LEGAL ENVIRONMENT FOR INTERNATIONAL INVESTMENTS IN UZBEKISTAN

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Abstrakt

Cílem tohoto příspěvku je přiblížit čtenáři současné podmínky pro umístnění mezinárodních investic v Uzbecké republice. Úvodní část příspěvku popisuje historické a geografické souvislosti ovlivňující investování v této zemi. Druhá část práce se věnuje jednak obecně problematice mezinárodního investování a mezinárodní ochrany zahraničních investic a současně i specifikům investování v Uzbekistánu. Tato část se rovněž zabývá vývojem právní úpravy zahraničního investování a jejím současným stavem. Závěrečná část práce poukazuje na některé problémy, se kterými se zahraniční investoři v Uzbekistánu stále potýkají.

Klíčová slova

Uzbekistán, Střední Asie, tranzitivní ekonomika, tržní ekonomika, zahraniční investice, investiční legislativa

Abstract

The purpose of this paper is to give the reader an overview of the current legal conditions for placing foreign investments in the Republic of Uzbekistan. Its first part describes the historical and geographical predispositions which still effect international investing in this country. The second part deals with international investments and their protection in general, as well as with specifics of placing investments in Uzbekistan. This part also deals with the evolution of law on international investments and their protection. The final part then points out some of the problems the foreign investors have to be dealing with.

Key words

Uzbekistan, Central Asia, transitional economy, market economy, foreign investments, investment legislation

Introduction

Uzbekistan and other Central Asian Countries sometimes seem to be forgotten by most European foreign investors when looking for a place to invest their capital. This is true even though the Central Asian republics are strategically located and land-locked between Europe and Asia[1]. The question arises if it is so because these territories are geographically quite far from Europe, because of a fear that Central Asia does not offer a secure environment for foreign investments or simply because of not having enough information about these countries, their investment legislation and their actual capability of enforcing such legislation. The purpose of this paper is to provide introductory information about the investment legislation of Uzbekistan, its implementation in practice and also to point out specific problems the foreign investors have to deal with once placing their investment in this country. The first part of my paper will briefly describe the country's location and history. Its purpose is to make sure that the reader is provided with at least a basic knowledge of the geographical location of Uzbekistan and its historical background because both of these are important for further elaboration on as well as for understanding the investment issues in this country. The second part will introduce some basic facts concerning the transfer of international capital and the main means of international investment protection. In the final two parts of my paper I will move onto discussing the current investment legislation and the problems connected with its application in practice.

1. Geography and History of Uzbekistan

Uzbekistan is the geographic and economic heart of Central Asia. With its population exceeding 27 million people[2], it is the biggest market[3] among other Central Asian countries[4]. Lying on the ancient Silk Road[5] between Europe and the Far East, the cities of Samarkand, Bukhara and Khiva have been centers of commerce and trade for centuries and have undergone revivals since the dissolution of the Soviet Union[6]. Uzbekistan is the only country to border each of the other four Central Asian republics, as well as Afghanistan and therefore offers an easy access to the entire Silk Road market of over 142 million people.

Since 1865 until the revolution in 1917, the territory of today's Uzbekistan was under the rule of Russian Tsar. In 1917 these regions initially supported the Bolshevik revolution thinking they could achieve independence from Russia. When realizing that independence was not

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[1] Dowling, M., Wignaraja, G., *Central Asia After Fifteen Years of Transition: Growth, Regional Cooperation, and Policy Choices*. Office of Regional Economic Integration, Asian Development Bank, 2006.

[2] Which is approximately half of the whole population of Central Asia. www.mzv.cz

[3] GDP of Uzbekistan is currently approximately 12 billion USD (12 billion in 2004, 12.9 billion in 2005, and approximately 11 billion in 2006)

[4] Kazakhstan, Tajikistan, Kyrgyzstan, Turkmenistan.

[5] Uzbekistán has been the Gross roads of the most important trade route in history, the Great Silk Road. UNDP, *Investment Guide to Uzbekistan*, 2007

[6] Baker & McKenzie – CIS, Limited; *Doing Business in Uzbekistan*. January 2007

possible, the nationalist opposition managed to force the Soviet military to withdraw. Nevertheless, the Soviet military power eventually prevailed[7]. On 27 October 1924 the Uzbek Soviet Socialist Republic was created, and in May 1925 it became part of the Union of Soviet Socialist Republics. On 29 August 1991, 10 days after the collapse of the anti-Gorbachev coup in Moscow, an extraordinary session of the Supreme Soviet voted to declare the Republic independent, and changed its name to the Republic of Uzbekistan[8]. The Republic of Uzbekistan then declared its independence of the Soviet Union on 31 August 1991[9]. After gaining the independence, the country was supposed to become "the Tiger" with the strongest economic potential among the former Soviet republic[10], which would be able to take the biggest advantage of foreign investments inflow. Compared to Central and Eastern European post-communist countries which were able to attract the foreign investors to their territories and to take advantage of the world's policy of liberalization of cross border investments, Uzbekistan was unfortunately less ready to do so[11].

2.1. International investing

The transfer of cross-border investments has become a daily reality of today's more and more globalized world. In order to promote international investment exchange, the states insist on mutual facilitation of transfer of international capital and are trying to take all advantages connected with the inflow of foreign investments.

For developing countries, the placement of foreign investment in their territories does not mean only acquiring financial capital, but also an opportunity to strengthen the stagnating economy, acquiring the latest foreign technologies, decreasing unemployment, as well as raising the qualification of the laborers and managers employed by foreign companies[12]. The

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[7] Even though the armed struggle for independente continued until the early 1920s. PriceWaterhouseCoopers; *Business and Investment Guide Uzbekistan 2007*

[8] PriceWaterhouseCoopers; *Business and Investment Guide Uzbekistan 2007*

[9] Uzbekistan is a presidential republic with bicameral legislature. The country is a member of the Commonwealth of Independent States (CIS), the United Nations, the International Monetary Fund, the World Bank, the European Bank for Reconstruction and Development, the Organization for Security and Cooperation in Europe, the Asian Development Bank, the Organization of the Islamic Conference, and several other international organizations. Baker & McKenzie – CIS, Limited; *Doing Business in Uzbekistan*. January 2007

[10] „Upon its declaration of independence in September 1991, the Republic of Uzbekistan appeared poised to take the lead among its Central Asian neighbors in attracting foreign investment". Newman, A., *Investing in Uzbekistan: A Rough Ride on the Silk Road*. 30 Law & Pol'y Int'l Bus. 1998-1999

[11] "Less than a decade after independence, Uzbekistan has fallen far short of investors' initial expectations. In comparison with other Central Asian nations – particularly Kazakhstan – Uzbekistan has failed to lure, and, more revealingly, to retain foreign investment". Newman, A., *Investing in Uzbekistan: A Rough Ride on the Silk Road*. 30 Law & Pol'y Int'l Bus. 1998-1999

[12] „For transitional economies foreign direct investments (FDI) has a special significance as it can accelerate the modernization of their economies not only through capital inflows but also through the transfer of technology and business and management skills". UNDP, *Investment Guide to Uzbekistan*, 2007

advantages for foreign investors lie especially in the opportunity to use cheaper labor force in the host state, opportunity to enter new markets and also getting an access to natural resources which are not available in his home country. The foreign investors, however, don't feel comfortable to invest in foreign territory, unless they feel that their investment is sufficiently protected against non-commercial risks. One of the indispensable conditions for attracting foreign investments is therefore the creation of favorable legal environment in the host state. In order to stimulate international investing, the states are usually concluding bilateral investment treaties[13], accessing to multilateral treaties dealing with international investment protection and passing national legislation aimed at protection and promotion of foreign investments[14]. Any country should however bear in mind at all times that the sole acceptance of international obligation in form of an international treaty or by passing national investment legislation, is not sufficient and that the protection embodied in these legal acts has to be effectively promoted in practice. The host country has thus an important duty to guarantee an appropriate protection of foreign investors property placed at the host state's territory. Such protection currently lies especially in providing foreign investor with such treatment as is guaranteed by investment treaties and investment legislation. Breach of these obligations leads to international responsibility of the host state and creates an investor's right to claim compensation at a national court or agreed arbitral tribunal[15].

2.2. Investing in Uzbekistan

2.2.1. Investment legislation

As for any other country, foreign trade and investment could be the major driving force for Uzbekistan, which would help to attain higher and more sustainable economic growth rates through supporting economy modernization and its structural adjustment, creating employment, providing more opportunities for domestic private sector, facilitating competition, transferring skills, knowledge and technology, etc[16]. It is obvious that there is a great need to promote foreign trade and at the same time attract foreign investments. After the collapse of the Soviet Union, the government of the independent Republic of Uzbekistan did

[13] So called „Bilateral treaties on reciprocal promotion and protection of foreign investments“.
[14] International Convention on Settlement of Investment Disputes between States and Nationals of Other States (the Washington Treaty), The Soul Treaty on Multilateral Investment Guarantees Agency, Energy Charter Treaty.
[15] As was for instance the case in C.M.E. v the Czech Republic (2002) in which the Czech Republic was found in breach of investment treaty treatment standards and had to pay compensation of about USD 300 milion.
[16]UNDP; Capacity Building and Strenghtening Foreign Trade in Investment Promotion Institutions in Uzbekistan

realize the chance and carefully began opening the door for market economy and working on improving business climate to become favorable for domestic and foreign investors[17].

The first piece of Uzbek investment legislation appeared in 1994 when "the Law on Foreign Investments and Guarantees of Foreign Investors Activity" (hereafter 1994 FIL) was passed. This initial law was replaced four years later by the Laws On Foreign Investments and On Guarantees and Measures for the Protection of Rights of Foreign Investors which was adopted on 30 April 1998 and which currently provide the legal framework for international investment in Uzbekistan[18]. These laws specify the means of foreign investors' participation[19], the conditions governing repatriation of profits and earnings as well as the general rights to and guarantees of foreign investors. These laws distinguish between "enterprises with foreign participation" and "enterprises with foreign investment which qualify to receive certain benefits. It is stated therein that in order to create "an enterprise with foreign investment", the charter capital of the entity must be at least USD 150,000, at least one participant must be a foreign legal entity and foreign investor owns at least 30 % of the total charter capital. All other enterprises with foreign investments which do not meet these criteria are considered to be "enterprises with foreign participation". In addition to national legislation applicable to foreign investments, Uzbekistan has also signed a number of bilateral investment treaties on reciprocal promotion and protection of investment (BITs)[20] which complement the national legislation aimed at protection and promotion of foreign investments. The content of these treaties is traditional. They contain the scope of definition of covered investment, admission and establishment, treatment of foreign investment (national treatment, most-favored-nation treatment, fair and equitable treatment, non-discrimination), compensation of damages to the investor in emergency events, prohibition of expropriation of the investment except for extraordinary cases, guarantee of transfer of funds,

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[17] „After declaring independence the Government adopted a gradual approach to its transition to market economy. UNDP, Investment *Guide to Uzbekistan*, 2007

[18] The main legislative acts concerning the rights and responsibilities of foreign investors consist of:

- Law of the Republic of Uzbekistan „On foreign investments" No. 609-I, 30. 04. 1998
- Law of the Republic of Uzbekistan „On investment activities" No. 719-I, 24. 12. 1998
- Law of the Republic of Uzbekistan „On guarantees and means of protection of foreign investors' righs No. 611-I, 30. 04. 1998
- Law of the Republic of Uzbekistan „On protection of investors' rights in equity market" No. 262-II, 30. 08. 2001

[19] Such are acquiring share in an existing company by participating in auction or tenders organised under the privatisation program, acquiring share in an existing company by direct negotiation with the owners of the shares (or by purchasing shares on the stock market), forming a joint venture with an Uzbek enterprise or individual, establishing a new, wholly owned comany etc. PriceWaterhouseCoopers; *Business and Investment Guide Uzbekistan 2007*

[20] By 1 January 2007, Uzbekistan has signed BITs with 48 States (including a BIT with the Czech Republic). UNDP, Investment *Guide to Uzbekistan*, 2007

and dispute settlement mechanism, both state-state and investor-state arbitration[21]. The body of Uzbek investment law therefore consists of both national and international legal norms.

2.2.2. Current Issues of Uzbek Investment Legislation

The biggest problem foreign investors faced in Uzbekistan during the early 1990s, was the legal uncertainty caused by high frequency of investment legislation's changes[22]. The first piece of investment legislation which was purported to change this situation was the above mentioned "Law on Foreign Investments and Guarantees of Foreign Investors Activity" passed in 1994(1994 FIL). The 1994 FIL introduced so called "grandfather clause" which gave the foreign investor the opportunity to opt out of any piece of legislation passed after the registration of its company in Uzbekistan which "impairs the conditions of investing."[23] The 1994 FIL guaranteed foreign investors protection from such changes for "a period of no more than ten years". The new investment law passed in 1998[24] (hereafter 1998 FIL) fixed the period of protection from these legislative changes at full ten years[25]. Despite these great sounding provisions, the real situation was somewhat different. The foreign investors were in reality not able to take advantage of this provision because the negative effect of any subsequent legislation was determined by the Uzbek authorities themselves[26].

According to the 1998 FIL the foreign investor has the right to freely transfer his hard currency income to and from Uzbekistan. The 1998 FIL then, however, adds that such right exists "pursuant to the legislation of the Republic of Uzbekistan" and therefore introduces an additional condition which is to be determined by following Uzbek legislation. This is in contrast with the right guaranteed by Uzbek investment laws to freely (and "without restriction whatsoever") to repatriate profits of foreign investors from Uzbekistan. The above mentioned provision thus grants (again[27]) the Uzbek authorities a great amount of discretion to restrict the freedom of profit repatriation basically at any time. International investors has

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[21] As far as dispute settlement mechanisms are concerned, i is important to note that Uzbekistan is a member of the International Center for the Settlement of Investment Disputes, as well as a signatory party to the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. UNDP, Investment *Guide to Uzbekistan*, 2007

[22] „A primary complaint of foreign investors was the legal uncertainty caused by the remarkable frequency with which the Uzbek government adopted new laws and repeals old ones." Newman, A., *Investing in Uzbekistan: A Rough Ride on the Silk Road*. 30 Law & Pol'y Int'l Bus. 1998-1999

[23] Article 11 of 1994 Foreign Investment Law

[24] „The Laws on Foreign Investment and On Guarantees and Measures for the Protection of Rights of Foreign Investors", adopted on 30 April 1998.

[25] Article 3 of 1998 FIL

[26] As can be implied from this fact, there has been a great scope of discretion on part of the authorities and their objectivity was unfortunately doubtful (comment of the author).

[27] See footnote 26

to realize and be aware of the fact that immediate transfer of hard currency capital is not going to be possible due to pertaining problem with hard currency conversion and that the conversion and transfer of hard currency profit out of the country is in reality not as simple and can last for several months[28] or even longer[29]. As can be implied from this fact and as was already mentioned above the conversion and following repatriation of profit can be very burdensome[30].

Conclusion

As can be implied from all of the above, the investment climate of Uzbekistan is far from being perfect. In spite of the current reality the government realizes its need to attract more foreign investors in order to start up the economy towards greater growth. At the same time Uzbekistan has quite a lot to offer to foreign investors as well. As was written already in the first part of this paper, the Republic of Uzbekistan is strategically located between Europe and Asia and has access to market of more than 142 million people. Uzbekistan has quite rich reserves of natural resources and also quite cheap but educated (and young[31]) labor force. All of these facts should make the country enough attractive for foreign investors. However, international investors are still coming very slowly especially due to the belief that investing in this country is still too dangerous. The first step the country has undertaken in order to change this perspective was to begin creating its national investment legislation and also concluding bilateral investment treaties[32]. The persisting problem, however, still lies in the frequency of legislative changes and the possibility of administrative interference in foreign investor's business. Any potential investor thus has to realize that establishing in Uzbekistan will not be easy and has to be ready to face the above mentioned problems with patience. However, if the investor will be able to do that, the reward for his patience may be very good.

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[28] According to information received from a country manager of an international company based in Tashkent, the conversion lasts six months.
[29] Information provided by the Ministry of Foreign Affairs of the Czech Republic. www.mzv.cr
[30] The Uzbek investment laws often employ disingenuous tactic of granting a right, then qualifying that right in such a way as to eviscerate it. Newman, A., *Investing in Uzbekistan: A Rough Ride on the Silk Road*. 30 Law & Pol'y Int'l Bus. 1998-1999
[31] "The labor force of Uzbekistan possesses a number of important characteristics; it is ample, literate, young and highly trainable according to the international requirements of the global office". UNDP, Investment *Guide to Uzbekistan*, 2007
[32] As of in January 2007, Uzbekistan has signed bilateral investment treaties on reciprocal protection and promotion of foreign investments with 48 countries. UNDP, Investment *Guide to Uzbekistan*, 2007

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