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## Balancing Regulations and Incentives for Foreign Direct Investment: a Case Study of Mexico and Kazakhstan

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BALANCING REGULATIONS AND INCENTIVES FOR FOREIGN DIRECT  
INVESTMENT: A CASE STUDY OF MEXICO AND KAZAKHSTAN

by

DAUREN B. TYNBYBEKOV

(Under the Direction of Professor Gabriel Wilner)

ABSTRACT

Foreign Direct Investment (FDI) has a global character. As globalization grows, foreign direct investment grows. This research analyses the relationship between foreign direct investment and developing countries. The main contributors to foreign direct investment are multinational corporations and this research will show the impact of this kind of investment on the economy of developing countries. The research will show the way the developing countries try to benefit from FDI in order to complement their economic growth. This thesis will analyze the incentives and regulations the developing countries use to attract FDI and what needs to be done to make this type of investment beneficial for developing world. The thesis concludes that countries can not rely only on FDI as a panacea for treating economic and social problems. The governments should regulate FDI accordingly to benefit the economy and people.

INDEX WORDS: Foreign direct investment, Foreign investment law, Foreign investors, International trade, International agreement, North American Free Trade Agreement, Sustainable development, Isolationist policy, Import substitution, Mexico, Kazakhstan, United States of America, Soviet Union, Soviet, Russia.

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by

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DEDICATION

To my wife, without whom this School of Law would be just a fantasy

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## I. INTRODUCTION

To write about foreign direct investment, it is necessary to mention the global character of this process: “As globalization continues, foreign direct investment, including investment in developing economies, continues to grow each year.”<sup>1</sup> In this research, we will pay attention to FDI and developing countries. For the developing countries, FDI may play an important role since FDI is a potential engine for development, “as the foreigner employs and trains local personnel, indirectly encourages secondary service providers and producers of goods, pays taxes, and-in some case-leaves behind valuable know-how.”<sup>2</sup> The flow of FDI to developing countries continues to grow year after year.<sup>3</sup> In the second half of 1990s FDI flow increased from Western Europe and the United States to developing countries “peaking at US \$ 1.3 trillion in 2001.”<sup>4</sup>

The main contributors to FDI are multinational enterprises (MNEs). It is now widely recognized that the multinational enterprise can play an important role in the industrialization of different countries.<sup>5</sup> Generally, the MNEs contribute toward the industrialization of a country through foreign direct investment.<sup>6</sup> In this research, we will explore why the developing countries are so interested in FDI and prefer this type of

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1 NOAH RUBINS & N. STEPHAN KINSELLA, INTERNATIONAL INVESTMENT, POLITICAL RISK AND DISPUTE RESOLUTION, XXIII (2005).

<sup>2</sup> *Id.* at XXVIII.

<sup>3</sup> *Id.* at XXXI.

<sup>4</sup> *Id.* at XXXI.

<sup>5</sup> Kojo Yelapaala, *In Search of Effective Policies for Foreign Direct Investment: Alternatives to Tax Incentive Policies*, 7 NW. J. INT'L L. & BUS. 208, 209 (1985).

<sup>6</sup> *Id.*

investment to the usual financial loans from international institutions, which also allow a country to develop its economy. Probably one of the answers would look like this: “The sharp decrease in net commercial bank loans to developing countries in the 80’s, from a peak of \$44.4 billion in 1981 to a low of negative \$4.1 billion in 1990, brought about renewed interest in other sources of private investment capital, including foreign direct investment.”<sup>7</sup>

For a discussion of this thesis, it is important to establish the meaning of FDI. The shortest definition is: “Foreign Direct Investment – overseas investment by multinational enterprises.”<sup>8</sup> This does not, however, explain how MNEs make this investment. Is it just a financial investment given to a country by a private party under certain conditions? Who is the beneficiary of this investment? Is there a government that receives a loan or a private party that manages to look attractive to foreign investors and at the same time trustworthy enough to get an investment? A more detailed explanation would look like this:

Foreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one economy (“direct investor”) in an entity resident in an economy other than that of the investor (“direct investment enterprise”). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.<sup>9</sup>

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<sup>7</sup> IBRAHIM F.I. SHIHATA, *LEGAL TREATMENT OF FOREIGN INVESTMENT*, 1 (1993)

<sup>8</sup> Glossary available at <http://www.bized.ac.uk/virtual/dc/resource/glos3.htm> (last visited on February 22nd, 2006)

<sup>9</sup> OECD BENCHMARK DEFINITION OF FOREIGN DIRECT INVESTMENT, THIRD EDITION, 3 (1996)

An investor may be “an individual, or incorporated public or private enterprise, a government, or a group of related individuals.”<sup>10</sup>

During the Earth Summit<sup>11</sup> in 1992, it was estimated that between 1993 and 2000 the developing world would need \$600 billion annually to achieve sustainable development and it was asserted that governments alone would not be able to meet that goal.<sup>12</sup> In this situation, “FDI can indeed play a role in the economic growth of debt-burdened Third World nations.”<sup>13</sup>

This research will demonstrate the impact of FDI on different countries, but the main focus will be on Mexico and the Republic of Kazakhstan, including analysis of the domestic policy of both countries towards foreign direct investment.

Mexico and Kazakhstan were chosen due to the relative similarity of their legal systems; both countries are civil law countries. Also Mexico and Kazakhstan have similar attitudes toward foreign influence which similarly affected the history of their economic development. The Republic of Kazakhstan was a part of the USSR and thus was closed to direct contacts with other countries, which in part explains the plethora of laws, decrees and regulations concerning foreign investments and adopted during the short history of modern Kazakhstan. The history of economic development in Mexico and other countries in Central and South America reflects those countries’ feeling of distrust towards their powerful northern neighbor: “The 1960s and 1970s were periods during which foreign

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<sup>10</sup> *Id.*

<sup>11</sup> The Earth Summit was an International conference held in Rio de Janeiro in 1992 to discuss issues concerning climate change, world poverty, environment and development, the worlds forest and biodiversity.

<sup>12</sup> Sophie Hsia, *Foreign Direct Investment and the Environment: Are Voluntary Codes of Conduct and Self-Imposed Standards Enough?* 9 ENVTL. LAW. 673, 675 (2003).

<sup>13</sup> CYNTHIA DAY WALLACE AND CONTRIBUTORS, *FOREIGN DIRECT INVESTMENT IN 1990s*, ix (1990).

investment and multinational corporations were considered threats to national sovereignty and economic development.”<sup>14</sup> Kazakhstan has a very long border with the Russian Federation,<sup>15</sup> which explains active interaction between the two countries in all possible fields including politics, economics and culture. Thus, the research about Mexico’s economic relationship with the United States would be a relevant example in terms of economic interactions between the developing and developed worlds.

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<sup>14</sup> *Id.* at 2.

<sup>15</sup> The length of the Kazakh-Russian border is approximately seven thousand kilometers, *available at* <http://www.eurasianet.org/resource/kazakhstan/hypermail/200409/0021.shtml> (last visited on March 3, 2006).

## II. MEXICO AND FOREIGN DIRECT INVESTMENT

### Historical Overview of FDI in Mexico

Mexico provides a useful basis for a case study of FDI because "Mexico has an economic and institutional history similar to that of many developing countries, particularly those of Latin America."<sup>16</sup> The legal system in Mexico is "based on Spanish civil law with some influence of the common law tradition."<sup>17</sup> To evaluate Mexico's attitude to foreign direct investment, it is necessary to be familiar with the Mexican history of economic development and especially with the history of foreign direct investment.<sup>18</sup> Foreign direct investment in Mexico has a long history and its prominent start was induced by the time General Porfirio Diaz<sup>19</sup> "seized power in 1876, and the Mexican government committed itself to aggressively wooing foreign investments."<sup>20</sup> FDI was needed for building infrastructure, especially railroads. Using foreign capital, about 24,000 kilometers of railroads were constructed by 1911.<sup>21</sup> This spurred "the further development of export economies in Mexico's agricultural and mining areas, the

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<sup>16</sup> SARAH BABB, *MANAGING MEXICO: ECONOMISTS FROM NATIONALISM TO NEOLIBERALISM* 12 (2001).

<sup>17</sup> TIM L. MERRILL & RAMON MIRO: *MEXICO: A COUNTRY STUDY* 244 (1997).

<sup>18</sup> Gloria Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 *VAND. J. TRANSNAT'L L.* 259, 282 (1994).

<sup>19</sup> Porfirio Diaz was president of Mexico two times: in 1876-80 and 1884-1911, *available at* [http://www.mexconnect.com/mex\\_/history/presidents.html](http://www.mexconnect.com/mex_/history/presidents.html) (visited on April 7th, 2006).

<sup>20</sup> JURGEN BUCHENAU, *MEXICO OTHERWISE, MODERN MEXICO IN THE EYES OF FOREIGN OBSERVERS*, 91 (2005).

<sup>21</sup> JAMES D. RUDOLPH: *MEXICO: A COUNTRY STUDY* 165 (1985).

modernization of the cities, and the emergence of a sizeable urban middle class.”<sup>22</sup> At the time, foreign investment was “attracted to Mexico by its potential resources and by the political stability of the Porfirian peace.”<sup>23</sup> The policy of attracting foreign investment influenced the development of foreign trade. In 1872 when Porfirio Diaz came to power the amount of imports and exports were \$20 million and \$29 million respectively, but by the end of his presidency these figures had increased tenfold to \$205 million in imports and \$293 million in exports.<sup>24</sup> Trade with the United States “stands out as a dominant factor, especially with the construction of railroad connection between two countries.”<sup>25</sup> Most of Mexican history is connected with its powerful northern neighbor and this is probably one of the reasons Mexico continuously stresses the importance of national independence and sovereignty. The importance of protecting its sovereignty is entrenched in the Mexican Constitution where the following sectors of activities are under government control: “Petroleum and all hydrocarbons, basic petrochemicals, electricity, nuclear energy and radioactive materials, telegraph and radio telegraph services, satellite communication, railroads, mail service, money issue and coinage.”<sup>26</sup>

Throughout its economic history, Mexico has implemented different development policies but they have all emphasized national sovereignty. “Mexican economics encompassed a broad spectrum of tendencies, from Marxist to populist to

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<sup>22</sup> BUCHENAU, *supra* note 20, at 91.

<sup>23</sup> RUDOLPH, *supra* note 21, at 165.

<sup>24</sup> HUBERT C. HERRING & KATHARINE TERRILL, *THE GENIUS OF MEXICO, LECTURES DELIVERED BEFORE THE FIFTH SEMINAR IN MEXICO, 1930*, 171 (1931).

<sup>25</sup> *Id.* at 171.

<sup>26</sup> SEYMOUR J. RUBIN & DEAN C. ALEXANDER: *NAFTA AND INVESTMENT* 6 (1995).

developmentalist – but was always and everywhere a fundamentally nationalist and statist discipline."<sup>27</sup>

Since foreign direct investment is an “investment made by a foreign individual or company in the productive capacity of another country,”<sup>28</sup> manufacturing and production have an important place in the economic development of a country. The disadvantage for Mexico lies in its dearth of coal, iron, and large waterfalls.<sup>29</sup> Manufacturing large quantities of goods for export was a remote idea in the first half of the twentieth century.<sup>30</sup> Such an opinion was buttressed by American and Mexican scholars.<sup>31</sup> But by 1994, twenty eight percent of the Mexico GDP (gross domestic product) derived from mining, manufacturing, and construction; “most industrial goods were produced, including automobiles, consumer goods, steel and petrochemicals.”<sup>32</sup>

By 1911, Porfirio Diaz’s tenure as president was coming to an end.<sup>33</sup> At this time, growing concerns about Mexican sovereignty arose and, as a result, the growing nationalistic trends in Mexico’s relationship with the foreign investors became more significant as “the economic penetration of Mexico by foreign enterprises triggered a growing fear of increasing foreign influence.”<sup>34</sup> During the Diaz presidency, Mexico modernized and became integrated into the world market but vital parts of its economy

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<sup>27</sup> BUBB, *supra* note 16, at 12.

<sup>28</sup> One of the definitions of foreign direct investment *available at* [http://www.jubileeaustralia.org/512\\_jubilee\\_debt\\_jargon.php](http://www.jubileeaustralia.org/512_jubilee_debt_jargon.php) (last visited on April 6th, 2006).

<sup>29</sup> HERRING & TERRILL, *supra* note 20, at 170.

<sup>30</sup> *Id.*, at 171.

<sup>31</sup> *Id.*, at 170.

<sup>32</sup> MERRIL & MIRO, *supra* note 17, at XXVI.

<sup>33</sup> Porfirio Diaz was president of Mexico two times: in 1876-80 and 1884-1911, *available at* [http://www.mexconnect.com/mex\\_/history/presidents.html](http://www.mexconnect.com/mex_/history/presidents.html) (visited on April 7th, 2006).

<sup>34</sup> Sandrino, *supra* note 18, at 283.



were under foreign control and thus the role of the Mexican government was limited to managing economic development.<sup>35</sup>

The Mexican revolution of 1910 was the event which reversed the political current of excessive foreign control over the economy. The constitution which followed embodied its revolutionary principles “including sovereignty and independence from foreign, economic, and political control.”<sup>36</sup>

In Article 27 of the Mexican Constitution, ownership rights to “land, waters and their appurtenances” belong to Mexicans by “birth or naturalization.”<sup>37</sup> In the same article, it is stipulated that foreigners can get the same right if they agree to be regarded as Mexican citizens, thus to become subjects under Mexican law, and not to invoke the protection of their governments.<sup>38</sup> A very important part of the new constitution became Article 123, which regulated relationships between employers and employees and which had very socialist overtones.<sup>39</sup>

The impact of revolution initially was very negative, because the economy was disrupted and many of the gains achieved during the Porfiriato were destroyed.<sup>40</sup>

In the first decade of the revolutionary era a national state barely existed in Mexico.<sup>41</sup>

The Great Depression of 1929<sup>42</sup> also negatively influenced the state’s welfare, bringing a “sharp drop in national income and internal demand after 1929” and challenging the

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<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> THE MEXICAN CONSTITUTION OF 1917 COMPARED WITH THE CONSTITUTION OF 1857 18 (H.N. BRANCH, TRANS. AND ARRANGED, 1917).

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 94 (Article 123 lists a wide variety of limitations on child labor and female labor, limitations on working hours and days. It also stipulates conditions for minimum wages, etc.)

<sup>40</sup> HERRING & TERRILL, *supra* note 24, at 145.

<sup>41</sup> RAYMOND VERNON, THE DILEMMA OF MEXICO’S DEVELOPMENT. THE ROLES OF THE PRIVATE AND PUBLIC SECTORS. 59 (1963).

country's ability to fulfill its constitutional mandate of social equity.<sup>43</sup> Nevertheless, the Great Depression did not hit the Mexican economy as hard as other countries and in the early 1930s a slow recovery started in manufacturing and other sectors.<sup>44</sup>

The nationalistic approach to protection of its economic independence continued in Mexico until the 1980s. "For more than sixty years, the interventionist, nationalist Mexican state, created by the Mexican Constitution, contributed significantly to the regulation of foreign direct investment."<sup>45</sup> During those times "this so-called nationalistic period, foreign direct investment provided the most direct challenge for the state policy."<sup>46</sup>

In the 1930s, the main effect of the structural reforms was to further the process of nationalization. Nationalization involved such strategic sectors as the railroads and oil industries, and accelerated land reform.<sup>47</sup> One of the most important industries in Mexico was and is the oil industry. "Each Mexican administration, in succession, tried to capture a share of the profits which oil exports were generating."<sup>48</sup> The battle for oil continued until 1938, when Lazaro Cardenas, president of Mexico from 1934 to 1940, nationalized the oil industry by expropriating assets of American and British oil companies.<sup>49</sup> A strong tradition of viewing FDI with hostility is a ubiquitous feature in Latin America "with

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<sup>42</sup> The Great Depression of 1929 which took place in the United States of America.

<sup>43</sup> *Id.* at 146.

<sup>44</sup> *Id.*

<sup>45</sup> Sandrino, *supra* note 18, at 281.

<sup>46</sup> *Id.*

<sup>47</sup> MERRIL & MIRO, *supra* note 17, at 146.

<sup>48</sup> VERNON, *supra* note 41, at 77.

<sup>49</sup> Jim Tuck, Mr. Clean, *The Phenomenon of Lazaro Cardenas 1990*, available at <http://www.mexconnect.com/mex/history/jtuck/jtlcardenas.html> (last visited on April 9th, 2006).

Mexico being a prime example.”<sup>50</sup> This tradition may be interpreted as “the imposition of strong foreigners on the local economy.”<sup>51</sup> Following mass nationalization in the 1930s, Mexico introduced a policy of import substitution in the 1940s.<sup>52</sup> During World War II, Mexico sold oil to the United States and Great Britain.<sup>53</sup> After World War II, President Valdez launched a full scale import-substitution program by raising import controls on consumer goods but relaxed them on capital goods, using international reserves accumulated during the war.<sup>54</sup> The Mexican government took measures (*e.g.*, undervaluing the peso) in order to reduce the prices of imported capital goods and increase productive capacity.<sup>55</sup> This policy of import substitution and developing its own industry and infrastructure reflected the general policy elaborated by the United Nations Economic Commission for Latin America (ECLA)].<sup>56</sup> The idea was based on denying classical economic theory about “comparative advantage” according to which rich and poor countries could specialize in different kinds of export and thus equally benefit from free international trade.<sup>57</sup> Instead ECLA proclaimed that developing countries “[n]eeded at all costs to industrialize through active government policies aimed at protecting “infant industries” from foreign competition and protecting salaries to maintain demand for domestically produced industrial products.”<sup>58</sup>

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<sup>50</sup> MICHAEL J. TWOMEY, A CENTURY OF FOREIGN DIRECT INVESTMENT IN MEXICO 4 (2001), <http://www-personal.umd.umich.edu/~mtwomey/fdi/MexInv.pdf> (last visited on April 9, 2006).

<sup>51</sup> *Id.*

<sup>52</sup> MERRIL & MIRO, *supra* note 17, at 146.

<sup>53</sup> Jim Tuck, Mr. Clean: THE PHENOMENON OF LAZARO CARDENAS 1990, *available at* <http://www.mexconnect.com/mex/history/jtuck/jtlcardenas.html> (last visited on April 9th, 2006).

<sup>54</sup> MERRIL & MIRO, *supra* note 17, at 147.

<sup>55</sup> *Id.*

<sup>56</sup> BABB, *supra* note 16, at 7.

<sup>57</sup> *Id.*

<sup>58</sup> *Id.*

## Mexican Economic Miracle and Isolationism

In Mexico, the years 1940-1970 were the years of economic growth and of social and political stability referred to as the period of the “Mexican economic miracle.”<sup>59</sup> During this period in Mexico industrial activity grew an average of 7.2% a year, and many of the country’s important businesses in the production of consumer goods were established.<sup>60</sup> As for foreign direct investment, the Great Depression slowed “the flow of foreign direct investment to a trickle,”<sup>61</sup> and this type of foreign investment was not of great importance in Mexico’s “tightly regulated, isolationist economy.”<sup>62</sup> In the 1950s, foreign direct investment in Mexico was only a small fraction of the GDP: 0.17.<sup>63</sup>

FDI as we know it now, appeared in the second half of the twentieth century; “its dominant mode-expansion by a firm which developed technology and productive capacity in its home country, to other sites via subsidiaries and branch plants had been nearly unknown before World War I in Mexico or anywhere else.”<sup>64</sup> Most of the foreign loans in Mexico were used by foreigners who operated the railroads, public utilities, and

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<sup>59</sup> EMMANUEL RAUFFLE, THE BRIEF ACCOUNT OF MEXICO’S EXPERIENCE WITH INTERNATIONAL BUSINESSES 3 (2004), <http://zonecours.hec.ca/documents/H2005-P6-359694.ERauffletMexicoIntro.doc> (last visited on April 15, 2006).

<sup>60</sup> *Id.*

<sup>61</sup> BABB, *supra* note 16, at 7.

<sup>62</sup> Michael W. Goldman et al, *An Introduction to Direct Investment in Mexico*, 5 IND. INT’L & COMP. L. REV. 101, 101 (1994).

<sup>63</sup> STEPHEN HABER, DEVELOPMENT STRATEGY OR ENDOGENOUS PROCESS? THE INDUSTRIALIZATION OF LATIN AMERICA, 46 (2005).  
[http://www.stanford.edu/~haber/papers/Development\\_Strategy\\_or\\_Endogenous\\_%20Process-The\\_Industrialization\\_of\\_Latin\\_America.pdf](http://www.stanford.edu/~haber/papers/Development_Strategy_or_Endogenous_%20Process-The_Industrialization_of_Latin_America.pdf) (last visited on April 15, 2006).

<sup>64</sup> MICHAEL J. TWONEY, A CENTURY OF FOREIGN DIRECT INVESTMENT IN MEXICO 14 (2001), <http://www-personal.umd.umich.edu/~mtwomey/fdi/MexInv.pdf> (last visited on April 16th, 2006).

other free-standing companies. Lending of foreign capital to Mexican entrepreneurs was minimal.<sup>65</sup>

By the 1970s import substitution started to slow down, exhibiting the symptoms of chronic unemployment, chronic inflation, currency overvaluations and balance of payments problems.<sup>66</sup> The situation was complicated by the so-called “rebirth” of global finance when it became possible for Latin American countries (including Mexico) to borrow from private foreign sources at variable interest rates to address “long-standing economic and social problems.”<sup>67</sup> Due to the “anti-inflationary policy in the United States, global interest rates began to rise, heavily indebting governments, and in 1982 Mexico, had the honor of inaugurating the Third World debt crisis when the Mexican finance minister declared that Mexico would be unable to continue servicing its external debt.”<sup>68</sup>

The policy of import substitution in Mexico still necessarily involved foreign investment in the industrial sector. “Mexico’s adoption of a nationalistic import-substitution economic policy made it reliant on the United States for industrial technology.”<sup>69</sup> The period of the economic miracle did not however affect the whole country; some regions suffered from high unemployment. Therefore, in 1965, the government of Mexico introduced the Border Industrialization Program which involved the creation of the Maquiladora Sector—a program to encourage the production of articles

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<sup>65</sup> *Id.*

<sup>66</sup> BABB, *supra* note 16, at 9.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> Melissa R. H. Hall, *Foreigners Funding the Future: Investment Opportunities in Mexico’s Privatized Pension System*, 34 TEX. INT’L L.J. 151, 154 (1999).

with foreign source components for export.<sup>70</sup> This program was originally designed to “promote industrialization in the border region, to create sources of employment and to attract new technology in the hope that it could be integrated into Mexico’s industrial base.”<sup>71</sup> Maquiladora plants were fully foreign-owned corporations where Mexico “relied on the foreign direct investment that arises from the operations of the Maquiladora industry to provide the economy with employment opportunities, technology and diversity.”<sup>72</sup> The Maquiladora program was introduced after the United States prohibited Mexican seasonal workers from performing farm work in the United States (1964 cancellation of Bracero Program).<sup>73</sup> Article 123 of the Mexican Constitution stipulates that the minimum wage of an employee must be “sufficient to satisfy the normal material, social and cultural needs of heads of a family and provide for the compulsory education of his children.”<sup>74</sup> American company owners of the factories in the Maquiladora sector do not pay the sufficient minimum wage. The average hourly wage “roughly calculates to about \$4.46 for harder, and sometimes, life-threatening work that does not provide a Mexican family with enough food to keep from starving.”<sup>75</sup> Already, through the example of the Maquiladora program, it was evident that the Mexican policy of import substitution did not completely exclude foreign investments. One commentator

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<sup>70</sup> RUBIN, ALEXANDER, *supra* note 26, at 38.

<sup>71</sup> *Id.*

<sup>72</sup> Jenna L. Acuff, *The Race to the Bottom: The United States’ Influence on Mexican Labor Law Enforcement*, 5 SAN DIEGO INT’L L.J. 387, 404 (2004).

<sup>73</sup> *Id.* at 392.

<sup>74</sup> *Id.* at 405.

<sup>75</sup> *Id.*

suggests that “the Mexican government has the philosophy that any job is better than no job, even a low-paying one.”<sup>76</sup>

### **1973 Foreign Investment Law**

Until 1973, Mexico had no single investment code on foreign investments and rules on this activity “were characterized by an emphasis on increasing exports and protecting existing national industries from domestic competition by foreign investors.”<sup>77</sup> In addition, the rules on foreign investments were represented by the various decrees “issued by the executive branch on a case-by-case basis.”<sup>78</sup> Throughout the era of the Mexican economic miracle, the Mexican government was flexible and its attitude towards foreign investors was “one of cautious acceptance.”<sup>79</sup> Mexico, as any country, was longing for foreign direct investments, and, as any county, was facing the problem “of gain[ing] just that amount and kind of foreign investment (and technology) that is desired to complement and support their development objectives while not losing the benefits through competitive incentives by permitting them to flow out of the country.”<sup>80</sup> Before the 1973 Foreign Investment Law (1973 FIL),<sup>81</sup> foreign investments were controlled by the Emergency Decree of 1944 whose purpose was to “avert disruption of

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<sup>76</sup> *Id.*

<sup>77</sup> RUBIN & ALEXANDER, *supra* note 26, at 87.

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> JACK N. BEHRMAN, DECISION CRITERIA FOR FOREIGN DIRECT INVESTMENT IN LATIN AMERICA, XI (1974).

<sup>81</sup> The Emergency Decree of 1944 issued by the Mexican President granted control over foreign investment to the Secretariat of Foreign Affairs.

the economy caused by the investments of temporary foreign capital.”<sup>82</sup> The official name of the 1973 FIL was: 1973 *Ley Para Promover la Inversion Mexicana y Regular la Inversion Extranjera* [Law for Promoting Mexican Investment and Regulating Foreign Investment] which indicates its purpose to regulate foreign investment while promoting Mexican investment.<sup>83</sup> Introducing the 1973 FIL, the government officially acknowledged that: 1) import replacement policies alone were not sufficient to solve its serious economic problems, 2) Mexican manufacturers needed to produce export-oriented products and capital goods and 3) Mexico needed foreign assistance to improve technology, stimulate investment in new industries, and manufacture goods for export.<sup>84</sup> As the first legislation regulating foreign investment, it looked restrictive to many foreign entrepreneurs. The general comment was that “this law was too anti-foreign investor and the international business community did not react positively.”<sup>85</sup> One of the main obstacles in the 1973 FIL was Article 5, which limited foreign ownership in Mexican corporations to forty-nine percent.<sup>86</sup> A significant exception to this limitation exists in relation to Maquiladora industries which may be 100% foreign-owned.<sup>87</sup> But even with these restrictions, the United States and other countries were ready to invest in Mexico’s economy. The “country’s sustained growth during the preceding three decades, the discovery of huge petroleum reserves and a relatively stable political climate made

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<sup>82</sup> RUBIN & ALEXANDER, *supra* note 26, at 87.

<sup>83</sup> Hall, *supra* note 69, at 154.

<sup>84</sup> Goldman et al., *supra* note 62, at 101, 107.

<sup>85</sup> RUBIN & ALEXANDER, *supra* note 26, at 88.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*, at 7.



Mexico an attractive location for direct investment.”<sup>88</sup> Most investment was in infrastructure and technology.<sup>89</sup> The 1973 FIL repeated the conditions stipulated in the Mexican Constitution with respect to activities reserved to the Mexican government and domestic investors such as petroleum, exploitation of radioactive minerals, electricity, railroad, and telegraphic and wireless communications.<sup>90</sup> The key body for administering investment law was the National Foreign Investment Commission (NFIC)], which was established by the Mexican Congress. NFIC possessed “broad discretionary power over whether and to what extent to allow foreign investment.”<sup>91</sup> This discretionary power included establishing rules and guidelines and adjudicating issues raised under the 1973 FIL, specifically the authority to increase or decrease the percentage of foreign investment in different geographical or economic zones, permit higher levels of foreign ownership in “exceptional circumstances and also establish criteria and requirements concerning foreign investment.”<sup>92</sup> The conditions placed on increasing the share of foreign ownership are listed in Article 13 of 1973 FIL: 1) complementing national investment strategies, such as increasing exports; 2) providing new employment opportunities for Mexican workers; 3) contributing to the development of economically less developed regions; 4) respecting the country’s social and cultural values; and 5) assisting in the country’s technological research and development.<sup>93</sup> These characteristics would justify the country’s efforts to “encourage long-term sustainable growth” targeted

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<sup>88</sup> Hall, *Supra* note 69, at 154 quoting Carlos M. Nalda, Note, NAFTA, *Foreign Investment, and the Mexican Banking System*, 26 GEO. WASH. J. INT’L L. & ECON. 379, 386 n. 50 (1992).

<sup>89</sup> *Id.*

<sup>90</sup> RUBIN & ALEXANDER, *supra* note 26, at 88.

<sup>91</sup> Goldman, et al., *supra* note 62, at 108.

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

by country-hosting foreign investments.<sup>94</sup> Another basic condition stipulated in the 1973 FIL was also regarded by foreign entrepreneurs as a hindrance to doing business in this country, The “Calvo Clause” which mandates that foreigners doing business in Mexico waive their foreign status (diplomatic protection) while defending themselves in Mexican courts.<sup>95</sup> As mentioned above, the 1973 FIL did little to discourage foreign direct investment in Mexico during the 1970s. The Mexican government and its agencies “still enjoyed too much discretion to expand or limit the possible areas of investment.”<sup>96</sup>

Why do foreign direct investments continue to enter into Mexico? Legal considerations play a large role in the decision to create FDI, but “legal concerns are not themselves the driving force in the initial calculations.”<sup>97</sup> In the case of Mexico, “other factors play a greater role, such as the importance of access to raw materials, the size and scope of the foreign market, or the geographical position of the target country in relation to other important markets.”<sup>98</sup> In 1976, Mexico’s financial situation (capital flight, inflation, external account imbalances) “demanded more than domestic policy changes.”<sup>99</sup> The Central bank of Mexico had to devalue the peso and President Echeverria’s administration asked the International Monetary Fund (IMF) for help and the resulting Mexico-IMF agreement “obligated Mexico to change a number of its economic policies as a condition to lending,”<sup>100</sup> and “[s]imply put, multilateral and U.S.

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<sup>94</sup> SHIHATA, *supra* note 7, at 20.

<sup>95</sup> Denise Manning-Gabrol, *the Imminent Death of the Calvo Clause and the Rebirth of the Calvo Principle: Equality of Foreign and National Investors*, 26 LAW & POL’Y INT’L BUS. 1169, 1183 (1995).

<sup>96</sup> Sandrino, *supra* note 18, at 298.

<sup>97</sup> Tamara Lothian & Katharina Pistor, *Local Institutions, Foreign Investment and Alternative Strategies of Developments: Some Views from Practice*, 42 COLUM. J. TRANSNAT’L L. 101, 109 (2003).

<sup>98</sup> *Id.*

<sup>99</sup> Sandrino, *supra* note 18, at 298.

<sup>100</sup> *Id.*

government agencies, such as the World Bank, IMF and U.S. Treasury, were committed to using debt relief as a lever to win market-oriented policy reforms from the governments of developing countries.”<sup>101</sup> The agreement with the IMF lasted only three years.<sup>102</sup> Massive oil discoveries in the late 1970s caused a short “rebirth” of nationalistic policy focusing on a domestic agenda which resulted in heavy borrowings from international financial firms based on future oil projections.<sup>103</sup>

### **1993 Foreign Investment Law and North American Free Trade Agreement**

#### **(NAFTA)**

In 1981, due to a sharp fall in oil prices, Mexico entered a period of deep economic crisis.<sup>104</sup> This time was regarded by the government as an optimal time for economic reform.<sup>105</sup> President Miguel De La Madrid Hurtado<sup>106</sup> started the structural reform with the purpose of redirecting the economy from its “traditional state-led development and trade protectionist strategy.”<sup>107</sup> One of the most important steps was to open the domestic market to foreign competition and a crucial step towards this goal was taken in 1986 when Mexico became a full member of General Agreement on Trade and Tariffs (GATT),<sup>108</sup> “which initiated a gradual elimination of some restrictions to foreign

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<sup>101</sup> BABB, *supra* note 16, at 10.

<sup>102</sup> Sandrino, *supra* note 18, at 299.

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> Juan Carlos Moreno-Brid et al, *Nafta and the Mexican Economy: a Look Back on a Ten-Year Relationship*, 30 N.C. J. INT’L L & COM. REG. 997, 1001.

<sup>106</sup> Miguel de la Madrid Hurtado was the President of Mexico in 1982-88.

<sup>107</sup> *Id.*

<sup>108</sup> An agreement negotiated in 1947 among 23 countries, including US, to increase international trade by reducing tariffs and other trade barriers, definition *available at*

investment, particularly in capital and technology intensive industries.”<sup>109</sup> Before entering GATT, initial restructuring took place. In 1984 the Mexican government cancelled the 49% ceiling on certain priority sectors. Then in 1985 the Mexican government allowed foreign investors currently holding majority ownership interests in Mexican business enterprises to raise their ownership interests to 100%.<sup>110</sup> These measures were followed by renegotiation with the IMF and other commercial institutions.<sup>111</sup> These and other measures, together with membership in GATT, promoted confidence on the part of investors.<sup>112</sup>

In 1989, then President Carlos Salinas de Gortari,<sup>113</sup> issued new 1989 Regulations on the 1973 FIL (1989 Regulations).<sup>114</sup> The official name of the document was: “*Reglamento de la Ley para Promover da Inversion Mexicana y Regular la Inversion Extranjera* (Regulations of the Law to Promote Mexican Investment and Regulate Foreign Investment).”<sup>115</sup> The Mexican Constitution gives the President the power to enact regulations but the scope of regulation is necessarily limited to the underlying law.<sup>116</sup> A regulation contradicting the law could be described as unconstitutional by the Mexican Supreme Court of Justice.<sup>117</sup> The purpose of the 1989 Regulations was to help open Mexico to foreign investment, but at the same time they had the potential to cause legal

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[http://www.google.com/search?hl=en&lr=&defl=en&q=define:GATT&sa=X&oi=glossary\\_definition&ct=title](http://www.google.com/search?hl=en&lr=&defl=en&q=define:GATT&sa=X&oi=glossary_definition&ct=title) (last visited on August 5, 2006).

<sup>109</sup> *Id.* at 1002.

<sup>110</sup> Goldman, et al. *supra* note 62, at 109.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* at 110.

<sup>113</sup> Carlos Salinas de Gortari was President of Mexico in 1988-94.

<sup>114</sup> See J. Hayden Kepner, Jr., *Mexico's New Foreign Investment Regulations: a Legal Analysis*, 18 SYRACUSE J. INT'L L. & COM. 41 (1992).

<sup>115</sup> RUBIN & ALEXANDER, *supra* note 26, at 89.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

problems, since these regulations were “vague and confusing in many areas, and the Mexican government exercises great discretion in interpreting many of its provisions.”<sup>118</sup> Moreover, the 1989 Regulations as they are written appear to violate certain provisions of Mexico’s Constitution.”<sup>119</sup> One clear contradiction between the 1973 FIL and 1989 Regulations is the reduction of Foreign Investment Commission role on deciding ownership percentage by foreign investors. “The new regulations severely diminish the NFIC’s authority in many areas and permit 100% foreign ownership in most industries without requiring any NFIC authorization.”<sup>120</sup> The regulations also cut numerous criteria (from 17 to 5) for consideration whether to permit a particular foreign investment in a restricted area.<sup>121</sup>

Did a potential foreign investor have to worry about the dubious character of new regulations? Taking into consideration at least two factors, there do not appear to be serious reasons for such concerns. First issuing the Regulations was the responsibility of the president, and the presidency in Mexico is the paramount institution, which critics labeled as the “six-year monarchy” due to “seemingly unchecked power that historically resided in the office.”<sup>122</sup> And second, because of the Amparo – a unique Mexican procedure for challenging the constitutionality of a law or an administrative action by an individual through petition to the appropriate tribunal (that is, only Mexican federal courts, including the Supreme Court).<sup>123</sup> A competitor, who suffered due to a

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<sup>118</sup> Kepner, *supra* note 114, at 42.

<sup>119</sup> *Id.*

<sup>120</sup> *Id.*, at 59.

<sup>121</sup> *Id.*

<sup>122</sup> MERRILL & MIRO, *supra* note 17, at 238.

<sup>123</sup> Kepner, *supra* note 114, at 61.

foreign investor, may invoke the Amparo procedure, but even if he wins the case and is granted an injunction, there will not be a “blanket” injunction against further government acts, since there is no stare decisis in the Mexican federal courts.<sup>124</sup> As for the Calvo Clause mentioned earlier, in 1992, Mexican legislators, in order to support foreign investment, enacted The Execution of Treaties Law, a very important addition to Mexican Legal System.<sup>125</sup> The importance of this law lies in the ability of the Mexican government to make international treaties and agreements attracting international dispute settlement mechanisms, since today’s international investors prefer to solve contractual disputes with the help of international commercial arbitration, forum of law and choice of law clauses.<sup>126</sup> It would be also relevant to mention that Mexico is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also referred to as the New York Convention, and to the Inter-American Convention on International Commercial Arbitration, which is also called the Panama Convention.<sup>127</sup> Both conventions give foreign investors confidence to use a legal basis for “enforcement of any arbitral agreement.”<sup>128</sup> As a member of these treaties, Mexico agreed to “permit its citizens and its businesses to agree to have disputes resolved in accordance with international norms rather than those established by its own government.”<sup>129</sup>

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<sup>124</sup> *Id.* at 62.

<sup>125</sup> RUBIN, ALEXANDER, *supra* note 26, at 90.

<sup>126</sup> *Id.*, at 91.

<sup>127</sup> Hope H. Camp, Jr., *Binding Arbitration: a Preferred Alternative for Resolving Commercial Disputes Between Mexican and U.S. Businessman*, 22 ST. MARY’S L.J. 717, 722 (1991).

<sup>128</sup> *Id.* at 723.

<sup>129</sup> *Id.* at 724.

Pursuing the policy of accelerating foreign investment in Mexico, President Salinas started talks with President George H. W. Bush about a free trade and investment agreement.<sup>130</sup> With this new agreement the United States planned to “remove existing barriers” for foreign investors, and in order to reach this objective it was necessary to replace the existing law to promote Mexican investment and to regulate foreign investment with a new law.<sup>131</sup> On December 28, 1993 Mexico adopted the new 1993 Foreign Investment Law (1993 FIL).<sup>132</sup>

The task of the new law was “to formulate the rules to channel foreign investment into the Nation and to ensure that said investment contributes to the national development.”<sup>133</sup> The new law codified many of the 1989 Regulations to answer the requirements stipulated by the NAFTA.<sup>134</sup>

The 1993 FIL had new provisions that were contrary to the 1973 FIL such as cancellation of the rule 49/51 that gave foreign investors minority ownership in the capital stock of Mexican companies. Now foreign investors can control up to 100% of the capital stock of a Mexican enterprise, though with specific limitations depending on certain industrial areas.<sup>135</sup> Other provisions contrary to the 1973 FIL include the elimination of most performance requirements, which earlier gave power to NFIC to authorize foreign investment projects, and now left NFIC with only few evaluations of foreign investment projects such as:

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<sup>130</sup> Acuff, *supra* note 72, at 411.

<sup>131</sup> *Id.*

<sup>132</sup> Brandon W. Freeman, *An Overview of Foreign Direct Investment in Mexico*, 3-AUT NAFTA: L. & BUS. REV. AM. 123, 125 (1997).

<sup>133</sup> *Id.*

<sup>134</sup> Goldman et al, *supra* note 62, at 115.

<sup>135</sup> *Id.*

1. The impact on employment and training of workers
2. The technological contribution of the project
3. Fulfillment of environmental provisions
4. The project's general contribution to the increase in competency of the productive goals of the country.<sup>136</sup>

Some provision of the 1973 FIL were incorporated into the new 1993 FIL unchanged, for instance the activities reserved exclusively to the Mexican government or to Mexican citizens and Mexican companies.<sup>137</sup> Because the Mexican government accepted, under NAFTA, that it must allow foreign investment in the construction of ducts for the transportation of oil and its derivatives as well as the perforation of oil and gas wells, an innovation in the 1993 FIL gave permission to foreign investors to participate in the Mexican oil industry.<sup>138</sup> President Salina's administration, while facing many political obstacles including clear opposition from some sectors of his party, managed to overcome them and achieve this change.<sup>139</sup>

Following passage of the 1993 FIL, on January 1, 1994 Mexico entered the NAFTA agreement with Canada and the United States, creating a free trade area where tariffs and other barriers to trade were greatly reduced.<sup>140</sup> Under Chapter Eleven of NAFTA, Mexico was obliged to "accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors..." a standard known as "national

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<sup>136</sup> *Id.*, at 116.

<sup>137</sup> *Id.*, at 117.

<sup>138</sup> RUBIN & ALEXANDER, *supra* note 26, at 94.

<sup>139</sup> *Id.*

<sup>140</sup> For a discussion of Mexico's entry into NAFTA see Freeman, *supra* note 132, at 128.



treatment”.<sup>141</sup> NAFTA also provides Most Favored Nation (MFN) treatment, which requires every party to this agreement to treat other parties of NAFTA and their investments no less favorably than third-party investors and investment.<sup>142</sup> Both the 1973 FIL and the 1989 regulations contained lengthy and burdensome lists of performance requirements.<sup>143</sup> An important provision of NAFTA’s investment chapter repeals these performance requirements, which had been one of the major obstacles faced by foreign investors in Mexico.<sup>144</sup> The performance requirements were one of the major obstacles for foreign investors in Mexico.<sup>145</sup> Article 1106 of NAFTA eliminates such barriers, enumerating these requirements and strictly prohibiting a party from imposing or enforcing them in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory.<sup>146</sup> This Article however did not repeal the performance requirements completely:

A party may still condition the receipt of an advantage, in connection with an investment in its territory of a party or of a nonparty, on compliance with the requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development in its territory.<sup>147</sup>

Law is a very important feature necessary for economic development and particularly with foreign direct investment law plays a crucial role in the process of market-oriented

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<sup>141</sup> Hall, *supra* note 69, at 156.

<sup>142</sup> Sandrino, *supra* note 18, at 309.

<sup>143</sup> RUBIN & ALEXANDER, *supra* note 26, at 103.

<sup>144</sup> Freeman, *supra* note 132, at 129.

<sup>145</sup> *Id.*

<sup>146</sup> RUBIN & ALEXANDER, *supra* note 26 (citing NAFTA, Annex I, I-M-4, at 103).

<sup>147</sup> Freeman, *supra* note 132, at 130.

development.<sup>148</sup> Law has two purposes: 1) to define and enforce private rights, especially the rights of foreign investors, and 2) to create the legal foundations for market-oriented reform, which can guarantee the basis for economic development, stability, and growth.<sup>149</sup> As for the rights of foreign investors, NAFTA did not include a Calvo Clause as an instrument in a dispute resolution. “NAFTA provides the most remarkable and groundbreaking evidence of Latin America’s new attitude toward international jurisdiction and law.”<sup>150</sup> Chapter Eleven of NAFTA establishes a complex mechanism for the settlement of private investment disputes for alleged breaches of NAFTA Chapter Eleven Section A obligations.<sup>151</sup> This dispute settlement mechanism provides for resolution via international arbitration, rather than by a NAFTA dispute panel.<sup>152</sup>

Among NAFTA members, disputes may be settled through international arbitration in accordance with the International Center for Settlement of Investment Disputes Convention<sup>153</sup> or the U.N. Commission on International Trade Law Arbitration Rules,<sup>154</sup> or through litigation before the courts of the NAFTA state, at the election of the investor.<sup>155</sup> For the first time, Mexico has entered into an international agreement providing for investor-state arbitration.<sup>156</sup>

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<sup>148</sup> Lothian & Pistor, *supra* note 97, at 101.

<sup>149</sup> *Id.* at 102.

<sup>150</sup> Manning-Gabrol, *supra* note 95, at 1187

<sup>151</sup> Goldman et al, *supra* note 62, at 124.

<sup>152</sup> *Id.* at 125.

<sup>153</sup> The International Center for Settlement of Investment Disputes, an institution of the World Bank group, was founded in 1966 [hereinafter (ICSID)].

<sup>154</sup> The “United Nations Commission on International Trade Law” is a body of member and observer states under the auspices of the United Nations a[hereinafter (UNCITRAL)].

<sup>155</sup> Sandrino, *supra* note 18, at 319.

<sup>156</sup> *Id.* at 320.

NAFTA also has provisions covering expropriation and compensation. No party may directly or indirectly nationalize or expropriate an investment of an investor in its territory or take a measure, except when nationalization is: (a) for a public purpose; (b) on a nondiscriminatory basis; (c) in accordance with due process of law and with treatment in accordance with international law, including fair and equitable treatment; and (d) is accompanied by payment to compensation equivalent to fair market value, paid without delay and fully realizable with interest from the date of expropriation.<sup>157</sup>

NAFTA sets a very important example for third world countries in terms of changing attitudes about foreign investment.<sup>158</sup> Like Mexico, debt-burdened Third World countries try to attract foreign investment by entering into arrangements that are changing the traditional rules of investment protection, but none of these arrangements “has the broad scope of protection for foreign investment found in the investment provisions in NAFTA.”<sup>159</sup>

It would be useful to give a final look at the progress in Mexico’s approach to foreign direct investment in a short review of 1973 and 1993 foreign investment laws. Both laws have a purpose to channel FDI into the country on the condition of complementing national development, but if 1973 FIL gave preference to Mexican investors and set limitations for the foreign ones, 1993 FIL stresses the importance of the foreign investment. 1973 FIL had a permit for only 49% of foreign ownership of Mexican

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<sup>157</sup> Freeman, *supra* note 132, at 132 citing NAFTA, drafted Aug. 12, 1992, revised Sept. 6, 1992, U.S.-Can.-Mex., 32 I.L.M. AT 605 (entered into force Jan. 1, 1994).

<sup>158</sup> Sandrino, *supra* note 18, at 323.

<sup>159</sup> *Id.*

companies.<sup>160</sup> 1993 FIL demised this rule and allowed foreign investors to have up to 100% shares in Mexican companies.<sup>161</sup> Another vital change in 1993 FIL was the reduction of performance requirements from seventeen to four, thus also limiting the role of NFIC.<sup>162</sup> In spite of Mexico's desire to make 1993 FIL attractive for foreign investors, this law still keeps the restrictive features of 1973 FIL, such as: activities reserved only for the Mexican government and Mexican companies and people.<sup>163</sup> And even the permission to buy 100% shares in Mexican companies is limited by the sort of activity where acquisition may vary from ten to forty nine percent of ownership and this list of activities covers more than thirty names. 1993 FIL alone would be another source of criticism from liberal economists, however NAFTA not only enforced the incentives for foreign direct investment stipulated earlier in 1993 FIL but also widened the conditions for International trade.<sup>164</sup>

### **Summary for Mexico**

This section on Mexico traces the love-hate relationship between FDI and this Central American country. It becomes apparent that, most of the time, Mexican political thought centered on achieving self-sufficiency and that the "perceived need for self-

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<sup>160</sup> 1973 Foreign Investment Law. Art 5. 12 Int'l Legal Materials, 643 (1973).

<sup>161</sup> 1993 Foreign Investment Law, Art 4 about the International Center for Settlement of Investment Disputes.

<sup>162</sup> *Id.* art. 29. The foreign investment commission is responsible for performance requirements.

<sup>163</sup> *Id.* art 5, 6.

<sup>164</sup> Chapter eleven of NAFTA not only repeals most of the performance requirements which was done in 1993 FIL but also introduces terms related to international trade, such as: most-favored-nation treatment and National Treatment.

determination via isolationism resulted from years of oppression under Spanish rule and was augmented by United States' aggression in 1840's."<sup>165</sup> The negative and suspicious attitude was also burdened by Mexico's aversion to foreign economic control and political influence that can be "traced back to the administration of Porfirio Diaz."<sup>166</sup> The principles of the Mexican Revolution included sovereignty and independence from foreign economic and political control.<sup>167</sup> The Mexican Constitution of 1917, which embodied these principles, discouraged, and in some areas prevented foreign direct investment in Mexico for more than seventy years.<sup>168</sup> In the 1980s, Mexico recognized the necessity of attracting foreign investments and started "a major modification of its foreign investment legislation."<sup>169</sup> Modifications included the 1993 FIL and participation in NAFTA. According to Freeman, "The implementation of NAFTA and the New Foreign Investment Law clears all doubts about the scope of the Calvo Clause in the Constitution and marks a new era in Mexico's international relations."<sup>170</sup> It is very difficult to describe in a few words a political creed of this very important country, because:

Unlike many other countries that have been committed to some ideology, such as private capitalism, free enterprise, or socialism, Mexico has never for long placed itself in an ideological straitjacket. At certain times and in relation to specific events, such ideologies as nationalism, socialism, and communism have attracted popular support. Yet rigid adherence to ideology or doctrine has rarely hindered Mexico's development drive.<sup>171</sup>

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<sup>165</sup> Godman et al, *supra* note 62, at 101.

<sup>166</sup> Freeman, *supra* note 132, at 123.

<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

<sup>169</sup> RUBIN & ALEXANDER, *supra* note 26, at 13.

<sup>170</sup> Freeman, *supra* note 132, at 134.

<sup>171</sup> ROBERT E. LOONEY, MEXICO'S ECONOMY: A POLICY ANALYSIS WITH FORECASTS TO 1990, 25 (1978)

The era of President Salinas produced dramatic changes in the Mexican legal system “so vast and deep that in those days it was common to refer to them as a legal revolution.”<sup>172</sup> Generally, public opinion supported those changes which were “shared by capitalist groups, the general populace, and high-ranking federal officials,” who enthusiastically proclaimed that Mexico had already become “a first world country.”<sup>173</sup> Mexico’s membership in the OECD<sup>174</sup> buttressed this opinion.<sup>175</sup> A critical examination reveals that Mexico “probably has not really given up anything, but has only gained.”<sup>176</sup> For example, the Calvo Clause is still “enshrined” in the Mexican Constitution, so all foreign investment laws and regulations adopted after 1985 can be revoked.<sup>177</sup> One of the reasons Mexico chose NAFTA dispute settlement mechanisms was to avoid political interference in dispute resolution, “thus eliminating the need for foreign governments’ asserting diplomatic protection on behalf of their investors.”<sup>178</sup> These facts, plus non-refusal from Calvo Clause and the availability of international tools for dispute resolution, show that Mexico regarded the years of liberal reforms as a trial period and did not completely depart from its policy of economic independence. After ten years of NAFTA, the concerns of its opponents have not been reduced by the passage of time and

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<sup>172</sup> Jorge A. Vargas, *an Introductory Lesson to Mexican Law: from Constitutions and Codes to Legal Culture and NAFTA*, 41 SAN DIEGO L. REV. 1337, 1367 (2004).

<sup>173</sup> *Id.*

<sup>174</sup> OECD stands for Organization for Economic Cooperation and Development. The OECD is an international agency which supports programs designed to facilitate trade and development [hereinafter (OECD)].

<sup>175</sup> *Id.*

<sup>176</sup> Justin Daly, *Has Mexico Crossed the Border on State Responsibility for Economic Injury to Aliens? Foreign Investment and the Calvo Clause in Mexico After the NAFTA*, 25 ST. MARY’S L.J. 1147, 1182 (1994).

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

“neither has the enthusiasm of its supporters been toned down.”<sup>179</sup> NAFTA’s advocates list positive impacts of this agreement such as increased FDI (40%), the exports growth (25%), higher per capita income (5%), and the availability of emergency loans to cure the consequences of crises (a \$50 billion support loan from the U.S. Treasury).<sup>180</sup> Opponents say that all NAFTA benefits were “more than compensated by its adverse effects on the overall economy” and that benefits realized from the Agreement “have been highly concentrated in relatively few firms.”<sup>181</sup> The opponents also note the “erosion of Mexico’s inter-industrial links,” the reduction of Mexico’s potential long-term economic growth and the widening gap between the “haves” and “have-nots.”<sup>182</sup> What may seem like a success story, in fact, undermines economic development. The success has been achieved “at the expense of the labor employed in these areas by the systematic lowering of regulations.”<sup>183</sup> Export Processing Zones remain simply assembly zones with the materials being imported by the firms, assembled and then exported. For example “Ford’s state-of-the-art engine assembly plant in Chihuahua exports more than 90% of its production, and uses almost no local inputs other than labor.”<sup>184</sup> We see the development “with little in government revenue to improve the infrastructure of the country and no possibility of local firms breaking into the supply chain.”<sup>185</sup>

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<sup>179</sup> Moreno-Brid et al, *supra* note 105, at 997

<sup>180</sup> *Id.* at 998.

<sup>181</sup> *Id.* at 999.

<sup>182</sup> *Id.*

<sup>183</sup> JANET DINE, COMPANIES, INTERNATIONAL TRADE AND HUMAN RIGHTS, CAMBRIDGE UNIVERSITY PRESS, 25 (2005)

<sup>184</sup> *Id.* at 26. Also, Export Processing Zones ease tax and labor restrictions and their primary purpose is to generate export revenues in poor developing countries, available at [http://en.wikipedia.org/wiki/Export\\_processing\\_zone](http://en.wikipedia.org/wiki/Export_processing_zone) (last visited on August 6, 2006)

<sup>185</sup> *Id.*

There are also problems with the Mexican legal culture which “have a high rate of concentration and practical use in urban centers like Mexico City, Guadalajara or Monterey because of a common level of education, economic means and national cultural patterns.”<sup>186</sup> In rural areas, legal culture resources as well as basic economic means for survival are absent; fifty million out of a total population of one hundred million in Mexico lives at or below the poverty level.<sup>187</sup> Only when Mexico becomes a middle class country like the United States or Canada will the legal culture in that country become varied and equally distributed and this can be done through the strengthening of the educational system at all levels.<sup>188</sup>

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<sup>186</sup> Vargas, *supra* note 172, at 1364.

<sup>187</sup> *Id.*

<sup>188</sup> *Id.* at 1365.



### III. KAZAKHSTAN AND FOREIGN DIRECT INVESTMENT

#### Overview of Economic Situation in Kazakhstan in 1990s

It is difficult to write about modern Kazakhstan in general and about foreign direct investments in particular. The reason lies in the short history of sovereignty of this new state in Central Asia. The Republic of Kazakhstan is the second largest republic in the former Soviet Union.<sup>189</sup> The large territory accommodates a disproportionately small population of fifteen million people, consisting of different nationalities. The main ethnic groups are: Kazakh 53.4%, Russian 30%, Ukrainian-3.7%, Uzbek-2.5%, German-2.4, Tatar 1.7%, Uygur 1.4% and 4.7% are other nationalities.<sup>190</sup> As a Soviet republic, Kazakhstan's economy was an inseparable part of the whole Soviet economic system of central planning and state-owned enterprises. The economic foundation of the Soviet Union was the principle of centralized economic planning.<sup>191</sup> The central planning had a universal character when "[a]ll of production and supply is subordinated to centralized tasks."<sup>192</sup> Mostly the planning was performed on two levels: the top one was the USSR Council of Ministers (Gosplan) and the lower one covered the Republican Council of

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<sup>189</sup>The territory of Kazakhstan is 2,7 million square kilometers *available at* <http://www.cia.gov/cia/publications/factbook/geos/kz.html> (last visited on June 13, 2006).

<sup>190</sup> *Id.*

<sup>191</sup> See OLIMPIAD S. IOFFE, MARK W. JANIS, *SOVIET LAW AND ECONOMY*, 8 (1986)

<sup>192</sup> *Id.* at 9.

Ministers (republican Gosplans).<sup>193</sup> Foreign trade in this respect was under strict government control and was a part of the State's foreign policy, "In the earliest years following its creation, the foreign policy of the Soviet State was aimed primarily at ensuring survival in an extremely hostile environment which threatened it on all sides."<sup>194</sup> At that time, for the Soviet Union foreign trade meant large scale procurement of Western technology. Without American and European firms, the Soviet Union probably would not have been able to construct and develop its steel and chemical industry, its automotive industry, electro-technical industry and military industrial complex.<sup>195</sup> For instance, the biggest automotive plant in Gorky, (today Nizhnyi Novgorod) Russia was built in the 1930s with the help of the Ford Company, and the whole agriculture tractor plant was imported from the Chicago suburbs to the city of Stalingrad (today Volgograd) and assembled there by the American companies International Harvester and Albert Kahn, Inc.<sup>196</sup> The main purpose of such contracts was the creation and development of an independent Soviet industry.<sup>197</sup> It was all done through the agreements on "technical cooperation and aid" under which the USSR paid hard currency to Western companies.<sup>198</sup> This kind of technical cooperation with foreign companies existed throughout the history of the USSR. When the Soviet government was interested in developing technological projects with foreign expertise, it usually negotiated and bought the whole project, but foreign direct investment did not exist in the Soviet economy. The Soviet Union mostly

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<sup>193</sup> *Id.*

<sup>194</sup> JEREMY RUSSELL, *ENERGY AS A FACTOR IN SOVIET FOREIGN POLICY*, 1 (1976).

<sup>195</sup> Shpotov B. M., *The Technical Aid of the West to the Soviet Industrialization*, available at <http://www.pseudology.org/razbory/IndustriaGAZ.htm>, (last visited on June 17, 2006)

<sup>196</sup> *Id.*

<sup>197</sup> *Id.*

<sup>198</sup> *Id.*

sold its raw materials to the developed countries and in exchange bought equipment and technology from them.<sup>199</sup> Soviet leadership did not want “something foreign, born of another type of organization and principles and transplanted into their system,” because it would “not produce the same effect that it gives in its own environment.”<sup>200</sup>

The Soviet Union ceased to exist in December of 1991. “The dramatic events that followed the change of leadership in 1985, culminated in the dissolution of the Soviet Union.”<sup>201</sup> As for Kazakhstan, on December 16, 1991, “a new law establishing the state independence of the Republic of Kazakhstan was approved.”<sup>202</sup> This independence was not long awaited and dreamt of by the people and leadership of Kazakhstan. “Kazakhstan was the last republic to leave the Soviet Union on December 16, 1991, following the surprise announcement on December 8<sup>th</sup> by Russia, Belarus and Ukraine that they were forming the Commonwealth of Independent States.”<sup>203</sup>

At the very beginning of its independence Kazakhstan faced many urgent problems, such as “formation, strengthening and perfection of its statehood, ”transition from one type of economy to another, problems of creating conformity in legislation and accepted models of development among other things.<sup>204</sup> Politically, the transition to independence went smoothly enough to avoid ethnic tensions. In the Soviet era, Kazakhstan was called “the laboratory of friendship” since more than a hundred nationalities called Kazakhstan their

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<sup>199</sup> See CONSTANTIN A. KRYLOV, *THE SOVIET ECONOMY*, 224 (1979).

<sup>200</sup> *Id.*

<sup>201</sup> Archie Brown, *Reform, Coup and Collapse: The End of the Soviet Union* (2001), [http://www.bbc.co.uk/history/worldwars/coldwar/soviet\\_end\\_01.shtml](http://www.bbc.co.uk/history/worldwars/coldwar/soviet_end_01.shtml), (last visited on June 17, 2006.)

<sup>202</sup> Zaure Ayupova, *The Republic of Kazakhstan: Six Years of Independent Development*, 6 *TULSA J. COMP. & INT’L L.* 65, 65 (1998).

<sup>203</sup> Philip M. Nichols, *The Viability of Transplanted Law: Kazakhstan Reception of a Transplanted Foreign Investment Code*, 18 *U. PA. J. INT’L ECON. L.* 1235,

<sup>204</sup> Ayupova, *supra* note 203, at 65.

home.<sup>205</sup> Also because the Great Silk Route<sup>206</sup> passed through Kazakhstan forming a bridge between Asia and Europe the local population “has always been opened for international dialogue.”<sup>207</sup> Kazakh people throughout their history have led a nomadic life and the source of Kazakh law was a customary law, “Historically, the most favorable conditions for Islamic culture were the permanent settlements and city-states.”<sup>208</sup> Islam was not the religion of all Kazakh people. “While traces of fiqh and Shari’a of Islam can be found in indigenous Kazakh law, Islam does not constitute a significant part of Kazakhstan’s legal heritage.”<sup>209</sup> The important influence on Kazakh law came from Mongol law; “several portions of Kazakh law were taken directly from Great Yasa (law) of the Mongols, and has also illuminated other portions of Kazakh law on which the Yasa had a significant effect.”<sup>210</sup> In 1928, eleven years after the Great October Revolution in Russia, a Decree was enacted about “the struggle against crimes based on customs,” which “[p]rohibited many of the practices that were required or provided for in Kazakh law.”<sup>211</sup>

Like other former Soviet republics, Kazakhstan went through a difficult time of modernization and transformation from a strictly centralized economy. The manufacturing sector of the economy has its roots mostly in the World War II era, when

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<sup>205</sup> See CHUMICHEV ET AL, ACROSS MIDDLE ASIA AND KAZAKHSTAN, 337 (1973)

<sup>206</sup> The Great Silk Route was an ancient trade route between China and the Mediterranean Sea, extending some 6,440 km (4,000 mi) available at [http://www.bbc.co.uk/history/worldwars/coldwar/soviet\\_end\\_01.shtml](http://www.bbc.co.uk/history/worldwars/coldwar/soviet_end_01.shtml) (last visited on August 9, 2006).

<sup>207</sup> Erzhan K. Dosmukhamedov, *Legal Aspects of Doing Business in the Republic of Kazakhstan*, 5-SPG INT’L LEGAL PERSP. 93, 94 (1993).

<sup>208</sup> *Id.*

<sup>209</sup> Philip M. Nichols, *The Fit Between Changes to the International Corruption Regime and Indigenous Perceptions of Corruption in Kazakhstan*, 22 U. PA. J. INT’L ECON. L. 863, 910 (2001).

<sup>210</sup> *Id.*

<sup>211</sup> *Id.* at 912.

Kazakhstan became the beneficiary of massive transplants of industries.<sup>212</sup> That is probably one of the reasons that, Kazakhstan has “a bifurcated economy, with heavy industry and collectivized agriculture in the north and large--scale agriculture--primarily cotton--in the south.”<sup>213</sup>

As part of the Soviet Union, Kazakhstan shared its civil law tradition.<sup>214</sup> The constitution in a civil law tradition is “the core of the whole system of legislation and incorporates the basic definitions.”<sup>215</sup> In order to build a new democratic and civil society where human rights, freedoms and the rule of law would be a priority, the leadership of the country brought together experts from Great Britain, the United States and Kazakhstan to draft a new constitution.<sup>216</sup> The first constitution of independent Kazakhstan was adopted on January 28, 1993.<sup>217</sup>

After reading this document thirteen years later, one may have the impression that the country did not yet define its true paradigm of socioeconomic development. The 1993 Constitution of the Republic of Kazakhstan embodied many social features inherited from the Soviet Union, for example, in a section on economic and social conditions, one can read that, “A citizen of the Republic shall have the right to working conditions meeting security and sanitary requirements, and also to social protection from unemployment.”<sup>218</sup> The payment-reward for the labor “should not be less than the

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<sup>212</sup> Nichols, *supra* note 209, at 1253.

<sup>213</sup> *Id.*

<sup>214</sup> Dosmukhamedov, *supra* note 207, at 95.

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

<sup>217</sup> CIA- The World Fact Book available at <http://www.cia.gov/cia/publications/factbook/geos/kz.html> (last visited on June 20, 2006)

<sup>218</sup> N. Nazarbaev, *President of the Republic of Kazakhstan, Appendix: The Constitution of the Republic of Kazakhstan*, 5-SPG INT’L LEGAL PERSP. 109, 112 (1993).

minimal wages set by law.”<sup>219</sup> The Constitution also stipulated the right of citizens to housing, not only promoting “implementation of the right to housing by encouraging house-building” but also by “selling of dwellings from the state housing fund.”<sup>220</sup> The same socially-oriented attitude referred to health care and education, but the important feature which is clearly seen though the whole section on economic and social rights are the conditions involving private initiative - letting private education and private healthcare exist and develop together with the State institutions providing services in this field.<sup>221</sup> The first constitution proclaimed Kazakhstan to be a democratic, secular and unitary state, but did not emphasize the leading role of the presidency as was done in the succeeding constitution. Also it gave more discretion to the Parliament which not only was involved in the law making but also: a) elected the Constitutional Court; b) elected the Supreme Court and the High Court of Arbitration, c) appointed the Prosecutor-General, and d) appointed the Chairman of the National Bank.<sup>222</sup> Of course, the first constitution paid attention to the new forms of economy such as private property and private entrepreneurship. It declared that “[p]rivate property shall be inviolable. The State shall guarantee the freedom of entrepreneurship activity and ensure its defense and support”.<sup>223</sup> At the same time the constitution stipulated the intention of the State to keep “[l]and, its bowels, rivers and lakes, flora and fauna, other natural resources” as its “exclusive property.”<sup>224</sup>

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<sup>219</sup> *Id.*

<sup>220</sup> *Id.* at 113.

<sup>221</sup> *Id.*

<sup>222</sup> *Id.* at 118.

<sup>223</sup> The Constitution of the Republic of Kazakhstan of January 28, 1993, (articles 47, 48).

<sup>224</sup> *Id.* art.46.

According to the first Constitution, foreigners, legal entities and “persons not admitted to citizenship” were participants in entrepreneurial activity and were under the protection of the Republic of Kazakhstan “as stipulated by laws and interstate agreements of the Republic of Kazakhstan”.<sup>225</sup>

In the beginning of 1995 the Republic of Kazakhstan found itself in the “midst of a constitutional crisis” the result of which was the dissolution of the parliament.<sup>226</sup> The first Constitution did not help to fulfill the embodied tasks especially in regulating the jobs of the legislative and executive branches, since the Kazakh parliament at that time “still embodied the bulky mechanism of its predecessor, the Supreme Soviet of the Kazakh SSR, and lacked any real mechanism for the execution of legislative initiative.”<sup>227</sup> A new constitution was adopted in August 1995 by national referendum.<sup>228</sup> The new constitution gave more power to the president by saying, “The Republic of Kazakhstan is a unitary state with a presidential form of government.”<sup>229</sup> This time the President took almost all appointing functions of the key executive officials except “election and discharge from the office, the Chairperson of the Supreme Court, the Chairpersons of the Collegium of Justice, and judges of the Supreme Court of the Republic and the proposal of the President of the Republic of Kazakhstan, and swearing them into office”, which was the duty of the upper chamber of the parliament (senate).<sup>230</sup>

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<sup>225</sup> *Id.* art.49

<sup>226</sup> Auypova, *supra* note 202, at 68.

<sup>227</sup> *Id.* at 67.

<sup>228</sup> CIA-The World Fact Book available at <http://www.cia.gov/cia/publications/factbook/geos/kz.html> (last visited on June 22, 2006).

<sup>229</sup> The Constitution of the Republic of Kazakhstan of August, 30 1995, Article 2.

<sup>230</sup> *Id.* Art. 55.

The two-chamber parliament was left mostly with law-making and approval tasks.<sup>231</sup>

The new Constitution confirmed the preceding Constitution's social protection of citizens in terms of labor conditions, health care and housing, but paid more attention to individual freedoms.<sup>232</sup> Also the new Constitution did not pay much attention to the business activity of foreign citizens except to give them "rights and freedoms as well as responsibilities established for the Kazakh citizens unless otherwise stipulated by the Constitution, laws and international treaties."<sup>233</sup> In the 1993 Constitution a whole section was devoted to property and entrepreneurship.<sup>234</sup> One more important feature was transferred from the 1993 Constitution to the 1995 Constitution; the State confirmed its intention to keep owning "the land and underground resources, waters, flora and fauna, other natural resources."<sup>235</sup> Also, in the same article, the new Constitution adds, "The land may also be privately owned on terms, conditions and within the limits established by legislation."<sup>236</sup> The constitution thus reveals the attitude of the new Kazakh State to the market economy, its readiness for foreign direct investment, international competition and foreign business activity in the country.

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<sup>231</sup> See Arts. 55, 56 and 57 of the Kazakh Constitution of 1995.

<sup>232</sup> See Section II, The Individual and Citizen of the Kazakh Constitution of 1995.

<sup>233</sup> *Id.* at Art. 12.

<sup>234</sup> See Section II, Chapter 8 (Property and Entrepreneurship) of Constitution 1993.

<sup>235</sup> See the Constitution of the Republic of Kazakhstan of 1995, art. 6.

<sup>236</sup> *Id.*



## 1990 Foreign Investment Law and Auxiliary Laws Facilitating Investments

In reference to the readiness of Kazakhstan for foreign direct investment we will shortly explore the document dated December 7, 1990 and which is called “Law of the Kazakh SSR on Foreign Investments in the Kazakh SSR, adopted Dec. 7, 1990.”<sup>237</sup> The date of this document suggests that the demand for foreign investments appeared earlier than independence itself.<sup>238</sup> In the early 1990s, the republics of the Soviet Union started the program of privatizing State enterprises.

To be successful, privatization in countries with centrally-planned economies must attract foreign capital for the modernization of their facilities, adopt foreign management skills in order to capitalize in new technology, and provide sufficient internal financial and production controls. To attract foreign participation, a country would want to enact investment laws that facilitate the movement of capital into and out of the country.<sup>239</sup> With this mindset the leadership of Kazakhstan drafted and adopted the law on foreign investment. This Soviet era law was drafted to attract foreign investors and included necessary basic incentives. It was short, comprised of only twenty nine articles.<sup>240</sup> To start with, one can see that that this law had no restriction on formation of enterprises; foreign entities could have any percentage of ownership in joint ventures and also could

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<sup>237</sup> Zakon Respubliki Kazakhstan ob Inostrannyh Investitsiah Law of Kazakh SSR on Foreign Investments in the Kazakh SSR, (Kaz.), Law No. 383-XII of December 7, 1990, KAZAKHSTANSKAYA PRAVDA.

<sup>238</sup> Kazakhstan became independent on December 16, 1991.

<sup>239</sup> Yuliya Mitrofanskaya, *Privatization as an International Phenomenon: Kazakhstan*, 14 AM. U. INT’L L. REV. 1399, 1406, (1999)

<sup>240</sup> Zakon Respubliki Kazakhstan ob Inotrannyh Investitsiah Law of Kazakh SSR on Foreign Investments in the Kazakh SSR, (Kaz.), Law No. 383-XII of December 7, 1990, KAZAHSTANSKAYA PRAVDA.

have fully owned enterprises.<sup>241</sup> Foreign investors had a one-year grace period to start operating a business before re-licensing.<sup>242</sup> The foreign investor, who brought property into Kazakhstan not for sale, but as an investment, did not have to pay custom duties.<sup>243</sup> Personal property of foreign specialists working at enterprises with foreign participation was also not subject to custom duties.<sup>244</sup> To provide additional tax incentives, the share of the foreign investor in the enterprise was not to be less than 30%.<sup>245</sup> These tax incentives were: five years free from income tax if employed in the production and services listed in the annex to this law; after five years only 50% on income tax for the next five years.<sup>246</sup> This law also guaranteed protection of foreign intellectual property.<sup>247</sup> Nationalization was not allowed and only in exceptional cases could the property of the enterprise with foreign participation be requisitioned. Requisition was followed by full compensation of the losses by the Government of Kazakh SSR.<sup>248</sup> Under this law Kazakh SSR guaranteed foreign investors the free transfer abroad of profits from business activity and liquidation of the legal entities with foreign participation, and also in the case of investors' shares in those enterprises being sold.<sup>249</sup> As for resolution of disputes between the legal entities with foreign participation and the state organs of the republic, the law offered state arbitration, the republican courts, or, by agreement of the parties, the dispute could be

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<sup>241</sup> *Id.* art. 1,4.

<sup>242</sup> *Id.* art. 7.

<sup>243</sup> *Id.* art. 16.

<sup>244</sup> *Id.*

<sup>245</sup> *Id.* art. 20.

<sup>246</sup> *Id.*

<sup>247</sup> *Id.* art. 15

<sup>248</sup> *Id.* art. 25

<sup>249</sup> *Id.* art. 26

resolved in an arbitral tribunal in accordance with the legislation of the Republic.<sup>250</sup>

Article 29 of the 1990 investment law contained an important condition: “If an international agreement or treaty of the Republic establishes rules of dispute resolution other than those under this law, the rules of an international agreement or treaty must be applied.”<sup>251</sup> At this time to adopt only one law to attract foreign direct investment, even a very progressive one, was not enough. In the 1990s, almost simultaneously with the law on foreign investment, a number of other laws designated to facilitate foreign investment in Kazakhstan were adopted:

- a) The law of the Kazakh SSR on Property, adopted December 15, 1990, which on the one hand confirmed the constitutional right of the State to own “...[t]he earth, its bowels, rivers and lakes...,” and on the other hand let the foreigners own property and guaranteed stability of property relations.
- b) The law of the Kazakh SSR on Leasing, adopted Feb. 2, 1990, under which “Land and other natural resources can be leased.”
- c) The law of the Kazakh SSR on Free Enterprise and Development of Entrepreneurship in the Kazakh SSR, adopted Dec. 11, 1990, under which the government identified the objects of foreign investments, on the territory of the Kazakh SSR as: “enterprises, which share participation in the property of Soviet juridical entities, shares and other securities and such other property as well as the acquired property rights to use natural resources in the Kazakh SSR for carrying out the economic and any such activity on the Kazakh SSR territory.”

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<sup>250</sup> *Id.* art. 28.

<sup>251</sup> Dosmukhamedov, *supra* note 207, at 102.

d) The law of the Kazakh SSR on Free Economic Zones in the Kazakh SSR, adopted Dec. 15, 1990. This law was intended to create “specially allocated territory with clearly defined administrative borders and special legal conditions established with the aim of attracting foreign capital, progressive foreign technology and management experience for accelerated social and economic development of the territory of the zone.”<sup>252</sup> The tax incentives in these free economic zones were as attractive as those in the law on foreign investments.<sup>253</sup>

An abundance of mineral resources and a stable political situation could make Kazakhstan an attractive object for investment, the 2004 estimated oil proved reserves are twenty--six billion barrels and estimated reserves of natural gas are three trillion cubic meters.<sup>254</sup>

In addition, Kazakhstan accounted for “ninety percent of the chrome reserves of the former Soviet Union, fifty percent of the tungsten and lead, and forty percent of the zinc and copper deposits. Kazakhstan was one of the Soviet Union’s bread baskets, producing about thirty-three percent of its total agricultural production.”<sup>255</sup> Post Soviet Kazakhstan managed to escape “the ethnic tension which has infected the Caucasian republics and the Central Asian states”, and the country is regarded as “one of the most stable states of the former Soviet Union.”<sup>256</sup> Moreover, Kazakhstan itself was seeking foreign direct

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<sup>252</sup> Andrew B. Derman, *KAZAKHSTAN: How a New Petroleum Law Can Fuel Economic Development*, *TULSA J. COMP. & INT’L L.* 57, 65-68, (1993).

<sup>253</sup> Article 13 in the Law on the Free Economic Zone says that entities within economic zones are profit tax exempt from two to five years from receipt of declared profit and there is no limitation on certain activities listed in the annex of the investment law of 1990, which covered the rest of the Republic.

<sup>254</sup> CIA-The World Fact Book *available at* <http://www.cia.gov/cia/publications/factbook/geos/kz.html> (visited on June 26, 2006).

<sup>255</sup> Derman, *supra* note 252, at 58.

<sup>256</sup> *Id.* at 57, 58.

investment because “foreign participation helps to introduce new technology and establish adequate systems of management and quality control.”<sup>257</sup> The President of Kazakhstan “has repeatedly emphasized that foreign investment and strong foreign relations are essential for the effective development of Kazakhstani natural resources,” and “[s]ince Kazakhstani policy is to attract foreign investors, legislation is intended to create a favorable investment climate.”<sup>258</sup> Later, research on foreign investment has demonstrated that Kazakhstan, in comparison with other former Soviet republics, “carries a relatively low risk” for foreign investors.<sup>259</sup> The successful policy of attracting foreign investment has resulted in a \$25 billion, 40-year term contract with a major American oil company, Chevron, and the consequent entrance into the Kazakhstan market of other leading oil companies such as British Gas, British Petroleum, Italian Agip, Mobil and French Elf-Aquitaine.<sup>260</sup> But the goal of Kazakhstan’s leadership was not only to attract international attention as an important source of oil, gas and mineral resources, but also to seek “foreign direct investment in other sectors, including agriculture, light industry, power, tourism, and infrastructure. The development of these sectors will enable the country to establish a diversified economy and avoid the problems encountered by some other economies dependent on energy production.”<sup>261</sup>

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<sup>257</sup> Mitrofanskaya, *supra* note 239, at 1432.

<sup>258</sup> *Id.*

<sup>259</sup> *Id.*

<sup>260</sup> Dosmukhamedov, *supra* note 207, at 94.

<sup>261</sup> OECD Centre for Co-operation with Non-Members, *Investment Guide for Kazakhstan*, 3, (1998) [hereinafter OECD].

## 1994 Foreign Investment Law and the 1997 Supplementary Law

The positive spirit of the intention and readiness to attract foreign investments launched in the first law on foreign investments was transformed into the next law on foreign investment, which was adopted on December 27, 1994.<sup>262</sup> The reason that the new investment law was introduced was that the 1990 foreign investment law (FIL) was introduced when Kazakhstan was still a part of the Soviet Union. In addition, the 1990 FIL was drafted in Moscow, and in 1994, in order to show the independence from its northern neighbor; the Parliament of Kazakhstan adopted a new investment law which was solely the law of a new state.<sup>263</sup> The 1994 FIL continued to encourage foreign direct investment by offering the same “tax holidays” as in the predecessor law. What was new was the additional measure of protection of investors against negative changes in legislation. The law states that in cases where the changes in legislation would be detrimental to the foreign investor, the legislation which existed when the contract was signed would cover the investor for ten years, and in respect to the long term contracts (more than ten years), changes in the law will not negatively impact the contract for the whole duration of the contract.<sup>264</sup> And in cases where the changes in the legislation improve the starting situation of the foreign investor the contract may be changed by mutual agreement between the investor and the state representatives.<sup>265</sup> Another

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<sup>262</sup> Zakon Respubliki Kazakhstan ob Inostrannyh Investitsiah Law of the Republic of Kazakhstan on Foreign Investments, Law No. 266-XIII on December 27, 1994, KAZAKHSTANSKAYA PRAVDA.

<sup>263</sup> Nichols, *supra* note 203 at 1261.

<sup>264</sup> Zakon Respubliki Kazakhstan ob Inostrannyh Investitsiah Law of the Republic of Kazakhstan on Foreign Investments, Law No. 266-XIII on December 27, 1994, Article 6. KAZAKHSTANSKAYA PRAVDA

<sup>265</sup> *Id.*

improved feature of the 1994 FIL was a new framework for the settlement of investment disputes:

- Where possible, investment disputes are to be resolved by negotiation. If no settlement has been reached by negotiation after a period of three months, any of the parties involved may refer the investment dispute (subject to the written agreement of the foreign investor) to a court in Kazakhstan or (in the event that such a dispute resolution procedure has been previously agreed) to any one of the following arbitration authorities:
- The International Centre for the Settlement of Investment Disputes (the “ICSID”), provided the foreign investor’s government is a signatory to the same.
  - The Additional Facility of the ICSID (functioning according to the Rules of the Additional Facility) if the investor’s government is not a signatory to the ICSID Convention.
  - Arbitration authorities established in accordance with the Arbitration Regulations of the Commission of the United Nations Organization for International Trade Law.
  - The Arbitration Institute of the Chamber of Commerce in Stockholm.
  - The Arbitration Commission of the Chamber of Commerce and Industry of the Republic of Kazakhstan.
- When one of the listed authorities is specified, the consent of the Republic is given automatically.<sup>266</sup>

Three years later a new law supplementary to the 1994 FIL was adopted. The new document was called “The Law on State Support of Direct Investments” and it was the result of pressure placed on the Kazakhstan government by the international financial organizations which held out large loans as an incentive for adopting this supplementary law.<sup>267</sup> An important part of this law was the creation of a State Committee on Investments. Due to this Committee on Investments, one third of the federal ministries and government agencies were eliminated and a Committee was “given sole responsibility for carrying out government policies with respect to direct foreign

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<sup>266</sup> OECD, *supra* note 261, at 43.

<sup>267</sup> *Id.* at 1262.

investment.”<sup>268</sup> The importance of this “move” lay in “placing all decision-making capacity for foreign investment in one agency,” thus simplifying the process of licensing and registration of the foreign investor.<sup>269</sup> The government declared that the purpose of this law was:

1. Introduction of new technologies and know-how
2. Filling the domestic market with high quality goods and services
3. State support and stimulation of domestic producers
4. The development of import substitute industries
5. Rational and complex utilization of mineral resources of the country
6. The introduction of modern way of management and marketing
7. The creation of new jobs
8. The introduction of the system of nonalienating training of the local work force and raising their qualification
9. The intensification of production
10. The improvement of environmental situation<sup>270</sup>

This law not only confirmed the existing tax and custom incentives but considerably reduced the control of the state representatives in terms of free transfer of capital; the state obligated itself not to create monopolies controlling the sales of mineral resources; and the state also refused to regulate prices in sales of mineral resources, the state gave permission to foreign investors to open bank accounts in national currency and exchange into hard currency and vice versa.<sup>271</sup> The 1997 law was drafted “by a small group of foreign advisors, and was modeled on laws that had been transplanted into Southeast Asia. Those laws, in turn, had been modeled on Western laws.”<sup>272</sup> This law also defined priorities for foreign investments: “Designated priority sectors exclude the energy sector,

<sup>268</sup> Nichols, *supra* note 203, at 1262.

<sup>269</sup> *Id.*

<sup>270</sup> Zakon Respubliki Kazakhstan o Gosudarstvennoi Podderzhke Priamyh Investitsyi The Law of the Republic of Kazakhstan on State Support of Direct Investments, No 75-1 on February 28, 1997 (hereinafter the Law of 1997) KAZAKHSTANSKAYA PRAVDA.

<sup>271</sup> *Id.* article 8.

<sup>272</sup> Nichols, *supra* note 203, at 1262.



which the government rightly judges does not need special incentives to attract foreign investment. The designated sectors cover infrastructure, light industry, agriculture, housing, social investment in health and education”<sup>273</sup> This section on Kazakhstan explores the laws directly related to foreign investments. Beside these laws, since the beginning of independence a plethora of other laws and decrees were adopted in Republic of Kazakhstan. The legal side of the activity of the state at the beginning of its independence was one of the reasons that:

Kazakhstan has achieved significant progress in transforming itself from a centrally planned to an open market economy. The process has been painful: the gross domestic product of the country almost halved between 1991 and 1995. But the country’s natural resources and the structural reforms which have been put in place have attracted increasing commitment and growing interest from international investors.<sup>274</sup>

From 1991 to 1997, Kazakhstan captured eighty percent of the total foreign direct investment flow designated for Central Asian republics, “It was the second most favored destination for FDI among former Commonwealth of Independent States after Russia. The cumulative value of FDI at the end of 1997 was at least US \$4 billion.”<sup>275</sup>

As mentioned above, multiple legal documents were adopted during the time when Republic of Kazakhstan was “getting on its feet.” It is necessary to mention that between 1995 and 1998, the government undertook additional measures to create conditions for a market economy. Key documents included a medium-term program for further reform of the banking systems and programs for step-by-step transfer of social and economic organizations to local budgets, for developing the securities market, for promoting employment growth, for developing small and

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<sup>273</sup> OECD, *supra* note 261, at 14.

<sup>274</sup> *Id.* at 11.

<sup>275</sup> *Id.*

medium businesses, for supporting entrepreneurial activity and for privatizing entities in state ownership. All these measures not only created an attractive climate for foreign investment but also promoted economic growth of the country. The GDP growth rate in Kazakhstan in 2001 was 13.2%, in 2002 it was 9.5%, in 2003-9.2%, and in 2004-9.1%.<sup>276</sup> It is also easy to see that in trade Kazakhstan exported primarily: oil products (65%), base metals (20%), food and agriculture goods (6%) and chemicals (4%). The total compounded figure in monetary equivalent is \$18.47 billion.<sup>277</sup> Kazakhstan also managed to maintain a stable monetary policy; the inflation rate did not exceed 6.6% in 2001-02, and the republic's strong macroeconomic performance allowed repayment of all of its debt to the International Monetary Fund seven years ahead of schedule.<sup>278</sup> And in March 2002, the U.S. Department of Commerce graduated Kazakhstan to market economy status under U.S. trade law.<sup>279</sup> In respect of foreign investments and Kazakhstan it would be impossible not to mention the role of the United States in the recent history of Kazakhstan. In December 1991 the United States was the first country to recognize Kazakhstan's independence and it opened its embassy in the capital of Kazakhstan in January 1992.<sup>280</sup> Economic cooperation between these two countries can be rated as successful since in 2004: "36.9% of total foreign investment in Kazakhstan came from the United States. American companies have invested more than \$6 billion in Kazakhstan since 1993. These companies are concentrated in the oil and gas, business services, telecommunications, and electrical energy sectors."<sup>281</sup> The Bilateral Investment Treaty between Kazakhstan and the

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<sup>276</sup> U.S. Department of State available at <http://www.state.gov/r/pa/ei/bgn/5487.htm> (last visited on June 30, 2006)

<sup>277</sup> *Id.*

<sup>278</sup> *Id.*

<sup>279</sup> *Id.*

<sup>280</sup> *Id.*

<sup>281</sup> *Id.*

United States was signed in 1992.<sup>282</sup> Article II lists obligation of the parties towards mutual investments:

On a basis no less favorable than that accorded in like situations to investment or associated activities of its own nationals or companies, or of nationals or companies of any third country, whichever is the most favorable, subject to the right of each Party to make or maintain exceptions falling within one of the sectors of matters listed in the Annex to this Treaty.<sup>283</sup>

In this agreement we can see the features of “equal treatment” and “most favored nation” status which are listed in Articles of GATT and Articles of WTO.<sup>284</sup> Article II also mentions exceptions listed in the annex of this agreement, which ensure national treatment in the sectors or matters it has indicated below.<sup>285</sup> The “American” list of exceptions is represented by a broad scope of business activities such as air-transportation, ocean and coastal shipping, banking insurance, broadcasting etc.<sup>286</sup> The list of activities granted national treatment will give Kazakhstan grounds for selected limitations it can employ in its further legal activity connected with investments. This agreement as a whole offers boon conditions and expresses an overly positive attitude towards foreign investment, in that it excludes performance requirements, and includes the opportunity to select top managerial personnel regardless of nationality, the free transfer of capital and much more.<sup>287</sup> Detailed attention to this document would reach beyond the scope of this thesis, but it is relevant to mention that dispute resolution may

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<sup>282</sup> International Centre for Settlement of Investment Disputes, Investment Promotion and Protection Treaties, Kazakhstan/United States, 1992.(hereinafter BIT USA/Kazakhstan)

<sup>283</sup> *Id.*

<sup>284</sup> John H. Jackson, *Legal Problems of International Economic Relations*, 20 (2002).

<sup>285</sup> BIT USA/Kazakhstan, *supra* note 282, Annex.

<sup>286</sup> *Id.*

<sup>287</sup> *Id.* arts. II and IV.

involve international arbitration organizations such as: The International Centre for the Settlement of Investment Disputes (ICSID), the United Nations Commission on International Trade Law (UNICTRAL) or “any other arbitration rules, as may be mutually agreed between the parties to the dispute.”<sup>288</sup> This bilateral agreement not only responded to the demands of developed countries for international investments, but its legacy influenced 1994 FIL.<sup>289</sup> The U.S. friendly and helpful attitude towards newly independent states played a positive role in turning Kazakhstan into a country with a market economy. The United States of America between 1992 and 2005 “provided roughly \$1.205 billion in technical assistance and investment support in Kazakhstan. The programs were designed to promote market reform, to establish a foundation for an open, prosperous, and democratic society, and to address security issues.”<sup>290</sup>

### **2003 Investment Law**

The most recent law on investment was adopted in 2003 and was called the “Law of the Republic of Kazakhstan on Investments.”<sup>291</sup> The content of this law gives the reader the impression that Kazakhstan’s leadership is confident in the country’s stable and safe economic position and thus is more demanding and selective in its attitude towards investments. This law is more restrictive in relation to incentives than previous laws. For

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<sup>288</sup> *Id.* art. VI.

<sup>289</sup> In the Law on Investments of 1994 the article on dispute resolution also discusses international arbitration organizations.

<sup>290</sup> U.S. Department of State available at <http://www.state.gov/r/pa/ei/bgn/5487.htm> (visited on June 30, 2006)

<sup>291</sup> Zakon ob investitsiah Respubliki Kazakhstan Law of the Republic of Kazakhstan on Investments, No. 373-II ZPK, KAZAKHSTANSKAYA PRAVDA, Jan. 8, 2003.

instance, we can see that in respect to customs dues this law considerably limits preferences. We can see that in the Soviet-era 1990 FIL and in 1994 FIL equipment and personal items of foreign investors were not subject to custom dues. In the 2003 investment law the conditions for custom exemption look different. Article 17 of the 2003 FIL states:

Exemptions from customs duties may be granted with respect to imported equipment in the following cases:

- 1) unavailability on the territory of the Republic of Kazakhstan of manufacture of similar equipment and components thereof;
- 2) insufficient manufacture of similar equipment and components thereof on the territory of the Republic of Kazakhstan in order to carry out activities with respect to the investment project;
- 3) nonconformity of similar equipment and components thereof manufactured on the territory of the Republic of Kazakhstan to the requirements pertinent to such project.<sup>292</sup>

And even if exemptions were granted, they would have a time limit of one year with “possible extension of such term, but not for the term exceeding five years from the moment of the contract’s registration.”<sup>293</sup>

The previous law on investment stated in the section (articles) devoted to nationalization that “[t]he nationalization of the property of enterprises with foreign participation will not be permitted, though this protection was “immediately undercut by a proviso permitting in exceptional circumstances requisition of investors’ property in accordance with the procedure established by law.”<sup>294</sup> Still, the previous law stressed the inviolability of investments and placed this sentence at the beginning while underlining the use of requisition as an exceptional action. In the 2003 law, Article 8 begins from:

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<sup>292</sup> *Id.* Article 17.

<sup>293</sup> *Id.*

<sup>294</sup> Gordon Elliot, *Kazakhstan, Nazarbaev, Foreign Investment & Oil*, 53 *La. L. Rev.* 1243, 1244 (1993).

“involuntary taking of the property of an investor (nationalization, requisition) for the state needs shall be allowed in the exceptional cases which are provided by legislative acts of the Republic of Kazakhstan”<sup>295</sup> In 1994 investment law compensation due to nationalization was provided in a manner similar to what is known as the Hull Formula, which asserts that: “taking of alien property requires the payment of prompt, adequate and effective compensation.”<sup>296</sup> The wording was very close: “The payment is carried out in a manner of immediate, adequate and effective compensation.”<sup>297</sup> In the 2003 investment law, the requisition of the property of the investor “shall be carried out together with payment of the market value of the property. The market value of the property shall be determined in accordance with established legislation of the Republic of Kazakhstan.”<sup>298</sup> And if the investor does not agree with the reimbursement, “the valuation of the requisitioned property may be challenged in court.”<sup>299</sup> Settlement of disputes is resolved in the same manner as in previous investment law involving the courts of the Republic of Kazakhstan and “as well as by means of international arbitration agreed by the parties.”<sup>300</sup> There is an additional proviso which stipulates that “[d]isputes, which do not pertain to the category of investment disputes, shall be resolved in accordance with the legislation of the Republic of Kazakhstan.”<sup>301</sup>

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<sup>295</sup> Zakon Respubliki Kazakhstan ob Investitsiah Law of the Republic of Kazakhstan on Investments, No. 373-II ZPK, January 8, 2003. KAZAKHSTANSKAYA PRAVDA.

<sup>296</sup> Henry J. Steiner et al. TRANSNATIONAL LEGAL PROBLEMS, MATERIAL AND TEXT, 471, (1994).

<sup>297</sup> Zakon Respubliki Kazakhstan ob Inostrannyh Investitsiah Law of the Republic of Kazakhstan on Foreign Investments, Law No. 266-XIII on December 27, 1994, Art. 7. KAZAKHSTANSKAYA PRAVDA.

<sup>298</sup> Zakon Respubliki Kazakhstan ob Investitsiah Law of the Republic of Kazakhstan on Investments, No. 373-II ZPK, January 8, 2003, Art. 8. KAZAKSTANSKAYA PRAVDA.

<sup>299</sup> *Id.*

<sup>300</sup> *Id.* Art. 9

<sup>301</sup> *Id.*

In addition, Chapter 2, Article 4 provides a list of guarantees of legal protection of investor's activity in Kazakhstan where "[a]n investor shall be entitled to the full and unconditional protection of the rights and interests... backed by the Constitution."<sup>302</sup> In the case where the investor will be damaged by the incorrect holding of the state body, he will have the right to be reimbursed.<sup>303</sup> But the guarantees shall not apply to:

changes in the Legislation of the Republic of Kazakhstan and/or coming into force of, and/or changes to the international treaties of the Republic of Kazakhstan, which change the procedure and conditions of import, manufacture, sale of the excisable goods; changes and supplements which are introduced to the legislative acts of the Republic of Kazakhstan in order to provide for national and ecological security, healthcare and morality.<sup>304</sup>

In this respect the 2003 investment law drops the conditions stipulated in 1994 FIL about the detrimental character of the legal changes towards investors where "the legislation which was current at the time the investment was made will apply for the period of ten years, or, in the case of a long- term contract with an authorized state body, until the expiration of that contract."<sup>305</sup>

The general attitude toward tax and custom preferences is expressed in Article 14 of the investment law of 2003. The idea is to take an individual approach to every investment contract in the priority type of activity: "Investment preferences shall be granted within the priority types of activity, the list of which is approved by the Government of the Republic of Kazakhstan at the level of the classificatory of activity

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<sup>302</sup> *Id.* Art. 4.

<sup>303</sup> *Id.*

<sup>304</sup> *Id.*

<sup>305</sup> *Zakon Respubliki Kazakhstan ob Inostrannyh Investitsiah* Law of the Republic of Kazakhstan on Foreign Investments, Law No. 266-XIII on December 27, 1994, Art. 6. KAZAKHSTANSKAYA PRAVDA.

subtypes.”<sup>306</sup> The government of the republic is now more selective about the size of investment and its duration: “The Government of the Republic of Kazakhstan shall approve maximum investment volumes and duration of investment tax preferences for each priority type of activity, under which the authorized body shall grant investment preferences.”<sup>307</sup> The adoption of this law confirms that the situation regarding investments in Kazakhstan is stable. By means of this law the government of Kazakhstan is trying to attract not only foreign investors but domestic investors as well. The title of the 2003 investment law does not bear the word “foreign”, which means that conditions framed there refer both to foreign and domestic investors. Defining the investor in the 2003 investment law, Article 1 states that investors are “individuals and legal entities, which carry out the investments in the Republic of Kazakhstan.”<sup>308</sup> The definition of legal “entity” includes “any legal entity with foreign participation, incorporated in accordance with the procedure established by the legislation of the Republic of Kazakhstan.”<sup>309</sup>

The process of attracting foreign investments took place in a time of unprecedented large-scale privatization of state property, during which “[s]tate property was transferred to its new owners by auctions, tenders, or directly to employees at no cost, or for a nominal charge.”<sup>310</sup> As a result “[p]rivatization in Kazakhstan changed the system of the national economy. It was an engine of institutional, legislative, organizational, and social

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<sup>306</sup> Zakon Respubliki Kazakhstan ob Investitsiah Law of the Republic of Kazakhstan on Investments, No. 373-II ZPK, January 8, 2003, Art. 14. KAZAKHSTANSKAYA PRAVDA.

<sup>307</sup> *Id.*

<sup>308</sup> *Id.* Art.1.

<sup>309</sup> *Id.*

<sup>310</sup> Mitrofanskaya, *supra* note 239, at 1436



change” and “Kazakhstan has developed completely new legislation and created new institutions.”<sup>311</sup> Thus, through privatization, a new class of domestic owners appeared, and the 2003 investment law considered them as active participants in a market economy of modern Kazakhstan.

The law of Kazakhstan has made significant progress towards providing a stable legal environment for foreign investment since independence. As a result, legislation aimed at promoting investment. Multiple reforms have “drawn upon the experience of more established capitalist economies and implemented many suggestions from international advisers. And today Kazakhstan is firmly in the vanguard of former Soviet Union republics in adapting its legal structure to meet the needs of mixed economy.”<sup>312</sup>

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<sup>311</sup> *Id.*

<sup>312</sup> OECD, *supra* note 261, at 70.

#### IV. CONCLUSION

This thesis discusses two examples of third world countries and their relationship with foreign direct investment. This thesis shows that foreign investment can have an important impact on the socioeconomic development of these countries. The analysis of this thesis was devoted to the developing countries. It is a fact that out of 100% of foreign direct investment only around 25% is designated for third world countries; "European Union nations, the United States, and Japan accounted for more than seventy percent of world inflows."<sup>313</sup> Foreign direct investment "tends to originate from a few developed market economies and go to a few developed countries", and "current statistics show that MNEs tend to locate their foreign operations in the richer of the richest and in the richer of the poorest countries of the world."<sup>314</sup> The biggest share of FDI comes from a small number of industrialized countries; "The United States, United Kingdom, Germany, Japan, Switzerland, and France-account for more than eighty percent of the total global stock of FDI."<sup>315</sup> The decision of multinational corporations to allocate direct investments is dictated by "various economic stimuli, costs, government attitude, and geopolitical considerations."<sup>316</sup> As demonstrated above, multinational corporations prefer to invest in developed countries, but they also choose to invest in developing countries. This is often

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<sup>313</sup> RICHARD J. HUNTER ET AL, LEGAL CONSIDERATIONS IN FOREIGN DIRECT INVESTMENT, 28 OKLA. CITY U.L. REV.851, 855 (2003).

<sup>314</sup> Kojo Yelapaala, *In Search of Effective Policies for Foreign Direct Investment: Alternatives to Tax Incentive Policies*, 7NW. J. INT'L L. & BUS. 208, 214 (1985)

<sup>315</sup> *Id.* at 217.

<sup>316</sup> *Id.* at 216.

determined by resources such as oil and gas. Other motivations to invest in developing countries are that “the market may be too big to ignore, as in China and Indonesia.”<sup>317</sup>

Almost all reading material written about the relationship between Mexico and foreign direct investment characterizes it as a “love-hate” relationship, because of country’s very contradictory approaches to this topic. In the case of Mexico, there are many reasons that this country is attractive for foreign investment. First of all, is Mexico’s geographic location--the country has access to the Pacific and Atlantic oceans. Mexico is a neighbor of the United States which makes this country an unavoidable destination for FDI. The abundance of natural resources, especially oil and gas, has always made Mexico an attractive target for foreign investments and the importance of this feature has dramatically increased in recent years.<sup>318</sup> A mild, warm climate and cheap labor, and a relatively developed infrastructure guarantee this country constant interest from multinational corporations. The analysis of Mexico in this thesis shows that Mexico throughout most of the twentieth century, willfully tried to avoid foreign influence and at all costs tried to stick to its own independent policy. For more than seventy years this isolationist policy yielded positive results, known by the name of “Mexican economic miracle,” the period from the 1930s to almost the mid-1970s during which this country had stable (not less than 6%) annual economic growth. There are many reasons which contributed to the deep economic crises in the early 1980s, but the most important, in my opinion, is inequality in income distribution. A low education level takes second place in

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<sup>317</sup> Tamara Lothian, Katarina Pistor, *Local Institutions, Foreign Investment and Alternative Strategies of Development: Some Views from Practice*, 42 COLUM. J. TRANSNAT’L L. 101,106 (2003).

<sup>318</sup> See the CIA world fact book which gives contemporary data on economic situation of Mexico). <http://www.cia.gov/cia/publications/factbook/geos/mx.html> (last visited on July 3, 2006).

contributing to Mexico's socioeconomic maladies. Unfortunately, the ruling class of Mexico failed to deliver social justice and relative equality, thus failing to balance market economy and social issues. Whether foreign direct investment is a "life saver" for Mexico in the recent times of crisis is a disputable question. The World Bank regards FDI and import of technology as "the second benefit" for the countries after financial investments.

It summarizes that:

the ability of countries to benefit from FDI in this and or other ways is country and industry specific. It appears to depend on a country's 'absorptive' capacity which grows strongly with better education. The poorest countries have the least absorptive capacity and are most likely to suffer the social and environmental dangers which come with FDI.<sup>319</sup>

It is difficult to argue with the opinion that "a certain threshold of development needs to be reached before liberalization becomes beneficial."<sup>320</sup> Mexico tried to handle foreign direct investment to its advantage when it adopted its first foreign investment law in 1973, and in spite its restrictive character, the investments continued to flow into the country. One of the internal reasons that brought Mexico into a deep financial crisis in spite of an abundant cash flow due to oil sales is that the Mexican government borrowed excessively from Western financial institutions "to address long-standing economic and social problems" after which the country ended up in a helpless situation when it could not service the international debts.<sup>321</sup> It took another twenty turbulent years before Mexico adopted a laissez-faire investment law in 1993 and entered NAFTA with the great hope that a liberalized economy and free trade would yield results in a not too distant future. Many advocates of the liberal economy insist that due to NAFTA

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<sup>319</sup> JANET DINE, COMPANIES, INTERNATIONAL TRADE AND HUMAN RIGHTS, 109 (2005).

<sup>320</sup> *Id.* at 107.

<sup>321</sup> SARAH BABB, MANAGING MEXICO: ECONOMISTS FROM NATIONALISM TO NEOLIBERALISM , 9 (2001).

agreement, trade with U.S. and Canada has tripled, and beyond this agreement, Mexico has twelve free trade agreements with more than forty countries including the European Free Trade Area and Japan, thus putting ninety percent of trade under free trade agreements.<sup>322</sup> Nevertheless reducing poverty and international competitiveness continue to be main goals of each new government, including a new one which will take over power in December 2006.<sup>323</sup>

As for Kazakhstan, the attitude of this country to FDI was very different from that of Mexico. When Kazakhstan became independent, it lost almost all economic ties with other former Soviet Union republics. Like other broken pieces of the USSR, it desperately looked for international economic partners and financial resources. Both soon were found, thanks to an abundance of mineral resources.<sup>324</sup> During the transition period, Kazakhstan managed to maintain its economic and financial stability, and recently could afford to implement a selective policy towards foreign investments. Today, economic performance in terms of GDP growth looks very impressive. Unfortunately, in spite of impressive economic growth figures, the population dramatically split into “haves” and “have-nots.” Social services like health care and education experienced a sharp decline in comparison with the Soviet era. Life expectancy decreased from an average 72 years to 64.<sup>325</sup> During its short modern history, independent Kazakhstan was and is successful in its policy of attracting FDI, but to being successful in attracting FDI and foreign

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<sup>322</sup> CIA-The World Fact Book available at <http://www.cia.gov/cia/publications/factbook/geos/mx.html> (last visited on July 5, 2006).

<sup>323</sup> *Id.*

<sup>324</sup> World Health Organization, Europe available at <http://www.euro.who.int/document/E88738.pdf> (last visited on July 5, 2006).

<sup>325</sup> World Health Organization Europe available at <http://www.euro.who.int/eprise/main/who/progs/chhkaz/home> (last visited July 5, 2006).

assistance is not the only prerequisite to achieving sustainable growth. Sustainable development can not be reached without complex, well thought out, socially-oriented policies regarding, for example, education and healthcare. FDI is only one part that, with the right proportion of regulations and incentives, can add to the general growth on the county's wealth. Obviously when governments try to work out the policies to attract FDI, they should have in mind that foreign investors make specific contributions to economic development, but also that FDI policy should not disturb national objectives or patterns of development.<sup>326</sup> The criteria for evaluation of FDI should include the following imperatives, and these imperatives are taken from "official proclamations and views expressed in several countries."<sup>327</sup> Foreign direct investment must:

- 1) complement national investment and make a significant contribution to economic development, especially in raising living standards;
- 2) not displace national investors or enter into sectors adequately supplied by national companies;
- 3) create positive-balance-of-payments effects, adding to the capital inflows of the country, generating net increases in exports, and reducing expenditures for imports;
- 4) increase employment at all levels and diversify employment opportunities, especially in the technical and administrative fields; train both technicians and managers;
- 5) develop local resources and use local suppliers;
- 6) stimulate activity in depressed regions;
- 7) not increase monopolistic tendencies on the market;
- 8) not cause a drain of local financial resources away from national investors;
- 9) contribute significantly to local R&D efforts, both through a transfer of appropriate technology and the building of a base for indigenous scientific and technical research;
- 10) demonstrate "good corporate citizenship" and not disturb the social and cultural values of the host country;

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<sup>326</sup> JACK N. BEHRMAN, DECISION CRITERIA FOR FOREIGN DIRECT INVESTMENT IN LATIN AMERICA, 36 (1974).

<sup>327</sup> *Id.*

11) assist local entrepreneurs in increasing their share of ownership and management of industry.<sup>328</sup>

If it is possible to apply these conditions to the situation in Kazakhstan, it is possible to say that at least half of the conditions are met by foreign investors, but mostly in the oil and gas sectors. The absence of the investors' interest in other economic sectors such as production and agriculture, can be explained by the location of Kazakhstan--it is a landlocked country with two powerful neighbors--Russia in the North and China in the South. These two countries with their immense territories make the transportation of Kazakhstan exports very expensive. A notion that the population is small can also play a negative role in attracting foreign investors who may not see a potential for a consumer market.<sup>329</sup> One of the positive Soviet legacies is the high rate of literacy in this young country, and this factor can contribute to the decision of the investors, where they needed educated working class. But, at the same time, the people of Kazakhstan, as former Soviet citizens, still regard free health care and education as natural elements of civilized life, and this can be a stumbling block for foreign investors, who may regard Kazakhstan as a developing country with cheap labor. The fact that Kazakhstan has no problems with foreign direct investments in the oil and gas sectors is not a ground for optimism, as "a sudden inflow of dollar-denominated revenues often leads to a sharp appreciation in the domestic

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<sup>328</sup> *Id.*

<sup>329</sup> The territory of Kazakhstan is 2,7 million square kilometers, and the population is only 15 million people. In contrast, Mexico's territory is around 2 million square kilometers, but its population is 107 million people. CIA-The World Fact Book, *available at* <http://www.cia.gov/cia/publications/factbook/geos/mx.html> (last visited on July 6, 2006).

currency. That tends to make non-profit sectors like agriculture and manufacturing less competitive in world markets, thus leaving oil to dominate the economy.”<sup>330</sup> The instability of oil prices hurts the poor the most because they are the least able to hedge their risks, and because this resource is concentrated, the wealth comes only into a few hands and “so is more susceptible to misdirection.”<sup>331</sup> Kazakhstan has had impressive GDP growth for the last few years but according to the United Nations Human Development Index, the country ranks 78th out of 177.<sup>332</sup>

The analysis of the investment laws in Kazakhstan shows that they contain all kinds of incentives which are able to attract the most demanding investors, but the distant location of the country, its small population and the absence of international waterways harm Kazakhstan’s investment image. There’s one more reason which can outweigh a lot of positive efforts applied to “lure” FDI into Kazakhstan. It is corruption. According to a 2002 report of the organization Transparency International, Kazakhstan kept its 88<sup>th</sup> place ranking out of 102 in country corruption.<sup>333</sup> Mexico in the same table looks better, but not much, maintaining 53rd place.<sup>334</sup>

In contrast to Kazakhstan, Mexico is not disadvantaged in regard to geographic location and population size. Mexico has everything necessary to become a

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<sup>330</sup> The paradox of plenty, *The Economist*, Dec. 24, 2005, at 45.

<sup>331</sup> *Id.*

<sup>332</sup> UNDP report, available [http://hdr.undp.org/statistics/data/country\\_fact\\_sheets/cty\\_fs\\_KAZ.html](http://hdr.undp.org/statistics/data/country_fact_sheets/cty_fs_KAZ.html) (last visited on July 6, 2006)

<sup>333</sup> Transparency International available at [http://www1.transparency.org/pressreleases\\_archive/2002/2002.08.28.cpi.en.html](http://www1.transparency.org/pressreleases_archive/2002/2002.08.28.cpi.en.html) (last visited on July 6, 2006).

<sup>334</sup> *Id.*



wealthy, competitive, and successful state: good location, abundance of resources, big population. Its foreign investment flow is one of the highest in Latin America, and if we look at figures such as GDP growth, oil and gas sales, and export and import rates, they would look very impressive and today Mexico has the ninth largest economy in the world. Yet, we also can see that demands listed in the United Nations Human Development Index are far from satisfactory in the areas such as education, income per capita, health care and everything that relates to decent conditions for human life. And this is probably one of the main reasons why so many Mexican people try to emigrate to the United States of America.

Foreign direct investment can benefit the country's socioeconomic development only in the case where the leadership of the country willfully and consequently pursues the goal of turning its developing country into a developed country through democratic instruments promoting fair and just distribution of wealth.

When the leadership of any country is trying hard to attract FDI, it must not forget that the main sources of this type of investment are multinational corporations, and corporations are created with the sole purpose, of making profit for their shareholders. So, when corporations invest in a country they do it with the purpose of making profit and this purpose may reflect both long and short-term economic interest. Sometimes, when after attracting the desired amount of FDI, the country finds itself not only without anticipated gains, but even worse off than it was before FDI inflow. This might mean that the government did not

assess properly the future impact of such a decision and in some cases was excessively optimistic or trustful when getting FDI on stipulated terms and conditions. It is crucial to remember that “[s]ome TNCs (transnational corporations) may be considerably more powerful than the regulating host state. Many of the TNCs based in the USA or United Kingdom are driven by the concept of maximizing shareholder value.”<sup>335</sup> Moreover, when attracting FDI, the host country should not be “lulled” by the OECD Guidelines for Multinational Enterprises in which “ethical, environmental and other public policy commitments are treated explicitly”, since this document is not legally binding.<sup>336</sup>

Foreign investments add positive impact to the national economy when the leaders of the county apply all their efforts to build a society of educated, affluent, and law-abiding citizens who know their rights and obligations.

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<sup>335</sup> Dine, *supra* note 319, at 223

<sup>336</sup> *Id.*, at 235

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