

## LEGAL PROBLEMS OF INTERNATIONAL INVESTMENT ACTIVITIES AND CONFLICTS IN CENTRAL ASIA

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**Annotation:** In today's interconnected global economy, international investment activity plays a crucial role in driving economic growth and fostering cross-border partnerships. However, along with the potential for substantial returns, investors often encounter a myriad of legal challenges that can significantly impact their success and profitability. From navigating complex regulatory frameworks to mitigating geopolitical risks, understanding and addressing these legal complexities is essential for ensuring the long-term viability of international investment ventures.

**Key words:** international investment, problems, Central Asian states, protection of Foreign investment in Central Asia

### *Introduction:*

Central Asia, with its rich history, diverse cultures, and abundant natural resources, has emerged as a promising destination for international investment. However, beneath the surface of economic potential lies a complex legal landscape fraught with challenges and conflicts. This article explores the legal problems inherent in international investment activities in Central Asia and examines the key sources of conflict that investors encounter in the region. International investment activities encompass a broad spectrum of transactions, including foreign direct investment (FDI), portfolio investments, mergers and acquisitions, joint ventures, and strategic alliances. These investments flow across borders, transcending geographic, cultural, and political boundaries, and encompass a diverse range of industries, from finance and technology to energy, infrastructure, and agriculture. As globalization accelerates and emerging markets attract increasing attention, the importance of understanding the legal complexities of international investment cannot be overstated. One of the foremost legal challenges facing international investors is navigating the diverse regulatory frameworks of different countries. Each jurisdiction has its own set of laws, regulations, and compliance requirements governing foreign investment, encompassing areas such as investment incentives, tax regimes, intellectual property rights, labor laws, and environmental regulations. Moreover, regulatory regimes are subject to change, often in response to shifting political dynamics, economic priorities, and global trends, creating uncertainty and complexity for investors.

### *Political and Geopolitical Risks:*

Political instability, geopolitical tensions, and regulatory uncertainty pose significant risks to international investment activities. Investors may face challenges

such as expropriation, nationalization, contract renegotiation, and arbitrary government actions, particularly in regions characterized by authoritarian regimes, ethnic conflicts, or geopolitical rivalries. Moreover, geopolitical tensions between major powers can further complicate investment dynamics, increase the likelihood of legal disputes, and impact the stability of investment environments. Moreover, geopolitical tensions between major powers, such as Russia, China, and the United States, can further complicate investment dynamics and increase the likelihood of legal conflicts.

*Environmental and Social Considerations:*

In recent years, environmental, social, and governance (ESG) factors have emerged as critical considerations for international investors. Heightened awareness of climate change, resource scarcity, social inequalities, and human rights abuses has led investors to scrutinize the environmental and social impacts of their investment decisions. Compliance with environmental regulations, adherence to labor standards, and respect for human rights are increasingly important criteria for evaluating investment opportunities and managing reputational risks.

*Dispute Resolution Mechanisms:*

In the event of legal disputes, investors must navigate the complexities of international dispute resolution mechanisms. Traditional litigation in domestic courts may be time-consuming, costly, and subject to jurisdictional challenges, particularly in cross-border disputes. As such, investors often turn to alternative dispute resolution mechanisms such as international arbitration, which offer advantages such as neutrality, expertise, confidentiality, and enforceability of awards across multiple jurisdictions.

*Regulatory Environment:*

Navigating the regulatory environment is a significant hurdle for international investors in Central Asia. Each country has its own set of investment laws, tax regulations, and licensing requirements, which can be complex and opaque. Moreover, regulatory regimes are subject to change, often in response to political dynamics, economic priorities, and geopolitical pressures. This unpredictability creates uncertainty for investors and increases the risk of legal disputes.

*Resource Extraction and Energy Projects:*

Central Asia is endowed with vast reserves of natural resources, including oil, gas, minerals, and water. As such, resource extraction and energy projects are key drivers of investment in the region. However, these projects often entail complex legal issues related to land rights, environmental regulations, and revenue sharing agreements. Moreover, disputes over control of natural resources can fuel conflicts between governments, local communities, and foreign investors.

*Infrastructure Development:*

Infrastructure development is critical for unlocking Central Asia's economic potential and facilitating regional connectivity. However, large-scale infrastructure projects, such as roads, railways, and pipelines, are prone to legal challenges related to land acquisition, environmental impact assessments, and public-private partnerships. Additionally, infrastructure investments may exacerbate social inequalities, displacement of communities, and cultural heritage preservation concerns.

#### *Resolution of Legal Disputes:*

In the event of legal disputes, investors in Central Asia face challenges in accessing impartial and effective dispute resolution mechanisms. Domestic courts may lack independence and expertise in complex commercial matters, while international arbitration can be costly, time-consuming, and subject to enforcement challenges. Moreover, investors must carefully consider the choice of law, jurisdiction, and dispute resolution clauses in investment contracts to mitigate legal risks.

Central Asia comprises five former Soviet republics: Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. Despite their shared Soviet legacy, each country has its own legal system, characterized by varying degrees of transparency, efficiency, and adherence to the rule of law. While efforts have been made to modernize and harmonize legal frameworks to attract foreign investment, significant challenges remain, including corruption, bureaucratic red tape, and inconsistent enforcement of laws.

It is widely recognized that foreign direct investment is the cornerstone of growth and sustainable development. In the light of such phenomenon, Central Asian states (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan) attempt to attract foreign investment into their countries through structural reforms. Foreign direct investment inflow into the Central Asia region has significantly increased since the collapse of the union of Soviet Socialist Republics (USSR). In this process, the Central Asian states attempted to create legal frameworks for foreign investment, in order to attract more of it. In comparison with developed and developing countries, foreign direct investment in the Central Asian states remains at a low level. Additionally, foreign direct investment is often concentrated in a just few sectors (and in natural resource extraction in particular).<sup>1</sup> Generally, Central Asian states are not classified as low risk for foreign investments. One of the explanations for this classification is that all Central Asian states have serious problems with the rule of law, control of corruption, and transparency. These factors play crucial roles in determining the host country's attractiveness for foreign investors. Kazakhstan fares better in all criteria

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<sup>1</sup> OeCd, Promoting investments and Job Creation in Central Asia through Business Linkage Programs, OeCd handbook (May 2013), at 14 (Nov. 4, 2019), available at <https://www.oecd.org/global-relations/BusinessLinkageProgrammes.pdf>.

compare to Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan<sup>2</sup>. Still, poor-quality regulations, as well as inconsistent interpretation and arbitrary application of laws, continues to be a major problem for the Kazakhstan foreign investment regime<sup>3</sup>.

Outside factors (such as regional conflicts and economic sanction against Russia) have an adverse effect on inflow of FDI in the region. In 2017, Kazakhstan attracted the most foreign direct investment among the Central Asian states, with \$4.6 billion while in 2016 it was \$12.223 billion. Turkmenistan received the second most FDI, with \$2.31 billion in 2017. Tajikistan garnered very low levels of foreign investment at \$141 million, followed by Uzbekistan with \$96 million and Kyrgyzstan with \$94 million<sup>4</sup>. Overall numbers indicate that FDI flows to Central Asia have declined considerably. This decrease of FDI into the region's developing countries, and the rise of pressure over foreign investment, is a major concern in the recent development of the host countries' investment policies.<sup>5</sup> In this phenomenon, Central Asian states are presented with a good opportunity to review their investment policies and regulation regimes in order to attract more FDI. From this perspective, those countries are focusing more on investment policy. However, while there has been some effort expended towards improving the legal framework for foreign investment in the region, it is difficult to say that such development can satisfy foreign investor's expectations.

#### Bilateral Investment Treaties in Central Asian States

Bilateral investment treaties (Bits) are described as a backbone of international legal instruments regulating foreign investment. A majority of Bits include provisions relating to admission and establishment of foreign investment, treatment of foreign investment, protection against expropriation, and dispute resolution procedures<sup>6</sup>. This section of the paper reviews the main characteristics of Central Asian states' Bits. There are some countries among the Central Asian states that have bad reputations as host countries for foreign investment. Being party to Bits helps to counteract the negative effects of these reputations by sending a message to foreign investors that their investments are protected. This is likely the reason why Central Asian states often include transparency provisions in their Bits (or comprehensive incentives in their FDI regimes).

<sup>2</sup> the world Bank, worldwide Governance indicators (Nov. 4, 2019), available at <https://info.worldbank.org/governance/wgi/home/reports>.

<sup>3</sup> OeCd, OeCd investment Policy reviews: kazakhstan 2017, at 26 (Nov. 4, 2019), available at <http://www.oecd.org/countries/kazakhstan/oecd-investment-policy-reviews-kazakhstan-2017-9789264269606-en.htm>.

<sup>4</sup> the world Bank, Foreign direct investment, data (Nov. 4, 2019), available at <https://data.worldbank.org/indicator/BX.kLt.diNv.Cd.wd>.

<sup>5</sup> uNctAd, world investment report 2018: investment and New industrial Policies, united Nations (2018) (Nov. 4, 2019), available at [https://unctad.org/en/PublicationsLibrary/wir2018\\_en.pdf](https://unctad.org/en/PublicationsLibrary/wir2018_en.pdf).

<sup>6</sup> See, for more detail, Muthucumaraswamy sornarajah, State Responsibility and Bilateral Investment Treaties, 20(1) Journal of world trade 79 (1986); tarcisio Gazzini, Bilateral Investment Treaties and Sustainable Development, 15(5-6) Journal of world investment & trade 929 (2014).

Besides Central Asian states' Bits, there are some regional agreements related to foreign investments such as the Eurasian investment Agreement<sup>7</sup> and the CIS (Commonwealth of independent states) investor rights Convention. Generally, these treaties do not provide more protection to foreign investors than Bits and usually heavily rely on the host country's legislation. For example, Article 2 of the EIA defies that admission of investment is determined by the host country's legislation. This provision allows the host country to discriminate or impose strict rules for foreign investment during the pre-entry phase.

### *Kazakhstan*

Kazakhstan has taken an active role in promoting foreign investment since the collapse of the USSR. The country is often recognized as the most favorable destination for foreign investment among the Central Asian countries. Kazakhstan is a part of more than 48 Bits including with Kyrgyzstan, Tajikistan, and Uzbekistan<sup>8</sup>. The vast majority of Kazakhstan's investment treaties are broad enough that investment arbitration defies the scope of protection. Kazakhstan's lack of predictability of investment treaties may raise the issue of maintaining a balance between investor protection and the host country's power<sup>9</sup>. Kazakhstan's investment treaties (Bits) define foreign investors as natural persons and entities, including public entities. Comparative analyses of Bits show that the involvement of public entities in a Bit is a common practice in comparison with other host countries. However, the majority of Kazakhstan's Bits do not contain public entities in the scope of foreign investors, whereas some of Kazakhstan's Bits expressly included public entities as foreign investors. For example, Kazakhstan's Bits describe as a "public institution, corporations, partnerships, foundations and associations" "government owned or controlled." Public entities in some of Kazakhstan's recent Bits have continued to be included in the scope of foreign investors. Another important point relating to the definition of investment in Kazakhstan's Bits is the requirement for territory. Nearly all of Kazakhstan's Bits impose a territory requirement. That means that foreign investment must be established and continued in the territory of Kazakhstan in order to take advantage of Bit protections. Investment treaties impose contracting state parties to enforce their national laws and regulations due to substantive obligations of investment. Enforcement of national laws and regulations by the home country is provided through international law on a territorial basis. In light of international investment arbitrations, if questions arise about territoriality requirements, tribunals frequently turn to identify

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<sup>7</sup> Belarus, Kazakhstan, Kyrgyzstan, Russian Federation, and Tajikistan are part of this agreement. The purpose of agreement is to promote and protect investment in the Eurasian Economic Community (Nov. 4, 2019), available at <https://investmentpolicyhub.unctad.org/iiA/country/175/treaty/3252>.

<sup>8</sup> Investment Policy Hub, UNCTAD (Nov. 4, 2019), available at <http://investmentpolicyhub.unctad.org/iiA/CountryBits/107?type=c#iinnerMenu>.

<sup>9</sup> OECD Investment Policy Reviews: Kazakhstan, *supra* note 3, at 134.

the scope of an investment treaty's objectives and purposes. If an investment treaty contains territoriality requirements in the scope of investments, it is highly possible that the investment treaty parties designated the restriction of foreign investment with territory on the scope of the protected investment<sup>10</sup>. Tribunals broadly interpret the territoriality requirement. A typical Bit starts with preamble that describes the general intention of the agreement and the provisions within its scope of application. In the case of Kazakhstan's Bits, nearly all include a reference to investments "in the territory of the other party." Expropriation is an indispensable part of all investment treaties. Kazakhstan's Bits provide foreign investors protection against expropriation. The scope of such provisions includes direct and indirect expropriations. Some of Kazakhstan's Bits describe no explicit definition relating to indirect expropriations. As a rule, the relevant terms relating to indirect expropriation, in the context of Bits, will be evaluated by arbitral and tribunal reference to their meaning under international law<sup>11</sup>. Expropriation is not illegal on the condition of the existence of international standards (public purpose, non-discrimination and compensation). From this point of view, Kazakhstan's Bits are in line with international law standards. Protection from expropriation is frequently excluded from public purpose and national interest in Kazakhstan's Bits. The scope of national interest may be problematic due to its broad definition. There is no guideline to define the general principle of national interest in Kazakhstan's legislation.

Additionally, while all of Kazakhstan's Bits contain dispute resolution provisions, access to arbitration is subject to the expiry of a certain period of time in most cases.

There is no provision relating to the exhaustion of domestic courts in Kazakhstan Bits. The exhaustion of domestic courts is a more common provision among older Bits. The requirement to exhaust local remedies is time consuming and poses additional expenses for foreign investors<sup>12</sup>. It is interesting to point out that the majority of Kazakhstan's Bits with capital-exporting countries contain a requirement for the elapse of a certain period of time (such as three or six months) before initiating international arbitration. In contrast to this, there are some Kazakhstan Bits with developing countries (such as Uzbekistan) which impose no requirement relating to the expiry of certain period to access arbitration.

### *Kyrgyzstan*

Kyrgyzstan is part of more than 35 bilateral investment treaties, as well as the energy Charter treaty. However, there are still some problems with implementation of

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<sup>10</sup> Christopher r. Zheng, The Territoriality Requirement in Investment Treaties: A Constraint on Jurisdictional Expansionism, 34 Singapore Law Review 139, 143 (2016). See, for more detail, Douglas 2009, at 54.

<sup>11</sup> expropriation, supra note 38, at 29.

<sup>12</sup> Christoph Schreuer, Interaction of International Tribunals and Domestic Courts in Investment Law in Contemporary Issues in International Arbitration and Mediation: The Fordham Papers 2010 71, 73 (Leiden: Martinus Nijhoff Publishers, 2010).

such investment policy. It is widely recognized that one of the main elements necessary to attract foreign investment into a host country is political stability. The recent developments in Kyrgyzstan indicate that there are problems with enforcement of the law and significant political instability. Kyrgyzstan's Bits include general principles of foreign investment in the country, like typical Bits. There are some similar provisions in Kyrgyzstan's Bits compared to Kazakhstan's Bits. One shared provision is the expiry of a certain amount of time before initiating international arbitration (typically, six months). The vast majority of Kyrgyzstan's Bits also contain territoriality requirements. Kyrgyzstan's investment treaties provide national and most-favored nation treatment. Some Kyrgyzstan Bits specify or limit the scope of national and most favored nation clauses. The function of such provisions may be viewed in two ways: First, this provision gives rights to Kyrgyzstan to apply its admission rules and screening procedures, and the scope of such rules and procedures are defined by domestic laws. Second, this provision may allow for Kyrgyzstan to discriminate between domestic and foreign investors during the admission of foreign investment. Once foreign investment is admitted by Kyrgyzstan, it is possible to apply non-discrimination rules (national treatment) to foreign investors. Kyrgyzstan guarantees protection against expropriation in the scope of its Bit. Such provisions provide no explicit definition relating to indirect expropriation. Instead of using this term, it is referred to as "equivalent to nationalization and expropriation." *Valeri Belokon v. Kyrgyz Republic* is good example by which to evaluate Kyrgyzstan's indirect expropriation practice in the light of a Bit. The claimant alleged that Kyrgyzstan authorities restricted the operation of foreign investment (Manas Bank assets) without a legitimate legal reason, which would be a violation of the expropriation provision in Kyrgyzstan–Latvia Bit. in response to the claimant's allegations, Kyrgyzstan argued that administration of Manas Bank is examined in the scope of regulatory exercise of the policy powers of the Kyrgyz republic. the tribunal pointed out that violation of the maximum time limit related to administrative control defined in Kyrgyzstan can be considered expropriation of investment. One of the conditions of expropriation in the scope of the Kyrgyzstan–Latvia Bit is public purpose. The tribunal noted that Kyrgyzstan's temporary administrative regime is not consistent with public purpose and that this administrative regime focused on scrutinizing suspicious wrongdoing of certain political authorities. in light of such evaluation, the measures taken by Kyrgyzstan related to expropriation (seizure of Manas Bank) including temporary administrative regime is to promote narrower interest of the government rather than public interest.<sup>13</sup>

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<sup>13</sup> Valeri Belokon v. Kyrgyz Republic, uNCitrAL, Award (Nov. 4, 2019), available at <https://www.italaw.com/cases/3800>

### *Turkmenistan*

Unlike other Central Asian states, most of Turkmenistan's Bits do not include public entity in the scope of foreign investor. The admission of foreign investment is also stricter compared to Kazakhstan's and Kyrgyzstan's Bits. The formulation of admission provisions in Turkmenistan's Bits are to be standardized. From this perspective, the admission of foreign investment highly depends on Turkmenistan's legislation. This is the main feature of Turkmenistan's Bits. For example, each Contracting Party shall encourage and create favorable conditions for investors of the other Contracting Party to invest capital in its territory, and, subject to its right to exercise powers conferred by its laws and regulations, shall admit such capital, or each Contracting Party shall admit the investment by investment of the other Contracting Party in accordance with its legislation and administrative practice, and promote such investments as far as possible including establishments of representative offices<sup>14</sup>. Turkmenistan's Bits provide most-favored and national treatment clauses to foreign investors. Primarily, foreign investors can extend the scope of Bit's protection through most favored nation clause. It is the case that the country imposes more restrictive provisions than others. In other words, the severability of provisions in Bits can raise questions in some cases. The tribunal found that the most-favored nation clause was granted and intended to refer only to the scope of substantive rights in the Turkmenistan–Turkey Bit. From the tribunal's point of view, remedial procedures do not cover the scope of the most-favored national clause. But this is not a widely recognized approach to determining the scope of the most-favored nation clause. The settlement of dispute provision can be extended as it is compatible with the "ejusdem generis" if a third party treaty provides more favorable treatment to the protection of investor's rights and interests than those in the basic treaty. From this point of view, the scope of the most-favored national clause relies on a broad interpretation. Foreign investors may have access to international arbitration in the scope of Turkmenistan's Bits. In the same manner as Kazakhstan's, Kyrgyzstan's and Tajikistan's Bits, the application of this provision is conditional. However, the duration of time as a condition of accessing international arbitration ranges from three months to six months. In light of recent practice in international investment arbitration, it seems to be difficult for foreign investors to go to international arbitration through the most-favored nation clause. The dispute settlement clause is considered within the scope of procedural rights, and the most-favored nation clause is only applicable for substantial rights. All of Turkmenistan's Bits provide protection for foreign investors against direct and indirect expropriation. Although the conditions (public purpose, due procedure of law, non-discrimination) for expropriation are nearly similar in most of Turkmenistan's Bit,

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<sup>14</sup> Art. 2.2 of the Turkmenistan–Egypt Bit (1995).

the formulation of expropriation clauses is not standardized. Some of Turkmenistan's Bits contains detailed and broad expropriation clause. Such provisions are not in existence in Turkmenistan's Bits with other countries. Most of Turkmenistan's Bits indicate how compensation shall be calculated, but formulation of compensation is different. several of Turkmenistan's Bits provide for "prompt, adequate and effective compensation," whereas some contain "effective and adequate compensation" or "fair and equitable compensation."

### Conclusion

From regulatory compliance to political stability, environmental sustainability, and dispute resolution, understanding and addressing the legal complexities of international investment is essential for safeguarding investors' interests, mitigating risks, and fostering sustainable development. In an increasingly interconnected and dynamic global economy, proactive engagement with legal experts, stakeholders, and regulatory authorities is indispensable for unlocking the full potential of international investment and navigating the complexities of the modern business world. Central Asian states have made some achievements with regard to attracting foreign investment since the fall of the soviet union. However, the effectiveness of Uzbekistan–Kazakhstan Bit (1997) Uzbekistan–China Bit (2011); Uzbekistan–Turkey Bit (2018). Economic reforms and the liberalization process, including FDI regimes, is dubious in the region. in particular, the rule of law, and the transparency and predictability of the legal framework governing foreign investment, continue to be major problems. Beyond these bounds, some of Central Asia's states do not have clear national investment policies. it is common tendency in Central Asian states' Bits to restrict the scope of such treaties with domestic laws. that is especially true in the case of Turkmenistan, Tajikistan, and Uzbekistan. This phenomenon may reduce the impact of investment treaties and negatively impact the flow of foreign investment into Central Asia. Furthermore, Central Asian states' Bits provide more favorable conditions for foreign investment compared to the Eurasian investment Agreement and the Cis investor right Convention. It should be kept in mind that foreign investors desire to have their investments protected in the context of international standards because national investment legislation usually provides for less protection for foreign investors than international standards. Additionally, problems with the transparency and predictability of the host country's legislation may create risks for foreign investment. these are the main reasons for the avoidance of host country legislation and for pressuring the host country to adhere to international standards. The main determiners of the relative attractiveness of foreign investment include the rule of law, and the transparency and predictability of the host country's legal framework governing foreign investments. Foreign investors planning their investments consider the overall investment climate, which is based on not only economic conditions but also the legal

framework for foreign investment. Transparency and predictability allow foreign investors to plan their investments with great certainty and reduce as much as possible non-commercial risks.

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