 billion), accounted for 9.9% of the global total of FDI outflows in the same period.

⁴¹ US Outward FDI Profile, Presentation Point by Lucyna Kornecki, PhD, Associate Professor in College of Business Embry Riddle Aeronautical University (ERAU), p.13

⁴² <http://economists-pick-research.hktdc.com/business-news/article/Research-Articles/China-Takes-Global-Number-Two-Outward-FDI-Slot-Hong-Kong-Remains-the-Preferred-Service-Platform/rp/en/1/1X000000/1X0A804W.htm>

In addition, the geographical distribution of Chinese ODI (Outbound Foreign Direct Investment) flows may be more balanced than previously thought, with developed markets in North America and Europe accounting for a larger share of final flows and stocks.⁴³

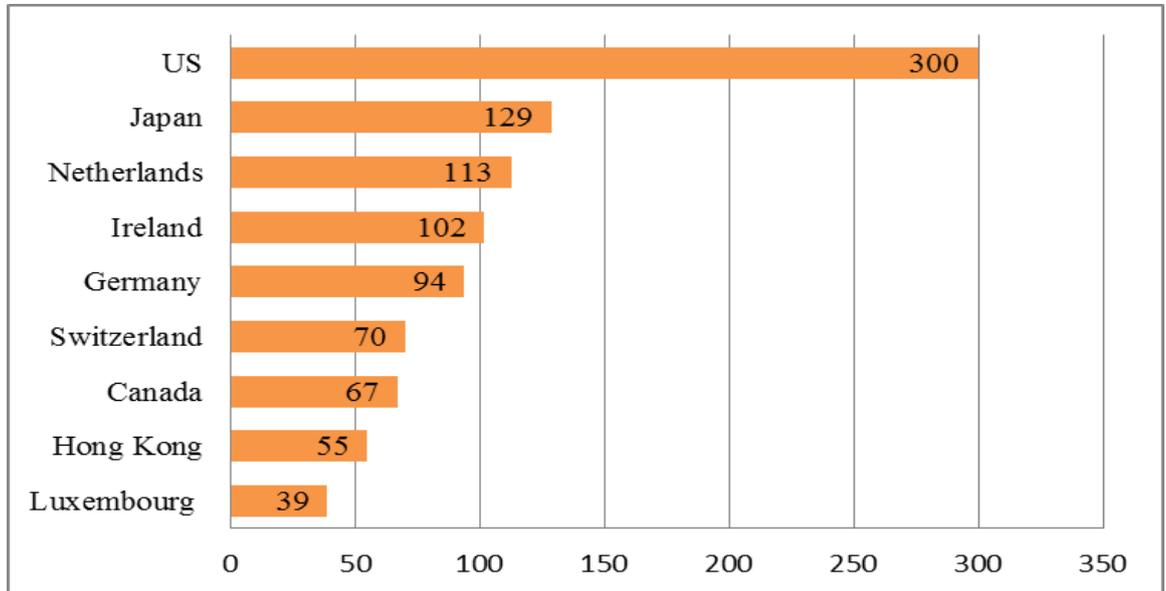


Figure 2.8. Geographical distribution of Chinese ODI flows, 2016⁴⁴

The fact that America with US\$300 billion is the main recipient of Chinese ODI makes sense given the region's geographical proximity and close trade links with China. Japan emerges as the second largest recipient with its share which equals to US\$129 billion according to official statistics. World Report Investment 2016 by UNCTAD says that Netherlands and Ireland each holds more than US\$100 billion Chinese outbound foreign Direct Investment. The list followed by Switzerland, Germany and other European countries.

Today, nations across the globe are moving toward a more open and positive approach regarding MNCs and FDI, a trend that has been reinforced by recent international agreements and new institutions, such as the World Trade Organization (WTO), the Asia Pacific Economic Cooperation (APEC) forum, and the North American Free Trade Agreement (NAFTA) and others. The available evidence indicates that, in almost all cases, foreign direct investment (FDI) is

⁴³ <http://bruegel.org/2015/06/chinas-outward-foreign-direct-investment/>

⁴⁴ Source: Statistical Bulletin of Chinese outward FDI 2016, p.24

beneficial for investing firms and host countries, and the importance of multinational corporations in the world economy will continue to expand.

2.2 Foreign Portfolio Investment's global flow

Over the last two decades the financial integration of emerging market economies (EMEs) with international markets has gained momentum. In the 1980s and early 1990s, net private capital inflows to EMEs were still relatively low, but they began to grow more rapidly in the mid-1990s⁴⁵. This phenomenon has been influenced by a number of factors reflecting, on the one hand both the expected profitability and the perceived investment risk of EMEs assets, and on the other hand, the changing external environment. These host-country specific factors (also called pull factors) include, particularly, a strong output growth of EMEs prospects, giving investors an opportunity to get a relatively high rate of return. However, the major external factors (also called push factors) capture, a loose monetary policy and expected low returns on financial assets in the developed countries.

Since the early 1980s capital has been flowing to EMEs primarily in the form of foreign direct investment (FDI). This resulted from the fact that historically FDI has been considered as a safe source of external financing and a factor stabilizing the financial system of the recipient countries. The abovementioned view has been reflected in the EMEs approach to financial account liberalization as they have lifted, in the first place, restrictions on long-term flows and then gradually on short-term flows. Along with the development of local financial markets in EMEs and their greater openness to foreign investors, the composition of capital inflows has shifted towards the rising share of foreign portfolio investment (FPI) in total flows. An increase in the volume of FPI flows to EMEs has been also connected with the growing importance of institutional

⁴⁵ According to the Institute of International Finance, the size of net private capital inflows to EMEs grew from about 30 billion US dollars during the 1980s to around 320 billion of US dollars during 2000-2005, before reaching an all-time high of 1,2 trillion US dollars in 2007

investors (insurance companies, pension funds, mutual funds, hedge funds, sovereign wealth funds, private equity funds, etc.), as they added liquidity to global securities markets.

Since the early 1980s capital flows between developed countries and towards developing economies have been growing as a result of, *inter alia*, the reduced controls on financial transactions as well as the evolution of the financial system and information technologies. These flows can be divided into three major categories, FDI, FPI and the so-called other investment. According to international standards (OECD, IMF), foreign investment which accounts for more than 10% of shares or voting rights is considered as FDI. In case it is below 10%, it is classified as FPI. The remaining forms of capital, such as trade loans, bank loans and deposits are considered as other investment.⁴⁶

Portfolio investment is considered to include securities transactions not belonging to direct investment and reserve assets. Portfolio investment refers to securities transactions in which the ownership or voting power after the investment remains below 10%. As securities transactions are valued at market prices, capital gains realized in connection with a change of ownership are reflected in valuation adjustments between stocks and flows.⁴⁷

A portfolio investment is a grouping of assets such as stocks, bonds, and cash equivalents. Portfolio investments are held directly by an investor or managed by financial professionals. In economics, foreign portfolio investment (FPI) is the entry of funds into a country where foreigners deposit money in a country's bank or make purchases in the country's stock and bond markets, sometimes for speculation.⁴⁸

Portfolio investments typically involve transactions in securities that are highly liquid, i.e. they can be bought and sold very quickly. A portfolio investment is an investment made by an investor who is not involved in the management of a company. This is in contrast to direct investment, which allows an investor to

⁴⁶ NBP Working Paper #167 by Marcin Humanicki on theme 'FDI and FPI in the contemporary globalized world. Economic Institute Warsaw, 2013. P.5-6

⁴⁷ http://www.stat.fi/meta/kas/arvopaperisijoi_en.html

⁴⁸ Appleyard, Dennis; Alfred J. Field, Jr (2014). International Economics, Indian Edition, 8e, p. 234.

exercise a certain degree of managerial control over a company. Equity investments where the owner holds less than 10% of a company's shares are classified as portfolio investment.⁴⁹ These transactions are also referred to as "portfolio flows" and are recorded in the financial account of a country's balance of payments. According to the Institute of International Finance, portfolio flows arise through the transfer of ownership of securities from one country to another.⁵⁰

Foreign portfolio investment is positively influenced by high rates of return and reduction of risk through geographic diversification. The return on foreign portfolio investment is normally in the form of interest payments or non-voting dividends.

Portfolio investment covers, but is not limited to, securities traded on organized or other financial markets. Portfolio investment usually involves financial infrastructure, such as a suitable legal, regulatory, and settlement framework, along with market-making dealers, and a sufficient volume of buyers and sellers. However, acquisition of shares in hedge funds, private equity funds, and venture capital are examples of portfolio investment that occurs in less public and more lightly regulated markets. (However, shares in these funds are included in direct investment when the holdings reach the 10 percent thresholds and in other equity in other investment when investment is not in the form of a security and not included in direct investment or reserve assets.) Portfolio investment is distinctive because of the nature of the funds raised, the largely anonymous relationship between the issuers and holders, and the degree of trading liquidity in the instruments.

Foreign portfolio investment consists of securities and other financial assets passively held by foreign investors. It does not provide the investor with direct ownership of financial assets and is relatively liquid depending on the volatility of the market. Foreign portfolio investment differs from foreign direct investment (FDI), in which a domestic company runs a foreign firm, because

⁴⁹ "Sixth Edition of the IMF's Balance of Payments and International Investment Position Manual (BPM6)" IMF. Retrieved 10 July 2014.

⁵⁰ "Portfolio Flows Tracker FAQ". IIF. Retrieved 10 July 2014.

although FDI allows a company to maintain better control over the firm held abroad, it may face more difficulty selling the firm at a premium price in the future. FPI is part of a country's capital account and shown on its balance of payments (BOP). The BOP measures the amount of money flowing from one country to other countries over one monetary year. It includes the country's capital investments, monetary transfers, and the number of exports and imports of goods and services.

Hence, we should distinguish the main differences between Foreign Direct Investment and Foreign Portfolio Investment. So, FPI lets an investor purchase stocks, bonds or other financial assets in a foreign country. Because the investor does not actively manage the investments or the companies that issue the investments, he does not have control over the securities or the business. However, since the investor's goal is to create a quick return on his money, FPI is more liquid and less risky than FDI.

In contrast, FDI lets an investor purchase a direct business interest in a foreign country. For example, an investor living in New York purchases a warehouse in Berlin so a German company can expand its operations. The investor's goal is to create a long-term income stream while helping the company increase its profits. The investor controls his monetary investments and actively manages the company into which he puts money. He helps build the business and waits to see his return on investment (ROI). However, because the investor's money is tied up in a company, he faces less liquidity and more risk when trying to sell his interest. The investor also faces currency exchange risk, which may decrease the value of his investment when converted from the country's currency to U.S. dollars, and political risk, which may make the foreign economy and his investment amount volatile.⁵¹

Although FDI and FPI are similar in that they both originate from foreign investors, there are some very fundamental differences between the two.

⁵¹ <http://www.investopedia.com/terms/f/foreign-portfolio-investment-fpi.asp>

The first difference arises in the degree of control exercised by the foreign investor. FDI investors typically take controlling positions in domestic firms or joint ventures, and are actively involved in their management. FPI investors, on the other hand, are generally passive investors who are not actively involved in the day-to-day operations and strategic plans of domestic companies, even if they have a controlling interest in them.

The second difference is that FDI investors performers have to take a long-term approach to their investments, since it can take years from the planning stage to project implementation. On the other hand, FPI investors may profess to be in for the long haul but often have a much shorter investment horizon, especially when the local economy encounters some turbulence.

Above mentioned facts brings us to the final point. FDI investors cannot easily liquidate their assets and depart from a nation, since such assets may be very large and quite illiquid. FPI investors have an advantage here in that they can exit a nation literally with a few mouse clicks, as financial assets are highly liquid and widely traded.

Cross-border transactions of securities are illustrated in the Balance of Payments (BOP). The stock of foreign securities acquired by domestic holders or domestic securities acquired by holders abroad is illustrated in the International Investment Position (IIP). Securities recorded as PI are rated at market values. In the BOP and IIP, a distinction is made between assets and liabilities of portfolio investments:

- PI-Assets: Foreign securities acquired by domestic holders.
- PI-Liabilities: Domestic securities acquired by holders abroad.

Domestic securities are defined as securities with a domestic issuer. Foreign securities are defined as securities with a foreign issuer. Thus, the classification is not determined by the country of the security issuance and it is independent of the security's currency. Portfolio Investment is divided directionally: foreigners investing in businesses in our country, and our residents investing in businesses abroad.

1. Portfolio Investment Assets – our residents’ portfolio investment abroad.

- When our residents buy foreign securities, we have to make payments to foreigners, so this will take a minus sign.

- When they sell those securities, foreigners have to make payments to us, so that takes a plus sign.

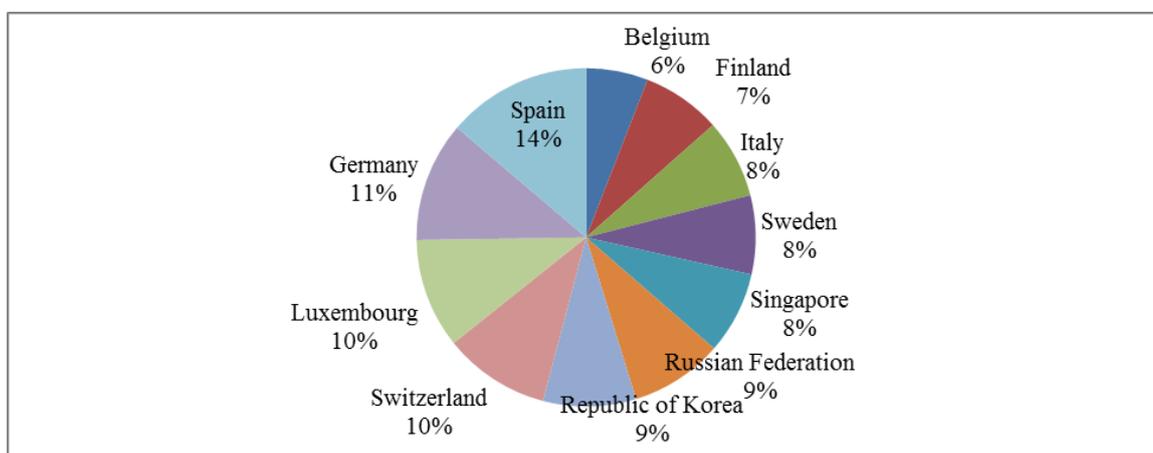


Figure 2.9. Top Ten Economies Portfolio Investment Assets, trillion USD⁵².

Because those securities are our assets and their liabilities, they are called as assets here. Below given Figure-2.9 illustrates the overall global scene of Portfolio Investment Assets in case of Top 10 economies in 2016.

2. Portfolio Investment Liabilities – foreigners’ portfolio investment in our country.

- When foreigners’ buy securities, they have to make payments to us, so that will take a plus sign.

- When foreigners sell those securities, we make payments to them, so that will take a minus sign.

Because these securities are our liabilities and their assets, they are called liabilities here.⁵³ Top 10 economies in terms of Portfolio Investment Liabilities are displayed in Figure 13 which is given below.

⁵² Coordinated Portfolio Investment Survey (CPIS) by IMF data Access to Macroeconomic and Financial Statistics <http://data.imf.org/?sk=B981B4E3-4E58-467E-9B90-9DE0C3367363>

⁵³ <http://faculty.washington.edu/danby/bls324/macro/categories.html>

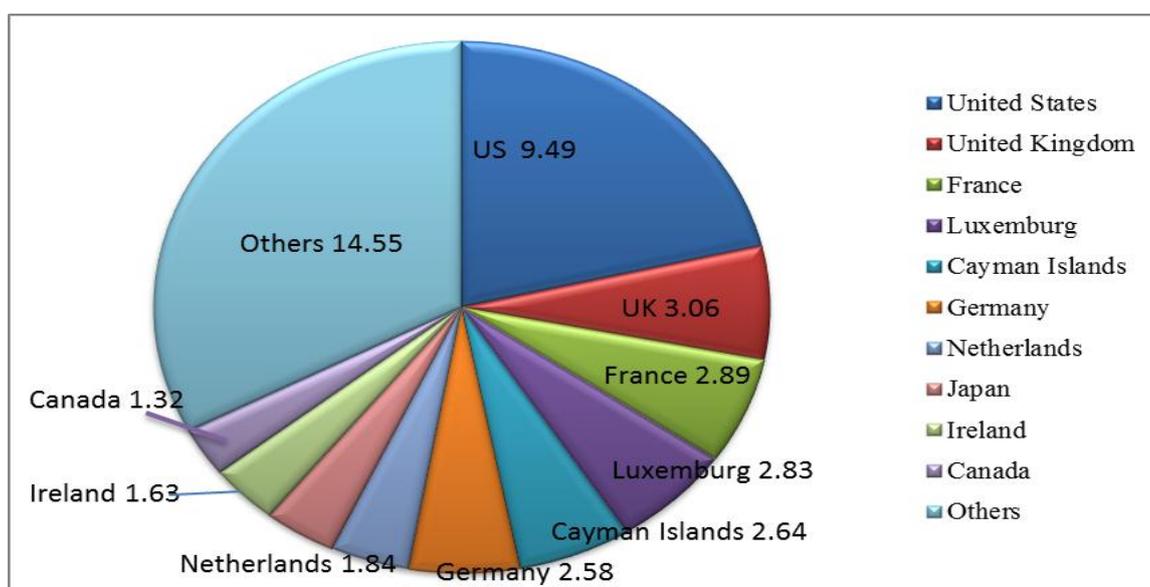


Figure 2.10. Top Ten Economies Portfolio Investment Liabilities, trillion USD⁵⁴

Securities are debt and equity instruments that have the characteristic feature of negotiability. That is, their legal ownership is readily capable of being transferred from one unit to another unit by delivery or endorsement.

While any financial instrument can potentially be traded, securities are designed to be traded, usually on organized exchanges or “over the counter.” (The over-the-counter market involves parties negotiating directly with one another, rather than on a public exchange.)

Negotiability is a matter of the legal form of the instrument. Some securities may be legally negotiable, but there is not, in fact, a liquid market where they can be readily bought or sold. Listed financial derivatives, such as warrants, are sometimes considered to be securities.

Foreign portfolio investment (FPI) consists of securities and other financial assets passively held by foreign investors. It does not provide the investor with direct ownership of financial assets and is relatively liquid depending on the volatility of the market. There are two types of financial instruments (securities) which are illustrated in the Figure-2.11 below.

⁵⁴Coordinated Portfolio Investment Survey (CPIS) by IMF data Access to Macroeconomic and Financial Statistics

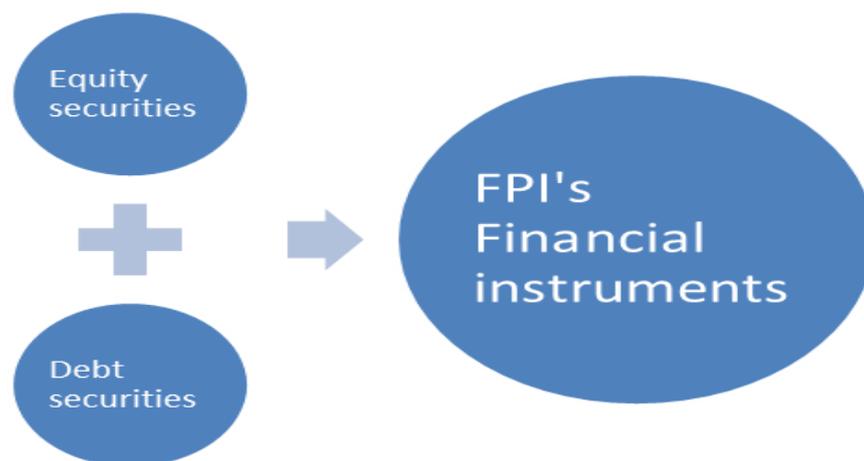


Figure-2.11. Foreign Portfolio Investment's financial instruments⁵⁵.

Securities are investments that can be traded on a secondary market. Examples include stocks and bonds. Securities allow you to own the underlying asset without taking possession. For this reason, securities are readily traded. That means they're very liquid. They are easy to price, and so are excellent indicators of the underlying value of the assets. Traders must be licensed to buy and sell securities to assure they are trained to follow the laws set by the Securities and Exchange Commission. The invention of securities helped to create the huge success of the financial markets.

As it said above, first type of securities is equity securities and they are shares of a corporation. You can buy stocks of a company through a broker. You can also buy shares of a mutual fund that selects and purchases stocks for you. The secondary market for equity derivatives is the stock market. It includes the New York Stock Exchange, the NASDAQ and BATS. An Initial Public Offering is when companies sell stock for the first time. Investment banks, like Goldman Sachs or Morgan Stanley, sell these directly to qualified buyers. That's because it is an expensive investment option. These shares are sold in bulk quantities. Once they hit the stock market, their price typically goes up. But you can't cash in until a certain amount of time has passed. By then, the stock price might have fallen below the initial price. Equity income is Dividend income that is earned through an investment in stocks (equity).

⁵⁵ Illustrated by the student herself

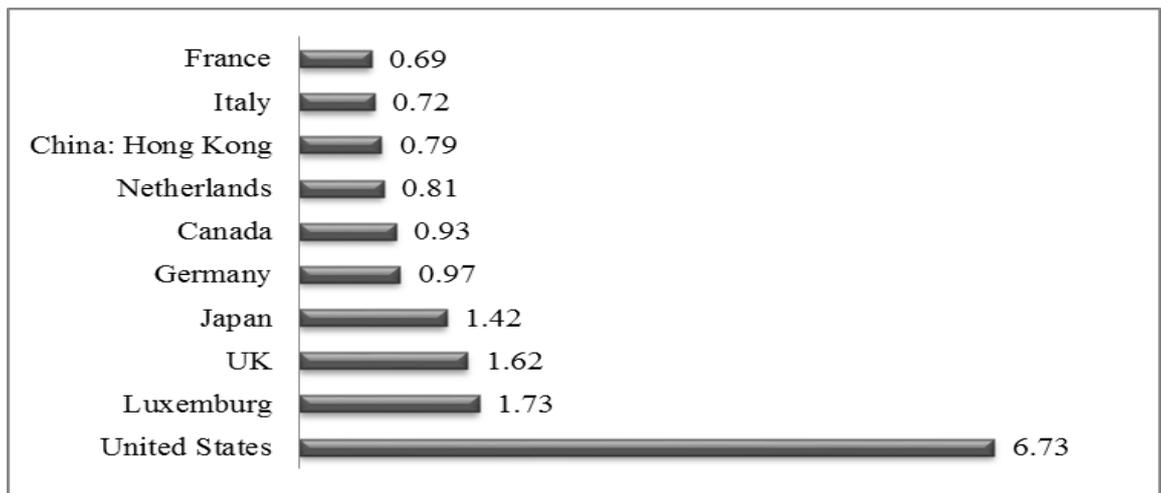


Figure-2.12. Total equity assets Top 10 economies, June 2016 (trillions USD)⁵⁶

Dividend paying stocks are usually those of large, well-established companies that are favored by moderately conservative investors and/or those seeking current income. In the mutual fund context, the investment objective will be a combination of generating both moderate current dividend income and moderate capital appreciation. Below given Figures 2.12&2.13 give information about Top 10 economies of the world who own the biggest portion of Equity Assets and Equity Liabilities in all over the globe in 2016.

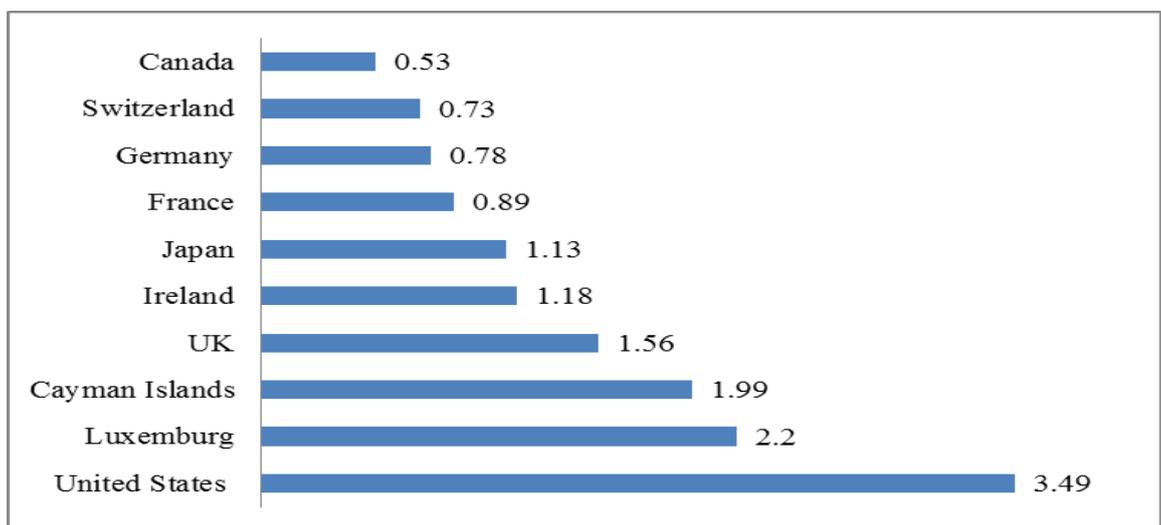


Figure-2.13. Total equity liabilities Top 10 economies, June 2016 (trillions USD)⁵⁷

⁵⁶ IMF(International Monetary Fund) Data - Access to Macroeconomic and Financial data, Coordinated Portfolio Investment survey, Chart about Total Equity Assets, <http://data.imf.org/?sk=B981B4E3-4E58-467E-9B90-9DE0C3367363&ss=1481578781832>

⁵⁷ IMF(International Monetary Fund) Data - Access to Macroeconomic and Financial data, Coordinated Portfolio Investment survey, Chart about Total Equity Liabilities, <http://data.imf.org/?sk=B981B4E3-4E58-467E-9B90-9DE0C3367363&ss=1481578781832>

Next type of securities is called as *debt securities* which are loans, called bonds, made to a company or a country. You can buy bonds from a broker. You can also buy mutual funds of selected bonds. Rating companies evaluate how likely it is the bond will be repaid.

These companies include Standard & Poor's, Moody's and Fitch's. To ensure a successful bond sale, borrowers must pay higher interest rates if their rating is below AAA. If the ratings are very low, they are known as junk bonds. Despite their risk, investors buy junk bonds because they offer the highest interest rates. Corporate bonds are loans to a company. If the bonds are to a country, they are known as sovereign debt.

The U.S. government issues Treasury bonds. Because these are the safest bonds, Treasury yields are the benchmark for all other interest rates. In April 2011, when Standard & Poor's cut its outlook on the U.S. debt, the Dow dropped 200 points. That's how significant Treasury bond rates are to the U.S. economy.

Debt securities, categorized as short-term debt securities (with an original maturity of up to one year) and long-term debt securities (with an original maturity of one year or more). Securities held by the central bank as reserve assets are not classified as Portfolio Investment but Reserve Assets. Debt securities generate an income from Bond valuation.

The fundamental principle of bond valuation is that the bond's value is equal to the present value of its expected (future) cash flows. The valuation process involves the following three steps:

1. Estimate the expected cash flows.
2. Determine the appropriate interest rates that should be used to discount the cash flows.
3. Calculate the present value of the expected cash flows found in step one by using the interest rate or interest rates determined in step two.

Let's throw some numbers around to further illustrate this concept

Example: The Value of a Bond.

Bond GHJ matures in five years with a coupon rate of 7% and a maturity value of \$1,000. For simplicity's sake, let's assume that the bond pays annually and the discount rate is 5%.

The cash flow for each of the years is as follows:

Year One = \$70

Year Two = \$70

Year Three = \$70

Year Four = \$70

Year Five = \$1,070

Thus, the PV of the cash flows is as follows:

Year One = $\$70 / (1.05)$ to the 1st power = \$66.67

Year Two = $\$70 / (1.05)$ to the 2nd power = \$ 63.49

Year Three = $\$70 / (1.05)$ to the 3rd power = \$ 60.47

Year Four = $\$70 / (1.05)$ to the 4th power = \$ 57.59

Year Five = $\$1,070 / (1.05)$ to the 5th power = \$ 838.37

Now to find the value of the bond:

Value = $\$66.67 + \$63.49 + \$60.47 + \$57.59 + \$838.37$

Value = \$1,086.59

As we can see from the above examples, an important property of PV is that for a given discount rate, the older a cash flow value is, the lower its present value. Another property of PV is that the higher the discount rate, the lower the value of a bond; the lower the discount rate, the higher the value of the bond.

As you see, we have already covered the types of financial securities in terms of Portfolio Investment, and we understood how the income can be generated from equity and debt securities.

Now turn to global scene (Figure 2.14&2.15) of total Debt securities in case of Top 10 economies. The date is obtained from IMF Statistical source due to latest available date which is June 2016 and the indexes are illustrated in trillions USD.

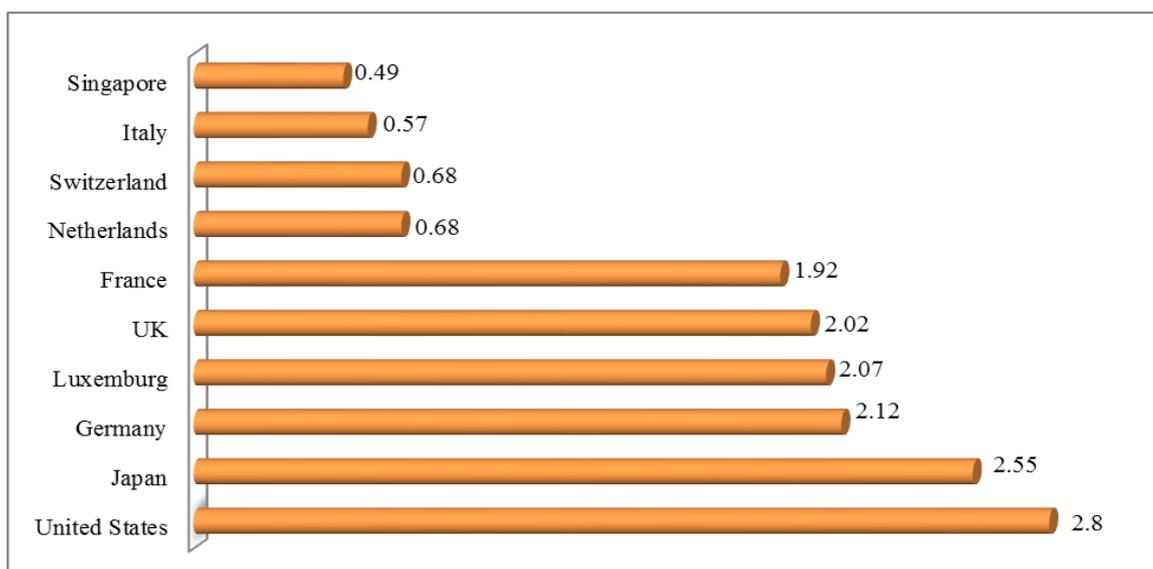


Figure-2.14. Total debt Assets Top 10 economies, June 2016 (trillions USD)⁵⁸

Portfolio debt flows totaled \$276 billion in 2016. The U.S. was the biggest holder of portfolio debt assets in 2016, with \$2.8 trillion, followed by Japan with \$2.55 trillion. Germany had portfolio debt equity flows of only \$2.12 billion in 2016 due to data which was gathered by IMF statistical Committee.

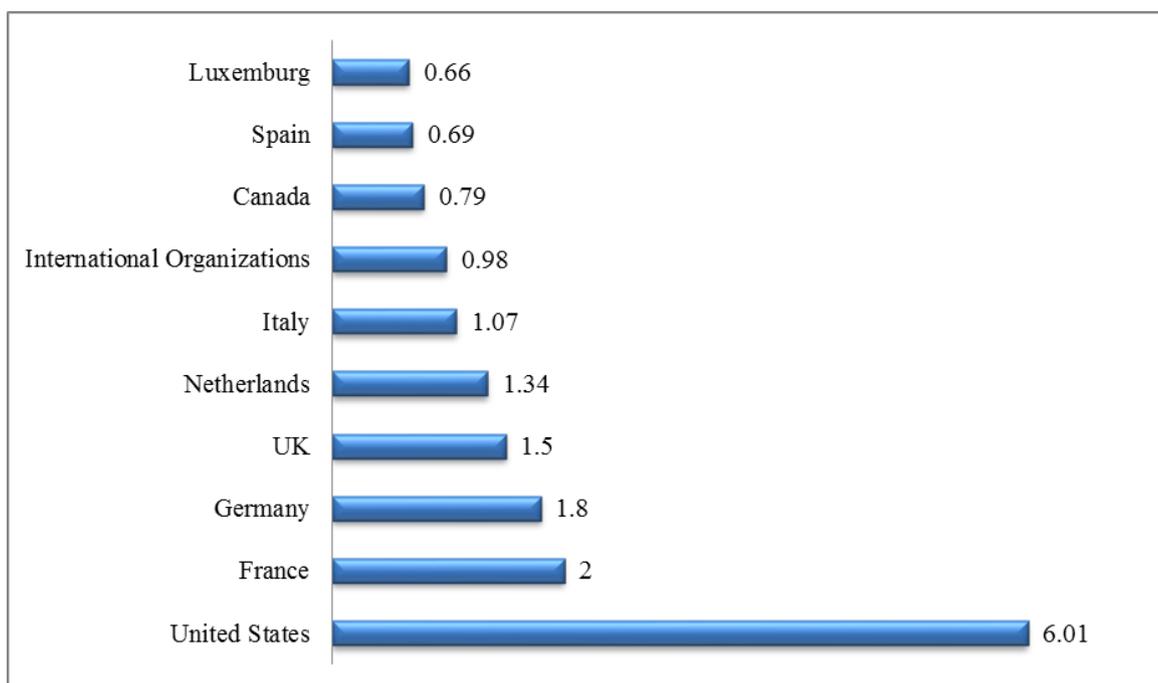


Figure-2.15. Total debt Liabilities Top 10 economies, June 2016 (trillions USD)⁵⁹

⁵⁸ IMF(International Monetary Fund) Data - Access to Macroeconomic and Financial data, Coordinated Portfolio Investment survey, Chart about Total Debt Assets, <http://data.imf.org/?sk=B981B4E3-4E58-467E-9B90-9DE0C3367363&ss=1481578781832>

⁵⁹ IMF(International Monetary Fund) Data - Access to Macroeconomic and Financial data, Coordinated Portfolio Investment survey, Chart about Total Debt Liabilities, <http://data.imf.org/?sk=B981B4E3-4E58-467E-9B90-9DE0C3367363&ss=1481578781832>

The data which is illustrated in Figure 18 is derived by Creditor data and it says that the biggest creditor country is - The United States of America with \$6.01 trillion, and the second stage is followed by France with \$2.00 trillion, and Germany concluded the powerful third with its \$1.8 trillion in terms of Total Debt Liabilities in all over the globe in 2016.

To sum up, it can be said that while FDI and FPI can be sources of much-needed capital for an economy, FPI is much more volatile, and this volatility can aggravate economic problems during uncertain times. Since this volatility can have a significant negative impact on their investment portfolios, retail investors should familiarize themselves with the differences between these two key sources of foreign investment.

2.3. The modern scene of attracting foreign investments to Uzbekistan's economy

Deterioration of economic ties with the countries of the former Soviet Union in the early years of independence, above the level of inflation and the country's sharp economic situation due to the arrival in 1995 the volume of investments fell to the 1991 level of 50%. Successful implementation of reforms in tax-budgetary and monetary policy, suspension of economic slowdown in the economy and the beginning of economic growth since 1996 and the necessary legal framework have facilitated the growth of investment volumes and positive changes in the structure. If in 1991 the country's investment portfolio was formed of 3 sources (budget, enterprise and population), then in 1995, the volume of foreign investments and commercial banks' loans in the structure of capital assets appeared. Since the second half of 1995, the volume of capital investments has increased dramatically. Since 1996, the Investment Program of the Republic of Uzbekistan has been adopted annually and priorities for economic development are identified. As a result, the volume of capital investments into the economy at the end of 2015

increased by 3.6 times as compared to the figure in 1991, which led to an increase in GDP by 2.6 times in comparison with the level of 1991 (Figure-2.16).

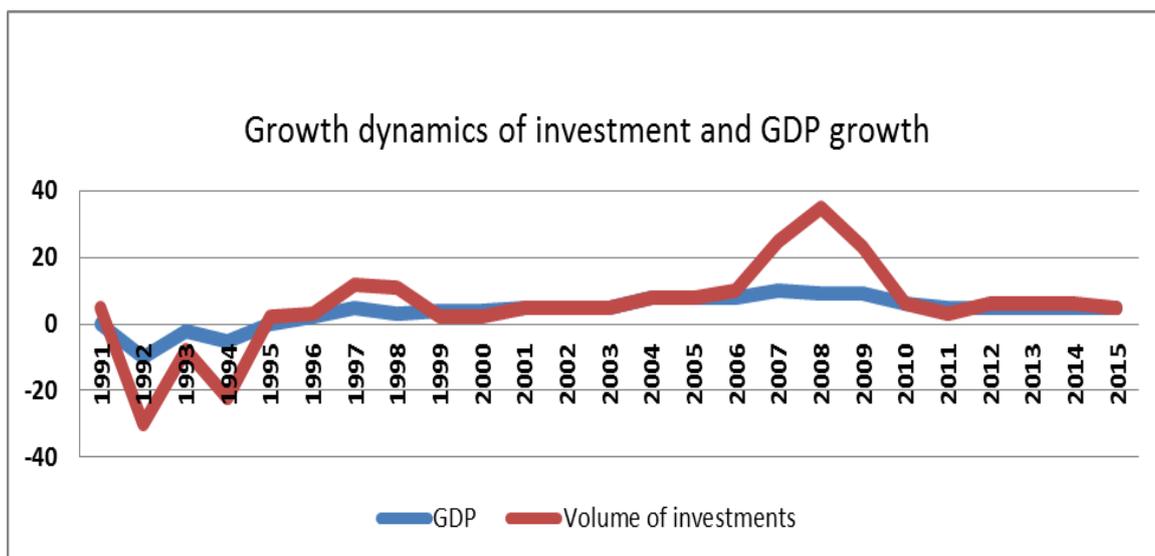


Figure-2.16. Growth dynamics of investment and GDP growth⁶⁰

The legal basis of regulation and attracting foreign investments in the Republic of Uzbekistan are:

- The law Of the Republic of Uzbekistan “On Foreign Investments” No. 609-I of 30.04.1998;
- The law Of the Republic of Uzbekistan “On Investment Activities” No. 719-I of December 24, 1998 (adopted in a new version);
- The law Of the Republic of Uzbekistan “On guarantees and measures of protection of the rights of foreign investors” No. 611-I of 30.04.1998;
- Decree of the President of the Republic of Uzbekistan from 11.04.2005. No. UP-3594 “On Additional measures to stimulate the involvement of direct private Foreign investments”;
- Decree of the President of the Republic of Uzbekistan from 10.04.2012. No. UP-4434 from “On additional measures to stimulate the attraction of Foreign direct investments” and other documents.

According to experts in Uzbekistan, a broad system of legal guarantees and benefits has been created for foreign investors, developed an integrated system of

⁶⁰ Annual statistical bulletins. State Statistical Committee, different years.

measures to stimulate the activities of enterprises with Foreign investments. For foreign investments in the Republic of Uzbekistan National treatment providing for foreign Investment conditions no less favorable than the corresponding Conditions for investment by legal and physical Persons of the Republic of Uzbekistan. Foreign investments in the territory The Republic of Uzbekistan can be implemented in various forms.

Foreign investors can create on the territory of the republic the enterprise in any, supposed by the legislation, organizational- Legal form. To date, potential foreign Investors are offered the following forms of investment:

- Creation of a joint venture;
- Establishment of an enterprise with 100 percent foreign capital;
- Acquisition of a part or a full block of shares of privatized Enterprises.

Enterprises with foreign investment are recognized again Established enterprises that meet the following conditions:

- The amount of the statutory fund of the enterprise is not less than the amount, Equivalent to 150 thousand US dollars;
- One of the participants of the enterprise is a foreign entity;
- Share of foreign investment is at least 30 percent of the authorized capital of the enterprise.

In addition, if enterprises with foreign investment receive more than 60% of income from the sale of their products or services, it is considered an industrial enterprise with foreign investments. Such enterprises are provided with additional tax, customs and other benefits and incentives.

The specified tax privileges are given at volume of direct Private foreign investment:

- from 300 thousand US dollars to 3 million US dollars for a period of 3 years;
- over \$ 3 million to \$ 10 million for a period of five years;
- over 10 million US dollars - for a period of 7 years.

For manufacturing enterprises with foreign investments, exporting products of own production for freely convertible currency, the following additional benefits and preferences:

- Export customs duties on products were abolished own production;
- the right to export their own products without Prepayment and opening of a letter of credit, subject to guarantees Authorized banks, serving customers, and compliance Terms of receipt of foreign exchange earnings provided for by the current Legislation;
- registration in the Ministry of Foreign Economic Relations, investments and trade of the Republic of Uzbekistan Contracts for the supply of own production (except for Export of licensed goods), while maintaining the current order of their Accounting in authorized banks and customs authorities.

Annually in Uzbekistan, by a presidential decree The Investment Program is approved. In accordance with the State Investment Program Republic of Uzbekistan for 2016, it is planned to master foreign Investment in the amount of 4 042.0 million US dollars for 154 investment Projects. Due to foreign loans under government guarantees in 2016 it is planned to master 1 339.0 million US dollars for 69 projects. Scope Foreign direct investment is expected to reach \$ 2,703.0 million USA for 85 projects.

The largest amount of foreign investment is planned to master in the fuel and energy sector -2,290.0 million dollars to 34 Projects. The volume of foreign direct investment in oil and gas the sector will amount to 2 104.0 million US dollars for 14 projects. In order to attract foreign investment to the national Economy, Uzbekistan has created 3 special economic zones: Free industrial and economic zone in the city of Navoi, the Special Industrial Zone in Angren and the Special Industrial Zone in the city of Jizzakh.

Significant qualitative changes in the structure of investment financing sources are reflected. During the years 2005-2015 the process aimed at increasing the importance of market sources of investment continued, and, correspondingly, the share of centralized investments decreased (from 23.9% in 2005 to 20.1% in

2015). For the years 2005-2015 the average annual growth rate of centralized investments amounted to 10.5%, which is much lower than the average annual growth rate of investments in general (14.7%). In 2015, compared to 2013, centralized investment grew by 10.6%. The volume of mastered centralized investments for the period under study grew by 2.8 times. The main role in the growth of the volumes of centralized investments was played by capital investment from extra-budgetary funds: their share increased by 5.9 percentage points to the level of 2005, mainly due to the creation of the Fund for Reconstruction and Development of Uzbekistan. In general, the volume of investments from non-budgetary funds increased in 2015 by 20.8% compared to the previous year 2014 and by 5.1 times compared with 2005.

Non-centralized investments grew during the period 2005-2015 by 3.9 times, and their structure became more balanced due to increased investment activity of the population, commercial banks and foreign investors. The share of enterprise funds in sources of investment decreased from 46.0% in 2005 to 30.9% in 2015. However, the volume of investment at the expense of enterprises increased 2.4 times compared with 2005. (Figure-2.17).

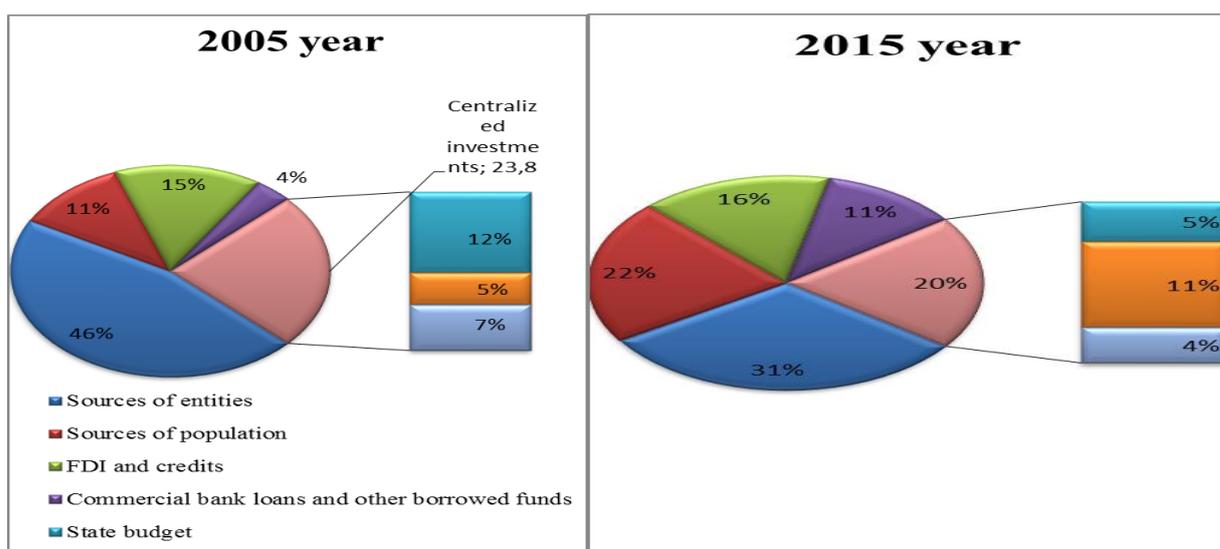


Figure 2.17. Structure of investments by sources of financing, in %⁶¹.

⁶¹ The data is illustrated based on the information which is obtained by the State Committee of Statistics of the Republic of Uzbekistan. www.stat.uz

In addition, if the scene is investigated by sectors, there can be seen several structural changes when the 2005 year's figures compared to 2015 (Figure- 2.18). It is displayed that in 2015 proportion of investments in manufacturing increased by 3.7% compared to 2005 year's figures.

The share of the transport and communications sector in the overall structure of investments has somewhat decreased due to the growth of investments in the implementation of projects for the development of industry and the social sphere of housing construction in rural areas.

As a whole for the period 2005-2015, it can be seen from the above illustrated figure that investments in manufacturing industries grew by 3.5 times and in non-production - by 3.8 times.

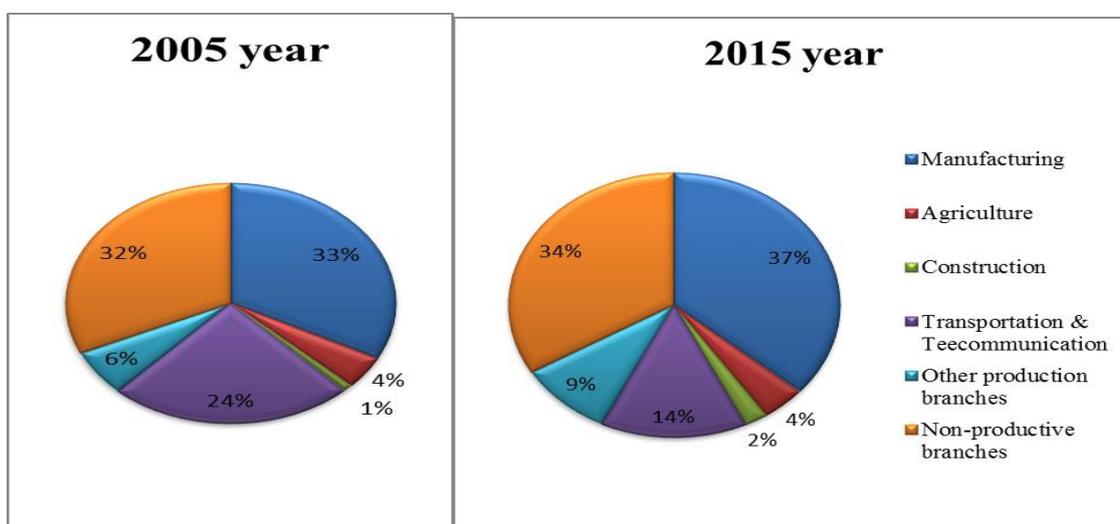


Figure-2.18. Structure of investments by sectors of economy, in %⁶²

If we make analytical review of the main sectors of Uzbekistan, the main manufacturing sector will be Oil and Gas Sector. About 60% of the territory of the Republic of Uzbekistan is Promising in terms of oil and gas production. In five oil and gas Regions of Uzbekistan, 211 hydrocarbon deposits raw materials, 108 of them - gas and gas condensate, 103 oil and gas, oil and gas condensate and oil. More than 50% of deposits 35% are prepared for mastering, on the remaining Exploration work continues. Annual production volume of hydrocarbon raw

⁶² The data is illustrated based on the information which is obtained by the State Committee of Statistics of the Republic of Uzbekistan. www.stat.uz

materials in Uzbekistan is about 86 million tons Conventional fuel. In the Republic of Uzbekistan there is a vertically integrated the three-level holding company “Uzbekneftegaz”, covering the entire oil and gas industry.

National holding company (NHC) “Uzbekneftegaz” and Chinese CNPC plan to begin construction of the fourth line Of the Uzbek section of the Central Asia-China gas pipeline Cost of \$ 800 million.

Introduction into operation the gas pipeline with the capacity of 20 billion cubic meters of gas is planned for 2017 year.

South Korean IRED Co. Ltd in the current year will prepare Technical solution for capacity expansion Shurtan Gas and Chemical Complex (MCC) in Kashkadarya Region. The project which costs about 570 million \$ is aimed to product butanediol and methanol from natural gas.

Thus, since 2003 OAO “LUKOIL” invested in the economy the republic has more than 5 billion US dollars. One of the largest Joint projects of this company and the national holding company “Uzbekneftegaz” is the development of a group of gas condensate Deposits “Kandym-Khauzak-Shady-Kungrad” with a period of implementation 35 years (until 2039).

The company also implements an oil production project and gas exploration in the territories of South-Western Gissar and Ustyurt Region and conducts geological exploration of the Uzbek part of the Aral Sea. Total investment in January-September 2015 in these 3 projects Amounted to \$ 759 million (an increase of 38.25% compared to the same period of 2014).

To date, the company's accumulated gas production in Uzbekistan amounted to about 30 billion cubic meters, and the annual – about 4 billion The company until 2017 plans to extract about 17-18 billion cubic meters of gas in Uzbekistan per year.

OAO Gazprom, represented by Gazprom EP International Service BV, Develops gas condensate field in Uzbekistan Shakhpakhty. The total investment in this project was about \$ 400.0 million. Since 2004, the accumulated gas production has exceeded 3.2 billion cubic meters, and in 2015 amounted to 350 million cubic

meters. According to Protocol of the 17th meeting of the Intergovernmental Commission on Economic cooperation between the Russian Federation and The Republic of Uzbekistan from 25.03.2016, currently JSC Gazprom negotiates with NHC “Uzbekneftegaz” on conclusion Agreement on the division of products for the development of this field.

In Uzbekistan today there are more than 2,2 thousand light industry enterprises. Uzbekistan attracted foreign investment in light industry worth \$ 1.8 billion and implemented more than 150 major investment projects. In particular, in 2015 completed the implementation of an investment project on the basis of OOO “Maxim Gold” (Tashkent region). At production sites the output of 3.5 thousand tons of cotton yarn per year is adjusted.

The cost of the investment project is \$ 7.0 million. The project on USD 2.44 million was realized in the Andijan region. On the basis of JSC “Bobur” organized the production of 1 million pieces of knitwear.

The investor was a foreign company, LemonInternational (Hong Kong).

Second place after the textile industry in light industry occupies leather and footwear production. Association of leather-shoe enterprises “Uzbekcharmoyabzali” (Memorandum on establishment of a joint venture with the “Uzbekcharmoyabzali” Association and Quanzhou Yiyuan Shoes Co., Ltd (China), Memorandum on the establishment of a joint venture on production of charcoal and charme products with the Uzbekcharmoyabzali Association and the company “Pirofin Consulting Srl.” (Italy) includes 252 enterprises, from 73 of them are engaged in the production of leather raw materials, 45 -Processing of leather, 129 - production of footwear, 4 – production Leather goods. Enterprises of “Uzbekcharmoyabzali” exported in 2015 Natural leather for up to \$ 20 million. Export is not Only to neighboring states, but also to European countries - Spain, Italy, Turkey and a number of Asian countries - India, China, Pakistan.

When the subject is about main manufacturing sectors of Uzbekistan, The automotive industry should be mentioned undoubtedly. The automotive industry of

Uzbekistan employs over 200 Enterprises and organizations that are part of the structure of JSC “Uz Avtosanoat”.

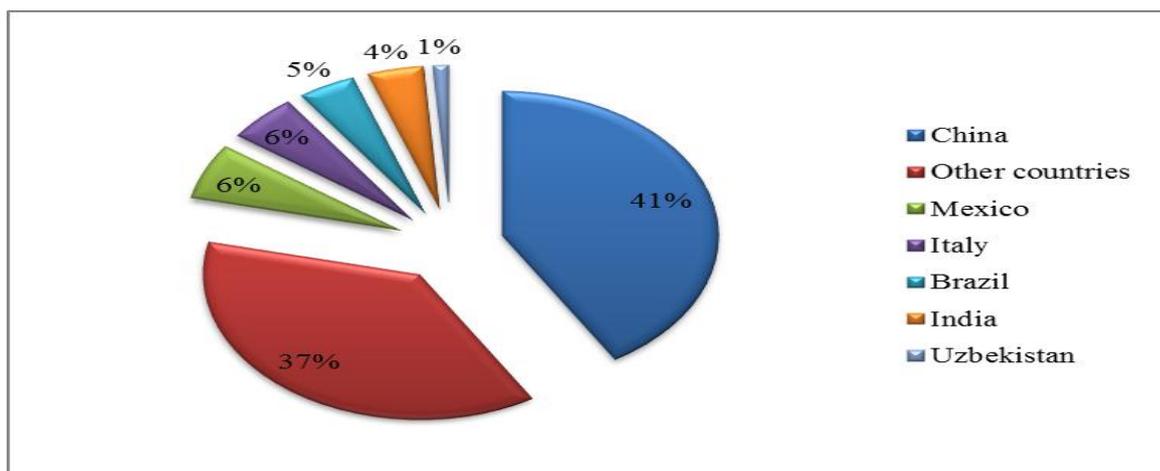


Figure-2.19. The share of Uzbekistan in international market.⁶³

The company also includes 25 major suppliers of components and 160 small car assembly plants. One of them is GM Uzbekistan is a joint venture between the Uzbek, OJSC UzAvtosanoat (75%) and the American General Motors Company (25%) for the manufacturing of automobiles⁶⁴ and is located in Asaka, Uzbekistan.

The JV originally was founded in 1996 between the Uzbek government and the South Korea-based Daewoo, and was initially known as Uz-DaewooAuto⁶⁵ Following the change of ownership of Daewoo to GM Daewoo, the facility was renamed GM Uzbekistan in 2008 to continue to produce Uz-Daewoo branded vehicles. More recently these models are now sold as Chevrolets as in other international markets.

GM Uzbekistan began production on 27 November 2008. The first assembled car on this day was an Chevrolet Lacetti which also was the 1,000,000 assembled vehicle out of the production from UzAvtosanoat. The annual production of GM Uzbekistan are 250,000 units. Since the beginning of the third quarter Chevrolet is manufacturing the Chevrolet Spark M300 in Asaka. The M300

⁶³ <http://uzcharm.uz/uzb/statistika-malumotlari/>

⁶⁴ “GM Uzbekistan to build Chevrolet small car”. autoevolution. 15 February 2010. Retrieved 23 July 2010.

⁶⁵ “Asaka automobile plant turns 13”. The Governmental portal of the Republic of Uzbekistan. 18 July 2009. Retrieved 31 December 2012.

is currently intended only for export. Currently, the models are assembled CKD and SKD kits. But GM Uzbekistan plans to manufacture up to 50% of all needed parts and want to realize it soon as possible.

Another plant is producing 200,000 units of front- rear- and side windows for the vehicles of the Uz-DaewooAvto and the Chevrolet Lacetti. A third production facility was opened in 2014 in Pitnak, Khorezm Region, manufacturing the Damas/Labo microvans and the Chevrolet Orlando minivan.

In 2010, about 5,000 employees were employed at the GM Uzbekistan assembly plant. GM Uzbekistan sold 121,584 vehicles locally in 2011, making the country the eighth-largest market for Chevrolet and produced more than 225,000 vehicles. Its products are also exported to Russia and other CIS countries.

In 2012, the Chevrolet Malibu and the Chevrolet Cobalt were added to the production line, followed by the revised Gentra model in 2013, the Chevrolet Orlando in 2014, and the Chevrolet Nexia T250 in 2015.

Another big foreign company which is operating in the territory of Uzbekistan is British American Tobacco. The company “British American Tobacco” has been operating in the market of Uzbekistan since 1994 and has more than 1000 employees. The volume of investment of British American Tobacco in the economy of Uzbekistan has exceeded 300 million US dollars. The portfolio of British American Tobacco Uzbekistan includes such well-known international brands as the Kent family, Pall Mall, Rothmans and Viceroy. The majority of cigarettes sold in Uzbekistan are produced at the Samarkand Cigarette Factory. The Samarkand Cigarette Factory was built in 1997 and is equipped with the most modern high-tech equipment. The potential production of the factory is 20 billion cigarettes per year, and its capacity allows us to completely saturate the local market and supply to neighboring countries world-class products. “British American Tobacco Uzbekistan” also deals with the processing and export of tobacco leaf. The company closely cooperates with farmers of the Samarkand region, due to which the competitive eastern types of tobacco “Izmir”, “Basma”, “Dubeck”, as well as the famous type of tobacco “Virginia”, which are processed

at the Urgut Fermentation Plant, are mastered. To date, Uzbek tobacco is exported to more than 10 countries, including the USA, Germany, Turkey, Malaysia, South Africa, Russia.

If we talk about FDI figures in Uzbekistan, the following scene can be mentioned. After a sharp decrease in FDI in 2011 (-35%), Uzbekistan decided to review the country's restrictive commercial policy (temporary closure of the border, increase in customs tariffs, heavy import procedures) and implemented new rules such as fiscal exemptions and administration reforms. More than 58 mixed companies work in the capital Tashkent. This change in investment attraction policy has been bearing results, as the FDI influx grew steadily from USD 1 billion to nearly USD 3 billion in a span of 4 years. FDI to Uzbekistan reached USD 1.2 billion in the first half of 2016 and USD 2.7 billion in total, according to preliminary findings. The volume of FDI is expected to reach USD 2.65 billion in 2017. On the other hand, after gaining sixteen places between 2015 and 2016, Uzbekistan lost five places in the 2017 Doing Business report of the World Bank, ranking 87th out of 190 countries.

Cooperation with China gained new momentum in 2011 with the launch of a construction project to build a pipeline extension linking the country to the Central Asia-China gas pipeline. The new extension will have an annual capacity of 25 billion cubic meters. China also pledged to invest USD 5 billion in infrastructure and in the mining sector. South Korea has also been an important partner since 2011, investing over USD 2.6 billion for the construction of a chemical plant. Japan has also expressed interest in Uzbek economy as the two countries signed an agreement concerning the exploration of new hydrocarbon deposits, with Japan contributing USD 5 billion to the project via the Japanese company JOGMEC.

Summary based on Chapter II

International investment or capital flows fall into four principal categories: commercial loans, official flows, foreign direct investment (FDI), and foreign portfolio investment (FPI).

Companies choose to invest in foreign markets for a number of reasons, some of them are market seeking, resource seeking, strategic asset seeking, efficiency seeking.

In a list of top 20 host economies in terms of FDI inflows, The United States remained the largest recipient of FDI, attracting \$391 billion in inflows, followed by the United Kingdom with \$254 billion, vaulting from its 14th position in 2015 on the back of large cross-border M&A deals. China was in third position with inflows of \$134 billion – a 1 per cent decrease from the previous year.

Due to top 20 home economies' list of FDI outflows, the biggest amount of money went out from the United States of America, China and Netherlands to over-sea countries.

FDI investors cannot easily liquidate their assets and depart from a nation, since such assets may be very large and quite illiquid. FPI investors have an advantage here in that they can exit a nation literally with a few mouse clicks, as financial assets are highly liquid and widely traded.

In the BOP and IIP, a distinction is made between assets and liabilities of portfolio investments: PI –Assets and PI – Liabilities.

Uzbekistan is a regional power in progress, even if the government is long in creating favorable conditions to attract foreign investments. A foreign-investor favorable taxation policy is to be noted and a will to modernize the main sectors of the economy.

CHAPTER III. THE FUTURES OF INVESTMENT ACTIVITY'S DEVELOPMENT IN THE WORLD ECONOMY

3.1. The future prospects of Foreign Direct Investments in the global economy

Looking ahead, the analysis of key factors affecting future FDI flows indicate that over the medium term, the flows will rise in 2017 (at 5-10%) and according to World investment report of UNCTAD, FDI flows will likely exceed \$1.8 trillion in 2018. Nevertheless, some uncertainties remain that could have material impact on FDI recovery in the future. Several indicators both macroeconomic and firm level factors are taken into consideration while forming the expectations and determining the probable FDI trends in the future. Based on the statistical reports, global economic growth will reach 3.4% which is 0.3% more than post-crisis low in 2016. Growth in developing countries is expected to improve including the USA, as well as in emerging economies. Anticipated significant economic growth in developing economies is primary effect of potential increase in natural resources exporting companies (mainly for crude oil) as the prices of goods will likely rise. It is undeniable that, the greater economic activities will assist in expansion of world trade volumes. This in turn stimulates investment activity.

The world economy continues to face major headwinds, which are unlikely to ease in the near term. Global GDP is expected to expand by only 2.4 per cent. A tumultuous start to 2016 in global commodity and financial markets, added to the continuing drop in oil prices, have increased economic risks in many parts of the world. In developing economies, sluggish aggregate demand, low commodity prices, mounting fiscal and current account imbalances and policy tightening have further dampened the growth prospects of many commodity-exporting economies. Elevated geopolitical risks, regional tensions and weather-related shocks could further amplify the expected downturn. The global economic outlook and lower

commodity prices has had a direct effect on the profits and profitability of MNEs, especially in extractive industries. After two years of increase, profits of the largest 5,000 MNEs slumped in 2015 to the lowest level since the global economic and financial crisis of 2008–2009.

Overall, many different factors determine prospects of foreign direct investment (FDI) in near future. Several macroeconomic factors as geopolitical uncertainty, volatility in exchange rates, debt concerns in emerging markets, and other factors as terrorism and cyber threats play crucial role in terms of prospects of FDI. In the survey carried by UNCTAD, the executives of MNEs consider that the conditions like rising urbanization in developing and developed countries (potential consumer markets), continuing technological change and digital economy, will boost future FDI growth.

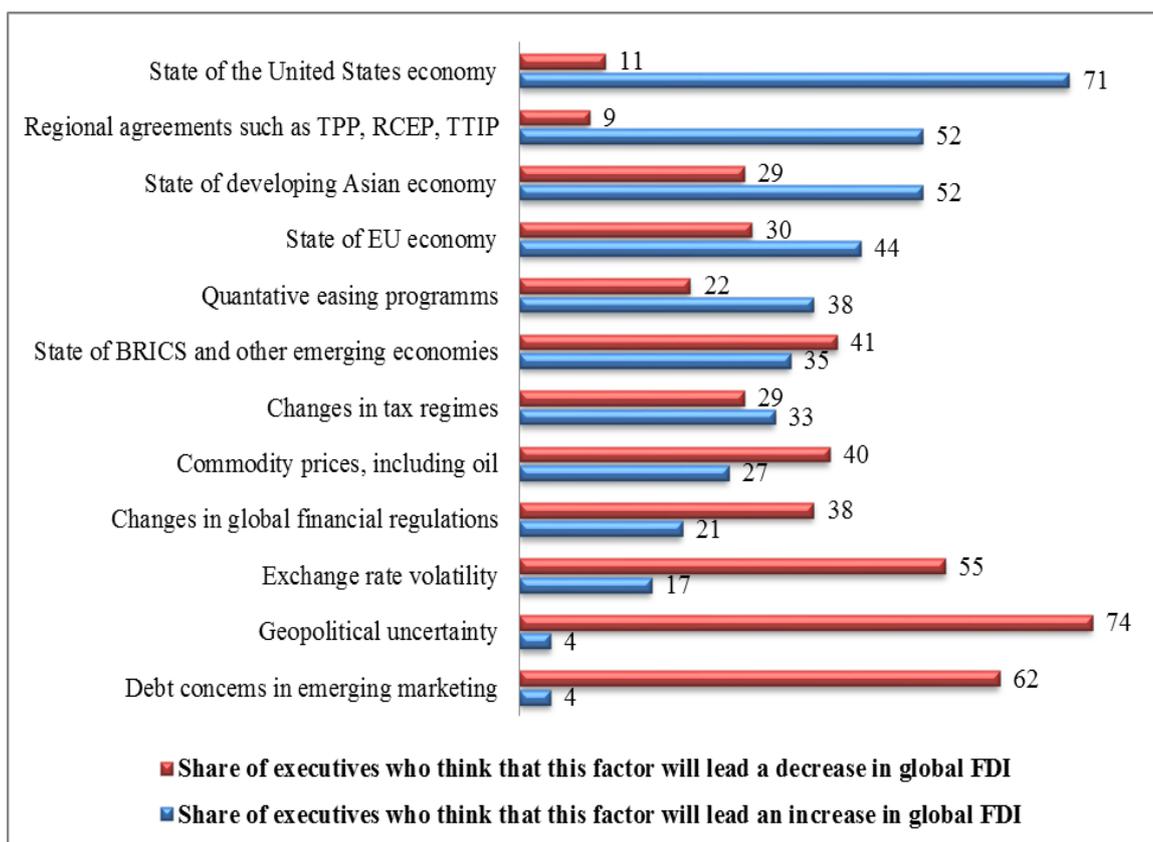


Figure 3.1. Factors influencing future global FDI, in % of all executives.⁶⁶

Due to the uncertainty over factors influencing FDI activity, it is difficult to form expectation about potential FDI spending. In spite of this some 40% of MNE

⁶⁶ UNCTAD World Investment Report 2017, p.24

executives anticipate their FDI spending increase to 53% by 2018. The GDP growth rate is very important for any country for foreign investor to make decisions for investment. The surveys concluded that high levels of growth in the host country indicates a high level of production that enhances the confidence level of investors. On the other hand, it is also suggested that the higher income in home countries attracts the foreign investor interest to invest in that country.

The GDP growth rate is considered as the national income growth indicator of the economic performance of the country, which is reflected through production, consumption, and varieties of goods and other economic facilities provided in the country. Indeed, countries possessing a higher GDP growth rate are expected to promote a large dose of FDI, inducing future Multinational Companies (MNCs) with high confidence to invest, especially, when growth trend is more consistent. Thus, there is a positive relationship between estimated future GDP growth rate and future FDI inflows.

Nevertheless, the extent of the flow of foreign direct investment is highly dependent on the political atmosphere of the host country. The well-being of legal institutions, level of corruption, political stability, and ability to protect intellectual rights are only some of the factors affecting the flow of FDI into a host country. The vast variety of organizations seek to analyze and structure the information about countries in order to make an assessment of an economy's ability to perform well in modern world. While the results of this research activity are not specifically tailored for the purpose of the investors, they have a high degree of correlation with the FDI inflows. In countries with corrupt political leadership, local businesses may exploit their political connection to gain preference for themselves to the disadvantage of foreign firms. In the current situation of the absence of a powerful international regulatory body, this particular risk seems to have special potential. A risk of sanctions, that had various examples recently, represents another threat for international businesses: it leaves them in the middle 8 (39) of a political standoff between the governments and bears costs associated with the divesting and selling of their assets. It would be a mistake, however, to associate

political risk solely with the countries of the developing world and volatile political systems. Although it is the case that emerging markets are traditionally believed to possess higher risks of political nature, the potential sources of vulnerability can be found in the most advanced economies too.

Among other factors, oil - its prices and control over its sources - continues to play a major role in the political stability of the world in the 21st century. To this day, oil is an important source of energy for the advanced economies, and even more so for heavy industries of the developing economies. The 1973 oil crisis has demonstrated that oil has a potential as a tool of international politics: a striking possibility of using military force on the territory of a historical ally, such as Saudi Arabia, shows the degree to which uninterrupted flow of oil can be crucial for the most powerful countries. Therefore, it is not surprising that a state views its access to oil, its reserves and operation of oil industry as a matter of national security. The most important geopolitical commodity (Stratfor, 2014) continues to provide a significant share of many of its exporters' national budgets and play one of the key roles in the formation of conditions for economic growth. It is not surprising, therefore, that the control of the oil industry may seem to be an attractive prey for the government in situations such economic distress, tightening internal policy or more assertive foreign policy, where exports of energy sources may be used as an instrument of foreign influence. Oil price is a subject to expectations of the players in energy markets and is affected by the availability of the substitutes of oil and other sources of energy. Therefore, it is fair to say that oil prices have codependent relations with politics and economics, affecting each other to a high degree. The factors of risk that could complement the existing political risk methodologies should include the most recent developments in the political environment of today, thus adapting these methodologies to the new forms of political risk. Special attention must be paid to the risks emerging in the developed world – particularly in the European Union and the United States: while the developing world has been a source of traditional type of political risks, such as revolutions, civil wars and expropriation, the developed world, which has been

regarded until recently as a “safe haven” for the foreign direct investments, has witnessed new, unconventional forms of risk manifest themselves.

Political stability is very important for normal macroeconomic balance and conducive business environment. Political risks largely depend on political stability and good governance of the government political instability is not good since it will adversely affect economic development and growth process by its unhealthy dent on the physical and human resources. When political stability condition is not good, foreign investors will hesitate to bring any projects until they are assured that the business environment would be conducive and favorable.⁶⁷

Exchange rates can influence both the total amount of foreign direct investment that takes place and the allocation of this investment spending across a range of countries. When a currency depreciates, meaning that its value declines relative to the value of another currency, this exchange rate movement has two potential implications for FDI. First, it reduces that country’s wages and production costs relative to those of its foreign counterparts. All else equal, the country experiencing real currency depreciation has enhanced "locational advantage" or attractiveness as a location for receiving productive capacity investments. In addition to these arguments supporting the effects of levels of exchange rates, volatility of exchange rates also matters for FDI activity. Theoretical arguments for volatility effects are broadly divided into “production flexibility” arguments and “risk aversion” arguments. To understand the production flexibility arguments, consider the implications of having a production structure whereby producers need to commit investment capital to domestic and foreign capacity before they know the exact production costs and exact amounts of goods to be ordered from them in the future. When exchange rates and demand conditions are realized, the producer commits to actual levels of employment and the location of production. An alternative approach linking exchange-rate variability and investment relies on risk aversion arguments. The logic is that

⁶⁷ Political Risk and Foreign Direct Investment, Vagif Asadov https://www.theseus.fi/bitstream/handle/10024/119215/Asadov_Vagif.pdf?sequence=1

investors require compensation for risks that exchange rate movements introduce additional risk into the returns on investment. Higher exchange-rate variability lowers the certainty equivalent expected exchange-rate level, as in Cushman (1985, 1988). Since certainty equivalent levels are used in the expected profit functions of firms that make investment decisions today in order to realize profits in future periods. If exchange rates are highly volatile, the expected values of investment projects are reduced, and FDI is reduced accordingly. These two arguments, based on “production flexibility” versus “risk aversion”, provide different directional predictions of exchange rate volatility implications for FDI. Overall, the current state of knowledge is that exchange rate volatility can contribute to the internationalization of production activity without depressing economic activity in the home market. The actual movements of exchange rates can also influence FDI through relative wage channels, relative wealth channels, and imperfect capital market arguments.⁶⁸

It is undeniable that external debts have significant negative effect on foreign direct investment, and increasing foreign debt has destroyed foreign investor’s vision and created negative expectations of the future economy which together reduced investment in the country. The government size has negative effect on attracting foreign investment and the presence of government reduces the presence of private sector. Trade and FDI on economic growth of least developed countries. The study findings suggest that high external debt depresses economic growth, regardless of the nature of the debt. According to Schnitzer (2000), the sovereign risks associated with debt finance are shown to be generally less severe than the ones that come with FDI. Therefore, FDI is chosen only if the investor is more efficient in running the project in question, if the project is risky, and if the foreign investor has a good outside option which deters creeping expropriation. Therefore there is a positive relationship between FDI and public debt. The results of empirical study suggest that foreign debt financing has no effect on the

⁶⁸ Exchange Rates and Foreign Direct Investment, Linda S. Goldberg, <https://www.newyorkfed.org/medialibrary/media/research/economists/goldberg/ERandFDIArticleGol>

investment. There is no evidence for a relationship of external debt financing and domestic investment in both regimes.

The empirical evidence from the literature studying the relationship between terrorism and investment shows that terrorism risk, domestic terrorism, and international terrorist attacks have a negative effect on FDI. The risk of terrorism lowers the expected returns of investment, reducing it in a country where terrorism risk is high. Terrorism is predicted to have a negative effect on foreign direct investment because it increases the instability of country, destroys capital, both human and inanimate, and increases the overall risk involved with an investment. Terrorism is a factor that multinational enterprises take into account when analyzing the risk factor that a potential investment may have. Terrorist incidents have the potential, by inducing an element of fear, to increase risk by destroying lives as well as destroying property. Although certain necessary limitations were conceded in the studies, it is the opinion that the results found are consistent with economic theory regarding risk and investment. As risk, i.e. terror incidents, increases, the amount of investment decreases.⁶⁹

The most promising sources of investment, from the perspective of IPAs, is little changed from previous years. Compared with 2016 India has moved up, as has Canada, while Japan has moved down and Spain has dropped out of the list. A number of potential investors, especially from developing economies, are perhaps magnified in terms of expectations, compared with their actual investments, but this probably reflects IPAs awareness of South–South and regional proximity and trends.

Thus, three quarters of African agencies have identified China as their most promising investor, despite its slowing economy and decreasing demand for oil and minerals. Similarly, increased investment by India and Turkey (including in transition economies and landlocked countries in both cases) has been observed;

⁶⁹ Terrorist Attacks and Foreign Direct Investment Flows Between Countries, Dragana Stanić http://kie.vse.cz/wp-content/uploads/Stanic_2013.pdf

and although South Africa is investing less than in the past, it remains a big source in Southern Africa.

The mix of factors influencing FDI activity, combined with uncertainty in the near term, translates into a mildly gloomy picture for FDI spending over the next two years. Overall about 40 per cent of executives expect their companies to increase FDI spending in 2017, rising to 53 per cent by 2018; while 26 per cent expect a fall this year, declining to 13 per cent by 2018. Top MNEs, which invest the most, are far more pessimistic. Only 32 per cent expect to spend more this year, while 45 per cent expect less FDI spending; and this marked difference with MNEs as a whole persists to 2018.

While developing- and transition-economy MNEs are more optimistic than those from developed countries overall, a bigger proportion are expecting to spend less (35 to 24 per cent) in 2017. This reflects the difficult investment environment currently faced by MNEs from emerging economies. The biggest difference in spending, however, is between different sectors. Sixty per cent of MNEs in the primary sector – mainly oil, gas and mining – anticipate lower FDI expenditures this year, with only a fifth expecting an increase. This compares with MNEs in manufacturing and services, where a little over 20 per cent expect a fall and over 40 per cent an increase in both sectors. Moreover, the slump in prices and activity in the primary sector is expected to persist. By 2018 still only 33 per cent of MNEs in the primary sector expect to be spending more. The equivalent proportion for MNEs in manufacturing and services is much higher, at 52 and 63 per cent respectively.

IPAs surveyed this year identified the most promising industries for attracting FDI to their country. There are differences between regions and – mirroring the MNE survey – extractive industries do not appear among the most promising in any region. Information and communication is identified as one of the top most promising industries in three regions – developed countries, developing Asia and Latin America and the Caribbean.

The industries regarded as most promising by IPAs in each region reflect the regional level of development, economic endowments and specialization. Thus, in addition to information and communication, IPAs in developed countries also select professional services and computers and electronics as being among the most promising for attracting FDI, while for developing and transition regions, industries most commonly chosen by IPAs are agriculture, food and beverages, and utilities. For a large, middle-income region such as Latin America and the Caribbean, it is not surprising that food and beverages are deemed a promising industry; but the selection of “other manufacturing” by local IPAs, which includes everything from jewelry to medical equipment, indicates that there is a degree of niche specialization in the region. Developing Asia includes a very large number of countries, with vastly different endowments, from least developed countries to highly advanced economies. The most promising industries in this region reflect this diversity: agriculture, utilities, food and beverages and information and communication.

MNEs’ three top prospective host countries – United States, China, and India– remain unchanged in this year’s survey compared with recent years, though the order has changed since last year. However, lower down in the ranking there has been some change. In particular Hong Kong (China) and Singapore do not rank in the top 15, while the Philippines and Vietnam have entered the list. Eight of the top prospective host countries are developing economies in Asia and in Latin America and the Caribbean, which reflects the longer-term prospects of these two regions. Interestingly, the list does not include major destinations of inward investment in 2016 (and recent years), including Belgium, Canada, Ireland, Luxembourg and the Netherlands (as well as Hong Kong (China) and Singapore).

Overall, developing country MNEs are optimistic about FDI spending but currently faced difficult investment environment by MNEs translates into biggest proportion of executives expecting less. As for the prospects of investing economies, it is expected that promising sources of investment will come from

China, United States and United Kingdom as survey reveals with probable top destinations hosting MNEs being China, India and United States.

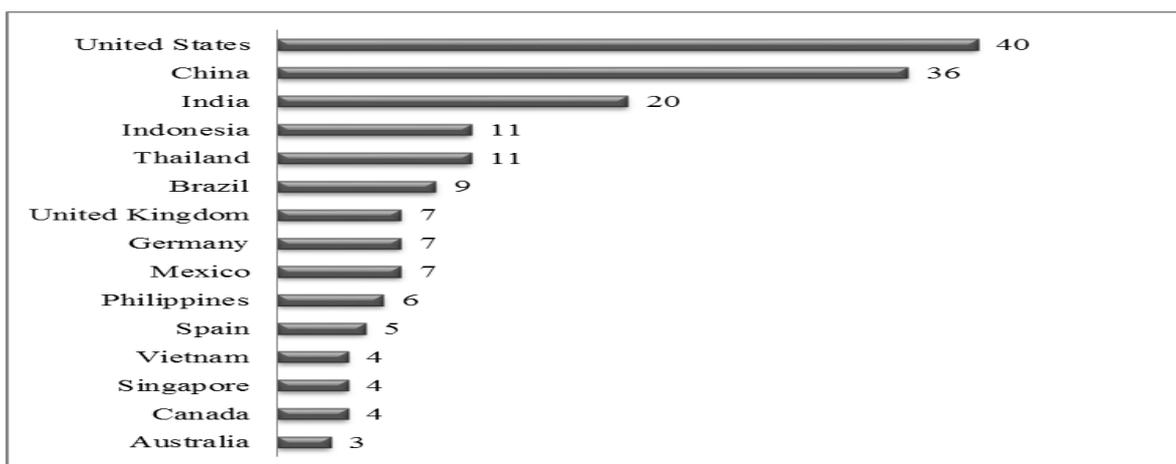


Figure-3.2. MNE's top prospective host economies for 2017-2019 (percent of executives responding)⁷⁰

However, some material uncertainties may serve as an obstacle in the recovery of FDI flow over anticipated period. Geopolitical uncertainty, debt concerns, tourism and cyber threats are universally treated as factors giving negative light to future FDI flow. To be more precise, change in historical low interest rates could cause significant shift in capital flows especially for emerging economies. This increase in cost of capital may impede investments by MNEs which have taken on considerable amount of corporate debt recently. Apart from that, the doubts about economic policies in the near future as well as political developments all heightens these uncertainties.

Finally, we should talk about the changing locational determinants of FDI. FDI flow will likely shift to the countries where there is more development in business-to-business electronic commerce and advanced uses of the internet in business purposes. The internet is a market facilitating instrument, as it reduces intra-firm information asymmetries and spatial transaction costs, both along and across value chains. In so doing, it has enormously widened the locational options open to firms in seeking out their suppliers, customers and possible collaborators. The internet is, indeed, a major force for globalization and widening the locational choice of MNEs. Moreover, in the case of the more labor intensive activities, it has

⁷⁰ World Investment Report 2017 by UNCTAD, p 18.

considerably favored the economies of lower and middle income developing countries that pursue the right policies towards, or in the light of, inbound FDI.

At the same time, the advent of E-commerce is having much less impact on the geography of the higher value and more idiosyncratic activities of firms. As these tend to involve market failures or distortions which the internet is unable to correct. This being so, we foresee only a modest geographical dispersion of the innovatory activities of MNEs in the years to come. We believe these are likely to remain concentrated in a relatively few locations where the resource capabilities and infrastructure are congenial to such activity.

Furthermore, it seems likely that MNEs will be increasingly drawn to sub-national groupings in the next decade or more. This is owing to sub-national agglomeration of related activities by firms. Sometimes this clustering is among firms producing similar products; sometimes between firms and their suppliers and customers. It is now recognized that, in the larger economies of the world at least, the principle is no less relevant in explaining the spatial distribution of some kinds of activities within countries.

Finally, we would mention the growing trend towards the setting up, diversification and expansion of the regional headquarters (RHQs) of MNEs. This trend is again evident both in the case of developed and developing countries; the MNE activity is becoming increasingly regionalized rather than globalized. Certainly, it is being encouraged by the growing number of regional integration schemes; and the extent to which MNEs engage in intra-regional and inter-regional trade. Such RHQs are, by no means, confined to the advanced industrialized countries or to firms engaged in manufacturing industry. There is a tendency both towards more geographical diversification, but also to an increased specialization within regions to take advantage of the economies of scale, access to high quality skills and services, and a strategic location.

Since foreign direct investment (FDI) is assumed to be a major source of foreign capital for industrialization and growth process in a developing country, it is virtually regarded as an engine of growth and economic expansion in the global

economic arena. A key concern for policymakers continues to be how to reactivate productive investment in their economies to generate employment and spur advances in productivity. To take full advantage of improving global economies environment countries must make boosting domestic and foreign investment key policy priorities. Within the ambit of foreign investment, in recent years FDI flows have largely been shaped by cross-border M&A that have not necessarily resulted in a concomitant increase in gross fixed capital formation. Investment promotion activities to attract greenfield announcements globally, while an increase indicator, suggest that the capital expenditure levels of foreign affiliates remain well below their 2008 peak.

3.2. The future prospects of Foreign Portfolio Investments in the global economy

Developments like the breaking down of Breton-Woods system, introduction of floating exchange system, world debt crisis of the eighties and increase in the private capital flows, and recent developments in the information and communication technology all have influenced the international financial sector. In this decade, international capital flows, especially portfolio investment flows, increase rapidly along with advances in globalization of the economy. Foreign investment is largely seen as a catalyst for economic growth in the future. Foreign investments can be made by individuals, but are most often pursued by companies and corporations with substantial assets looking to expand their reach. As globalization increases, more and more companies have branches in countries around the world. For some companies, opening new manufacturing and production plants in a different country is attractive because of the opportunities for cheaper production, labor and lower or fewer taxes. There are two additional types of foreign investments to be considered: commercial loans and official flows. Commercial loans are typically in the form of bank loans that are issued by a domestic bank to businesses in foreign countries or the governments of those

countries. Official flow is a general term that refers to different forms of developmental assistance that developed or developing nations are given by a domestic country. Commercial loans, up until the 1980s, were the largest source of foreign investment throughout developing countries and emerging markets. Following this period, commercial loan investments decreased and direct investments and portfolio investments increased significantly around the globe.

Capital is an essential ingredient for economic growth, but since most nations cannot meet their total capital requirements from internal resources alone, they turn to foreign investors to supply capital. Foreign direct investment(FDI) and foreign portfolio investment (FPI) are two of the most common routes for overseas investors to invest in an economy. FPI means investing by investors in financial assets such as stocks, securities, bonds and other financial assets located in another country. It does not provide the investor with direct ownership of financial assets vice versa it provides the investor with indirect ownership and is relatively liquid depending on the volatility of the market. Foreign portfolio investment is chosen on two bases. First, FPI is more volatile in nature so FPI is attracting the attention of regulators, policy makers and investors because it is challenging the monetary policy by affecting macroeconomic variables. Second, the literature has focused on the relationship of capital flows (in general) to macroeconomic variables so this factor leaves the gap for identifying the effect of macroeconomic variables to FPI volatility specifically. FPI is part of a country's capital account and shown on its balance of payments (BOP). The BOP measures the amount of money flowing from one country to other countries over one monetary year. It includes the country's capital investments, monetary transfers, and the number of exports and imports of goods and services.

Foreign portfolio investment is very hot and the debatable topic of the last decade among the economists. The trend of foreign portfolio investment changes in the last century and foreign investors shifts their investments towards the emerging economies. As seen, the foreign portfolio investment has significantly increased in one of the world's economically strong country in CHINA since 1997.

The decisions of the foreign investors to invest in the foreign countries depend on upon the different factors such as economic growth, the political and social stability of the country. Foreign portfolio investment shifted massively from developed to developing countries before the financial crises of 2008. The capital inflows and outflows have positive and long term relationship with the market capitalization and degree of openness of the host country. The FPI are also affected by the neighboring countries of the host country either in the positive and negative way. The foreign investor is very keen about the safety of its funds. The expected rate of return is also connected with the political stability of the country. Foreign investor mostly prefers the political stable country for the investment as compared to the less political stable country. The foreign investors shift their fund from politically unstable to politically stable country to ensure the safety of the funds. The cultural characteristics of the investing country and the host country also an important factors to determine the foreign portfolio investment in the host country FPI lets an investor purchase stocks, bonds or other financial assets in a foreign country. Because the investor does not actively manage the investments or the companies that issue the investments, he does not have control over the securities or the business. However, since the investor's goal is to create a quick return on his money, FPI is more liquid and less risky than FDI. In contrast, FDI lets an investor purchase a direct business interest in a foreign country. For example, an investor living in New York purchases a warehouse in Berlin so a German company can expand its operations. The investor's goal is to create a long-term income stream while helping the company increase its profits.

The investor controls his monetary investments and actively manages the company into which he puts money. He helps build the business and waits to see his return on investment (ROI). However, because the investor's money is tied up in a company, he faces less liquidity and more risk when trying to sell his interest.

The investor also faces currency exchange risk, which may decrease the value of his investment when converted from the country's currency to U.S. dollars, and political risk, which may make the foreign economy and his

investment amount volatile. The critics like Stiglitz⁷ are of the opinion that capital market liberalization produces instability and not growth and hence argued for intervening in short-term capital flows. Generally, the institutionalization of reserve funds by institutional investors in majority of developed countries acted as source for the short-term portfolio flows. Combined with this, the low rates of profits also resulted in the export of financial savings from these developed nations. As the assets of institutional investors expanded, their diversification strategies progressively resulted in an expansion of cross-border investments, particularly to emerging markets, which had high rates of return and was mainly in the form of equity finance. These portfolio investments have always been subject to controversies in terms of their motives, desirability, their effect to the domestic economy and stock market and their impact on domestic policy making. By and by the world's portfolio flows' stands at about US \$ 60 billion. Today India is a noteworthy beneficiary of world portfolio flows (Patnaik, 2005). The increased relevance for the speculative capital flows arises firstly from the ongoing financial market advancement in the majority of the developing countries. The dismantling of capital controls in many of the developing countries made it possible for the institutional investors from developed countries to invest in these emerging markets where previously they were restricted to invest. Currently, investors in major developed countries invest less than one percent of their assets in emerging markets. A one percent increase in this allocation corresponds to net capital flows of more than \$120 billion. Together with this, the 1990s saw an explosion in the global derivatives market. Financial derivatives became an important factor in the growth of cross-border capital flows, including emerging markets. However, the portfolio capital is often characterised by several asymmetries like spread of information, volatility, aiming for short-term profits and investment strategies often depending upon the rating agencies.

Economic conditions of the country also affect FPI positively. Increase in savings and investment, technology transfer to developing economies, improved macroeconomic policies and financial market development brings more FPI to

home country. According to the Ducca 2012, the major factors affecting the capital inflows are GDP growth rate, market efficiency, and higher returns expectation. These factors play an important role in attracting the foreign investment. All these factors raise the macroeconomic level of the country by brought in the foreign investment which helps the country to rectify the deficit of the current account of the country. That leads the economy towards the growth. On the other side because of the volatility of this kind of investment, it can cause the economic crisis in the country. In the normal circumstances the foreign portfolio investment is very beneficial but when it flew out of the country it has the very disastrous effect on the economy. According to the study of Garg and Dua in the year 2014 the foreign portfolio investment increases five times in the developing countries in last five years. The figure of foreign portfolio investment reached up to 128 billion dollars till 2010. The major share of foreign portfolio investment has been shared by the China, India, Brazil and South Africa. China, India and Brazil receipt seventy percent of the total foreign portfolio investment invested in the whole world. CHINA gets the largest part of the foreign portfolio investment because of the remarkable growth of last thirty years. The Chinese reforms started in 1978 in the agricultural sector and ultimately it spreads in the whole economy. The private sector of the China flourished tremendously in the era of 1978-2005. According to Fayyaz et al. (2015), the main determinants of the foreign portfolio investments are the GDP growth, market size and market efficiency and higher expectation of returns played a vital role in the movement of the foreign portfolio investment. If these factors of any country are in a stable form that country get the smooth and stable capital inflows from all over the world. In the case of China, the external debt is the most significant factor to drive the foreign portfolio investment in the country. The GDP growth, exchange rate, and FDI are among the important determinants of the foreign portfolio investment. As we consider the in the present situation Foreign Portfolio investment (FPI) is becoming a renowned type of investment in various countries of the world. The main aim of investing in any foreign country is both that is to earn source and on the other side and the risk also

diversified for the investors. Policies relating to development of stock market structure, improving the country infrastructure, strengthening institutions and reduction in the instability in country's macroeconomic factors would reduce the volatility in foreign portfolio investment that would bring more foreign investment in country. As mentioned earlier, if the inflows are coming from institutional investors and the developing country is staying on a path of sustained market-oriented reforms in an endeavor to achieve long-run growth, one may expect these inflows of portfolio investment from the international capital markets to the emerging markets to continue and even increase (given that the institutional investors are a potential source of very large inflows of capital) in the near future. When more comprehensive dataset on these flows becomes available, it may be possible to carry out a more rigorous econometric analysis of the determinants of foreign portfolio investment to developing countries. More light can then be shed on two issues, in particular: the determinants of portfolio investment flows to developing countries (internal vs. external), and also, sources of portfolio investment to developing countries.

Summary based on Chapter III.

The analysis of key factors affecting future FDI flows indicate that over the medium term, the flows will rise in 2017 (at 5-10%) and according to World investment report of UNCTAD, FDI flows will likely exceed \$1.8 trillion in 2018.

Overall, many different factors determine prospects of foreign direct investment (FDI) in near future. Several macroeconomic factors as geopolitical uncertainty, volatility in exchange rates, debt concerns in emerging markets, and other factors as terrorism and cyber threats play crucial role in terms of prospects of FDI.

Due to the uncertainty over factors influencing FDI activity, it is difficult to form expectation about potential FDI spending.

IPAs surveyed this year identified the most promising industries for attracting FDI to their country. Information and communication is identified as one of the top most promising industries in three regions – developed countries, developing Asia and Latin America and the Caribbean.

MNEs' three top prospective host countries – United States, China, and India– remain unchanged in this year's survey compared with recent years, though the order has changed since last year.

The surveys concluded that a high level of growth in the host country indicates a high level of production that enhances the confidence level of investors. On the other hand, it is also suggested that the higher income in home countries attracts the foreign investor interest to invest in that country.

CONCLUSION AND RECOMMENDATIONS

The findings of the research on “The development and future prospects of investment activities in the world economy” have resulted in the following conclusions:

- in the current period of globalization and in terms of market relations, the world countries face keen struggle for investment. So, the article reflects the role of investments in the world countries’ economy, and the level of influence of investment introduced in the economy;

- in a narrow sense, two types of investments have been identified. Due to sources, there are real (capital-forming) investments - investments in the creation of new ones, reconstruction or technical re-equipment of existing enterprises and financial (portfolio) investments in the purchase of shares and securities of the state, other enterprises, investment funds;

- an international investment is a much more powerful force in propelling the world toward closer economic integration. Investment can alter entire methods of production through transfers of knowledge, technology, and management techniques, and thereby can initiate much more change than the simple trading of goods;

- in recent decades, foreign investment increased dramatically due to several factors such as development of technology, the lure of higher profits, financial liberalization and etc. Financial liberalization has been the most direct, and probably the single biggest, factor accounting for the growth of international investment flows over the past several decades;

- we will be able to solve many problems related to the development of an attractive market economy through the development of effective investment projects. Its implementation does not only ensure the creation of additional activities and production but also reflects the actual level of life of the society, contributing to the growth of well-being and the economic power of the state;

- the investment projects in the market economy are funded by various sources created by investors. In general, the sources of funding for investment projects can be grouped as follows: investor's own financial resources; Investor's borrowed funds; The financial resources attracted by the investor; Public budgetary funds; Foreign investments and loans;

- an investment activity is a necessary condition for the circulation of the funds of the economic entity. In turn, production activity creates the prerequisites for new investments

- UNCTAD report figures say that a majority share of foreign investment's inflow is owned by Developing Asia, while world Developed countries are the biggest owners foreign investment outflows, whereas Transition economies display the tiniest figures in terms of FDI and FPI inflow & outflow.

The following suggestions and recommendations have been developed to improve the financial and economic efficiency of the projects to effectively establish investment activity in our country:

1. Use of foreign experience in assessing the creditworthiness of participants in investment activity. In the practice of foreign banks, the practice of scoring a borrower is widespread. This method involves determining the client's credit rating. The criteria for evaluating the debtor are strictly individualized for each bank, derived from its position in practice and are periodically revised.

2. It is necessary to organize training seminars in all commercial banks in order to prepare investment projects deep, comprehensive, objective and objective assessment experts

3. Reduce the size of a loan to a debtor. This method can be used to reduce the credit risk used by the bank when it is completely unaware of the client's creditworthiness

4. Risk management should be diversified in order to manage risks effectively. Diversification allows for a variety of risk-based divisions of investments to be allocated

5. Insurance of the investment project. Credit insurance involves the risk of non-return of the insurance company. All expenses related to insurance should be paid by recipients.

6. Getting more information and more information on the investment project will help investors to identify the project's future outlook and reduce project risk.

Implementation of the above suggestions and recommendations will contribute to the improvement of financial and economic efficiency of investment projects.

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