

The Growing Prominence of Kazakhstan as a Destination for Foreign Direct Investment in the Post-Soviet Space

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The Invasion Sounded the Death Knell for Western Capital in Russia

Russia's full-scale invasion of Ukraine has sent shockwaves around the globe. Trade, development and investment flows have been particularly hard hit, especially in the Commonwealth of Independent States (the "CIS") and Caucasus region, where Russia accounts for almost 80% of the region's GDP.¹

Pre-invasion, Russia was the prime destination for foreign direct investment in the region. According to the last UNCTAD's World Investment Report, as of the end of 2021, the foreign direct investment in Russia amounted to US\$521.8 billion.² In 2021 alone, Russia attracted US\$38.2 billion of foreign investment,³ mainly from Western Europe,⁴ despite sanctions imposed on Russia in response to its annexation of Crimea in March 2014.

Post-invasion, the picture looks very different. The radical expansion of Western sanctions and countermeasures adopted by Russia have caused havoc on the country's economy. Big companies pulled out by the hundreds. Scores of others suspended their operations or are exiting the market now.⁵ Over the last year, we assisted more than a dozen U.S. and European companies in exiting the market. The lessons learned from successful exits—and some of the pitfalls to avoid—are discussed [here](#).

¹ Investment monitor, "An investor's guide to the CIS and Caucasus", 25 March 2022 (see [here](#)).

² UNCTAD, World Investment Report 2022 (see [here](#)).

³ UNCTAD, World Investment Report 2022 (see [here](#)).

⁴ FDI Intelligence, "Ukraine war jeopardises \$500bn in foreign investment", 25 March 2022 (see [here](#)) [On average, investors from OECD countries made up about 80.8% of the FDI projects announced in Russia since 2014].

⁵ KSE Institute, LeaveRussia Project, Analytics (see [here](#), last accessed on 4 April 2023); The New York Times, "Russia-Ukraine War, Tech Giant Aims to Cut Ties With Russia," 24 November 2022 (see [here](#)).

As investors are reassessing their strategies, new opportunities and alternative destinations for foreign direct investment in the CIS and Caucasus region are topics that continue to feature in boardroom discussions.

The Growing Role of Kazakhstan as a Foreign Direct Investment Destination

Kazakhstan has long sought to boost its share of foreign direct investment in the region. Ever since gaining independence in 1991, the government has been improving its regulatory framework and promoting the rule of law to create a stable investment regime. In 2022, it saw a steady increase in the levels of foreign direct investment.⁶ Over the next few years, the government aims to attract over US\$150 billion in foreign capital into the country.⁷

Kazakhstan is creating incentives for businesses relocating from Russia in the aftermath of the invasion. It signed agreements with more than 50 such companies, including Honeywell, WEG, TikTok, Fortescue Metals Group and Carlsberg, and is targeting three hundred more businesses from more than 20 countries, mainly from Germany and the United States. Kazakh President Tokayev has urged the government to create favourable conditions for their relocation to Kazakhstan.

Kazakhstan is also considering improving the country's investment protection regime. President Tokayev announced the government's plans to introduce a new tax code to create an effective fiscal environment, exempting businesses from complicated and excessive requirements.⁸ Alikhan Smailov, the Prime Minister, pointed to an "arsenal" of measures available to the government, including entering into investment agreements and introducing certain tax and regulatory preferences.⁹ Most recently, the Economic Policy Council of Kazakhstan considered proposals to accelerate the application

⁶ The Astana Times, "Kazakhstan Among Central Asia's Most Attractive Countries for Investment, According to Ernst & Young Survey", 9 November 2022 (see [here](#)). See also The Astana Times, "Kazakhstan's FDI Inflow Reaches \$22.1 Billion in Nine Months This Year", 30 December 2022 (see [here](#)). (In the first nine months of 2022, the net inflow of foreign direct investment in Kazakhstan has increased by 17.8%, amounting to US\$22.1 billion (compared to US\$18.7 billion in the same period in 2021)).

⁷ Interfax, "Kazakhstan plans to attract \$150 bln in foreign direct investment within seven years - Tokayev," 26 October 2022 (see [here](#)).

⁸ Official Website of the President of the Republic of Kazakhstan, Speech by the President of the Republic of Kazakhstan Kassym-Jomart Tokayev at a meeting with the heads of foreign diplomatic missions accredited in Kazakhstan, 4 November 2022 (see [here](#)).

⁹ The Astana Times, "Kazakh PM Pushes for Attractive Investment Conditions During Investment Headquarters Meeting," 12 September 2022 (see [here](#)); Official Information Source of the Prime Minister of the Republic of Kazakhstan, "Alikhan Smailov holds Investment Headquarters meeting," 10 September 2022 (see [here](#)); Interfax, "Fifty-six companies that left Russia intend to relocate businesses to Kazakhstan - Kazakh PM," 19 October 2022 (see [here](#)).

procedure for state support measures by investors and reduce the threshold for investment to be eligible for obtaining such state support measures.¹⁰

By creating incentives for companies relocating from Russia and attracting Western capital that would otherwise have been routed to and deployed in Russia, Kazakhstan may seek to become a leading Eurasian trading hub at the crossroads of the European and Asian markets.

Investment Protections and Compliance Considerations

As Kazakhstan is looking to amend its regulatory framework, investors should keep an eye on these developments. Businesses should also remain alert to any compliance and regulatory risks, especially when entering the market and/or expanding their operations in Kazakhstan.

Investment Protections in Kazakhstan

One of the key considerations when investing in any country is the availability of investment protections. Such protections are typically found in international treaties and/or domestic legislation. Relevant provisions can also be found in a contract with a state (or a state entity) and may include stabilisation clauses aimed at freezing the legal regime applicable to the contract for the duration of the project or fixing the economic benefits under the contract (sometimes called an economic equilibrium clause).

International Protections

Kazakhstan has signed a wide network of international investment agreements. The country is a party to 42 bilateral investment treaties (“BITs”) and 10 other international treaties with investment protection provisions, including multilateral instruments such as the Energy Charter Treaty and the Treaty on the Eurasian Economic Union.

Most of those treaties include a broad asset-based definition of the term “investment” (*i.e.*, “*every kind of asset*”), with some treaties explicitly providing that investments have to be made in accordance with the host state’s laws. Most treaties also contain a broad definition of the term “investor” based on a pure incorporation test (*i.e.*, requiring legal entities to be constituted under the laws of the home state), with some treaties also requiring them to carry out substantial business activity in the place of incorporation

¹⁰ Official Information Source of the Prime Minister of the Republic of Kazakhstan, “Proposals to improve investment climate considered by Government,” 12 January 2023 (see [here](#)). The Council did not specify the state support measures covered by the proposal. State support measures available to investors in Kazakhstan generally include tax preferences, subsidies, grants, investment agreements and guarantees of stability of the legal regime (among other measures).

(e.g., Kazakhstan–Austria BIT) or have a seat in its home state (e.g., Kazakhstan–Germany BIT). Several treaties expressly extend protections to companies directly or indirectly controlled by a foreign investor (e.g., Kazakhstan–Netherlands BIT and the Kazakhstan–Sweden BIT).

All treaties protect against uncompensated expropriation and contain broad fair and equitable treatment provisions and most-favoured-nation clauses.¹¹ Most treaties also include a full protection and security standard. Umbrella clauses are found in approximately one third of the treaties. That being said, excluding these clauses from investment treaties and/or curtailing their scope is a recent trend more globally.

Most investment treaties concluded after Kazakhstan’s accession to the ICSID Convention in 2000 allow parties to pursue either: (i) arbitration under ICSID or other institutional rules or (ii) *ad hoc* arbitration under the United Nations Commission on International Trade Law (UNCITRAL) rules. Almost all of the treaties to which Kazakhstan is a party require a cooling-off period, and only a few include a fork-in-the-road provision.

Some Kazakh BITs exclude taxation measures from the scope of protection. These can limit the ability of investors to challenge tax-related measures that violate their substantive rights, including the potential to challenge revocations of certain tax preferences. BITs that include a taxation carve-out have exceptions, or clawbacks, typically for expropriation claims.¹² For instance, the Kazakhstan–United States BIT includes a broad carve-out for taxation measures but allows claims with respect to expropriation and free transfers of funds.

International Protections in Practice

To date, Kazakhstan has been a party to 21 investment treaty proceedings: eight concluded in favour of the investor; eight concluded in favour of the State; two settled; and two are pending.

Most cases are/were in the energy (oil and gas) and mining sectors and related to the government’s alleged intervention into the investors’ exploration and production activities; unlawful expropriation; termination of investment contracts, concession agreements or licences; imposition of fines and tariff restrictions; and withholding of certain approvals. Most investment claims were brought by investors from the United States, the Netherlands and Turkey and conducted under ICSID or SCC Rules.

¹¹ The only exception is the EU–Kazakhstan Enhanced Partnership and Cooperation Agreement, dated 1 March 2020.

¹² Japan–Kazakhstan BIT (2014), Article 22; Kazakhstan–United States of America BIT (1992), Article XI.

The state has generally refused to comply voluntarily with investment treaty awards and, in most cases, was successful in resisting enforcement for extended periods of time. In *AIG v. Kazakhstan*, for example, Kazakhstan paid the US\$9.9 million ICSID award only five years after it was issued and only after AIG launched several enforcement actions and the United States exerted pressure on the Kazakh government.¹³

Domestic Protections

Apart from investment protections available under Kazakhstan's investment treaties, its domestic law also provides certain guarantees to both domestic and foreign investors. The principal legal act which establishes a legal framework for investment protection and measures of state support is the Law on Investments No. 373-II (the "2003 Law"). It guarantees the stability of the agreements concluded between investors and public authorities against changes in the legislation for priority investment projects. Priority investment projects are defined broadly as projects related to particular activities approved by the government.¹⁴ Such priority investment projects may also receive tax preferences and subsidies; however, only legal entities incorporated in Kazakhstan are eligible for investment preferences.

Unlike its predecessor, the Law of the Republic of Kazakhstan on Foreign Investments, dated 27 December 1994, the 2003 Law does not provide a standing offer to arbitrate future disputes.¹⁵ This is a serious limitation. There have been no reported investment treaty claims against Kazakhstan where investors invoked the 2003 Law as a basis for jurisdiction of the tribunal. Nevertheless, it is possible that in future proceedings investors may seek to rely on provisions of the 2003 Law in support of claims for violation of substantive investment treaty standards.

Compliance Considerations

Investors should also remain alert to any compliance and regulatory risks. As bribery and corruption issues remain a significant concern in many countries of the former Soviet Union, such issues should be given serious consideration at every stage of the project, especially when entering the market or expanding operations in this part of the world.

¹³ GAR, "Kazakhstan must assure payment, tribunal says", 30 March 2009 (see [here](#)).

¹⁴ Law of the Republic of Kazakhstan on Investments, No. 373-II, dated 8 January 2003, Article 1.

¹⁵ *Ibid*, Article 9. The 2003 Law provides that investment disputes not resolved through negotiations or dispute settlement procedures agreed by the parties "shall be settled in accordance with international treaties and Kazakhstan laws by national courts and/or an arbitral tribunal as specified in the agreement between the parties." (unofficial translation into English).

Kazakhstan has in recent years improved its global rankings for the ease of doing business¹⁶ and for rule of law in the country.¹⁷ In addition, the government established the Anti-Corruption Agency with a view to implementing the government's anti-corruption policy and streamlining the process for obtaining governmental approvals (among other things). This is a positive step that should aid the government's efforts in strengthening the rule of law in the country.

Companies relocating from Russia should also consider any sanctions restrictions that may apply to their operations in Kazakhstan. As many such companies had and/or continue to have commercial dealings with a Russian or Ukrainian nexus, it is important to ensure that they have an up-to-date and accurate understanding of which of their products and operations are subject to sanctions, as well as policies and procedures in place to ensure compliance. In particular, companies must ensure that any exports of goods to Russia comply with the relevant U.S. trade restrictions (discussed [here](#)) and that they do not do anything that may be viewed as circumventing those restrictions. Companies should also review their contracts, as some may include express limitations on doing business with countries and entities subject to sanctions.

Conclusions

The radical expansion of Western sanctions and mass exodus of foreign companies have sowed havoc on the Russian economy. As investors continue to search for new ways to deploy their capital in the post-Soviet Union space, Kazakhstan is taking steps to improve its reputation as a popular destination for foreign direct investment in the region.

Businesses with operations in Kazakhstan and those looking to invest into the country should take note of the existing domestic and international investment protections and consider how they can leverage those protections in light of these developments. Businesses should also remain alert to any compliance and regulatory risks, especially when entering the market and/or expanding their operations in Kazakhstan.

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¹⁶ The World Bank, Doing Business Archive, Ease of Doing Business in Kazakhstan (see [here](#)).

¹⁷ Official website of the Anti-corruption Agency of the Republic of Kazakhstan, "Kazakhstan has risen by 19 positions, gaining 38 points for the first time in the Corruption Perceptions Index," 30 January 2021 (see [here](#)).

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