THE DAVID HUME INSTITUTE

FOREIGN INVESTMENT AND THE LAW IN THE RUSSIAN FEDERATION

Papers presented at a Colloquium
Moscow, 7-16 December 1991

Edited by
ELSPETH REID

Hume Occasional Paper No.37

The David Hume Institute
21 George Square
Edinburgh EH8 9LD

© The David Hume Institute 1992

ISBN 1 870482 33 6

Printed by Pace Print (Edinburgh) Ltd.

FOREIGN INVESTMENT AND THE LAW IN THE RUSSIAN FEDERATION

Papers presented at a Colloquium
Moscow, 7-16 December 1991

Edited by
ELSPETH REID

THE DAVID HUME INSTITUTE

1992

CONTENTS

FOREWORD

In 1987 the Faculty of Law in the University of Edinburgh and the Institute of State and Law of the Academy of Sciences of the USSR, based in Moscow, began discussions which culminated in 1989 with the signing of a Protocol. Under this agreement, the two institutions have held several colloquia in Edinburgh and Moscow on a variety of legal topics. These exchanges have been generously funded by the British Council, the support of which has been and is greatly appreciated by the Faculty and the Institute, and by those fortunate enough to have participated in the colloquia.

A colloquium on the subject of Foreign Investment Law was held in Moscow in December 1991. The Edinburgh participants - Professor John Murray (one of this Institute's Trustees), Mr John Gooding, Mr George Gretton, Dr Hector MacQueen (Executive Director of this Institute) and Mr Kenneth Reid - arrived in Moscow on the eve of the signing of the Minsk Agreement, which signalled the collapse of the Soviet Union and the rule of Mikhail Gorbachev, and the birth of the Commonwealth of Independent States. It was symptomatic of the fundamental shifts taking place that in the same week the Academy of Sciences became the Russian Academy.

These remarkable events provided a stimulating background to the colloquium which followed, quite apart from the intrinsic interest of the legal problems which beset the transition from a command to a market economy. A market cannot operate without laws which facilitate and encourage commercial activity. The gigantic problems of the former Soviet Union and its successor states in establishing a system of laws consonant with a market economy emerged clearly from the Russian contributions to the colloquium. Each shows how difficult it is to overcome the legacy of the past. Avgust Rubanov draws attention to the continuing influence of `communist fundamentalism' and the contradictions in law and policy which flow from this. A. Yu Kabalkin is concerned that the protection of foreign investment from nationalisation and confiscation measures is by no means clear-cut. Nina Solovyanenko points out that the necessary conditions of stability and sympathy towards free commercial activity are far from fully established. And L. B. Maximovich comments on the variable nature of the provision in the various states for Free Economic Zones. Yet the papers also show how much had been achieved legislatively even before the fall of the Soviet Union; and given that the Minsk Agreement provided for the continuation of Soviet laws until their supersession by

legislation in the successor states, it can be seen that there has been real progress towards the legal framework required for a market economy.

It was thought that the attempts to meet these problems would be of interest to the subscribers of The David Hume Institute, as well as providing information which is otherwise difficult to obtain for those investing, or advising investors in Russia and the other states of the CIS. The Institute is grateful to Elspeth Reid and Rona Somerville for undertaking the translation of the papers. Elspeth Reid also agreed to edit the collection and provide an introduction, and the Institute is also grateful to her for this work. It may be noted here that the Scottish contributions to the colloquium have also been published (in Russian) by the Institute of State and Law under the (translated) title, *Foreign Investment in the Countries of the CIS and Great Britain.*

It is customary and necessary to note that the views expressed in the publications of The David Hume Institute are those of the authors alone; the Institute, as a charity and non-political organisation, has no collective view or standpoint on any of the issues ventilated in its output.

Hector L. MacQueen
Executive Director
December 1992

INTRODUCTION

The papers in this collection are those given by the Russian speakers at the symposium on Commercial Law held in Moscow in December 1991. They all address the increasingly important subject of foreign investment in the former USSR in general, and Russia in particular, and examine the legal provision made for it.

The central planning system previously governed all aspects of economic relations in those states. Foreign commercial contacts, especially those with the West, were relatively restricted, and existed within a framework circumscribed by political considerations. The attempt to make the transition to a market economy in a rapid time scale has transformed foreign relations, and commercial relations in particular. It is recognised that Russia cannot survive in economic isolation. Foreign investors must be attracted in order to inject capital, resources, technology and know-how into the faltering economies of the CIS as a whole. This is matched by a readiness on the part of many countries to support economic reform, and to take a risk on what may turn out to be a valuable long-term investment.

In the months since the collapse of the Soviet Union, as in the years of *perestroika*, there has been an enormous amount of legislative activity in its former member states. There has also been a degree of legal continuity: in Russia at least, the Russian legislature ruled, when it ratified the Minsk Agreement on 12th December 1991, that Soviet laws should remain in force until superseded by Russian legislation. In some areas, the legislators are able to build on developments begun during the years of *perestroika*: joint ventures, for example, were first established by legislation enacted in 1987.[1] In others, they are faced with a *tabula rasa*. They are grasping the opportunity to enact legislation for which there was little precedent

---

1 Decree of the USSR Council of Ministers adopted 13th January 1987 "On the Procedure for the Creation on the Territory of the USSR and the Activities of Joint Ventures, with the participation of Soviet Organisations and Firms from Capitalist and Developing Countries".

in the Soviet era: the Soviet legislation on Companies, for instance, was still in its infancy. Western models, previously disregarded on ideological grounds, are being eagerly consulted as a basis for the new laws. It is against this background that regulations to provide a favourable environment for foreign investors are being formulated.

The papers in this collection consider the various forms which foreign investment may take: joint ventures, and Russian registered companies in which the shares are wholly or partly owned by foreign investors. The paper by Professor Rubanov takes an overview of the legislation, and places it in context. Professor Kabalkin examines the way in which the legislation differentiates between foreign and Russian investors, the forms of business activity which they may undertake, the property rights which they can acquire, and the legal safeguards offered for their investment. The more technical points relating to the formation of businesses, and the requirements of registration procedures are explored in Ms. Solovyanenko's paper. Finally, Ms. Maximovich explains the workings of the Free Economic Zones established under Gorbachev to offer attractive conditions for investors in specific geographical areas. She argues that the regulations have been overtaken by more general reforms, and now require revision if they are to offer a more favourable regime than is available for the rest of Russia and the other states.

It is particularly difficult to ensure that any account of Russian law is fully abreast of all the most recent legislative and administrative developments by the time it is published. While the legislation examined in these papers remains substantially in place, there are other initiatives which are of great importance to the foreign investor, for example, major legislation on privatisation of state property, and on rights in security. Some of these topics were explored in a further joint symposium held at the University of Edinburgh in October 1992 with the participation of the Institute of State and Law. It is intended that the proceedings of this symposium will be published by The David Hume Institute at a later date.

Elspeth Reid

THE LAW ON FOREIGN INVESTMENT IN THE FORMER SOVIET UNION: A STEP FROM THE PAST INTO THE FUTURE

Avgust A. Rubanov

Legislation on foreign investment was enacted in 1990-91 by Kazakhstan, Lithuania, Uzbekistan and Russia. The Ukraine and Byelorussia included provisions on foreign investment in more general legislation. In addition, at USSR level, the "Fundamental Legislation on Foreign Investment in the USSR" became law. As it turned out, the legislation on foreign investment became the last major legislative initiative of the Soviet Union. After the defeat of the August 1991 coup, the legislative activity of the Soviet state ceased to have any direction, and on 7th December 1991, the Soviet Union ceased to exist.

When the legislation on foreign investment was adopted, it was still within the framework of the single state. The legislative organs which enacted these laws were confronted with a general problem: the country was in desperate need of foreign capital investment. However, the various legislative organs involved used different methods of dealing with this problem, and these methods were often contradictory, even as regards the major issues.

The first question to be decided was whether to allow unrestricted foreign investment or to set up a procedure by which authorisation was required. This question was a particularly vexed one for the former Soviet Union. Over the course of several decades, the country had isolated itself from the world economy, in so far as its administration consistently restricted communication with the outside world to within politically defined limits. It was only in the middle of 1990 that it declared officially its intention to make the transition to a market-based economy. This decision marked a turning point. The market economy cannot be restricted by national boundaries. By definition, it must function as part of the world economy. If the Soviet Union was to forge economic links with the rest of the world, it needed to emerge from self-imposed isolation.

This applied to questions of foreign investment just as it did to other areas. There were various methods of doing this.

The initial legislation on foreign investment made foreign investment subject to the administrative control of the state. The Kazakh and Lithuanian legislation provided that the foreign investor required official authorisation to invest before placing his investment. In both republics, authorisation was granted by a special government organ empowered to do this. The Lithuanian law imposed a particularly stringent set of rules, allowing no scope for deviation, for obtaining preliminary authorisation. In Kazakhstan, foreign investment did not require authorisation in certain cases.

Two laws on foreign investment passed subsequently take a diametrically opposed position. The Russian and Uzbek laws are more radical in striving to end isolation from the world economy, and they are based on the fundamental principle of unrestricted foreign investment. This principle received positive expression in the provisions of the law designed to allow foreign investors to acquire shares issued by Russian (or Uzbek) juristic persons. For instance, the Russian law provides that "foreign investors have the right to obtain...shares and other securities issued by an enterprise situated on RSFSR territory" (Article 35). There are no other provisions in these laws which have a direct bearing upon other forms of foreign investment. However, they do not contain any requirement that foreign investors must obtain authorisation from the appropriate government organs. In all cases, foreign investors can place their investment as they choose. This is also the way the issue is dealt with in the "Fundamental Legislation on Foreign Investment in the USSR." However, the Russian and Uzbek laws allow for deviation from the principle of unrestricted foreign investment in certain instances. For example, according to the Russian law, property in federal ownership and valued at more than 100,000 roubles can only be leased to a foreign investor if preliminary authorisation is granted (Article 39).

This hesitation over past and future is also apparent in the choice between ownership and leasing in foreign investment laws. The laws are based on the premise that it is more desirable for the foreign investor to lease rather than to own property. The Russian and Uzbek laws contain various articles which deal with the rights of

foreign investors to lease property. But there is not a single reference to the fact that foreign investors may have the rights of ownership. Of course, these laws are based on the premise that foreign investors can own property. But they avoid spelling this out directly. Usually they say that foreign investors can "acquire" property. Of course, acquisition denotes acquiring the rights of ownership over something. But not one of the laws on foreign investment says this directly even once.

However, other laws do make direct provision on this subject. For example, the law "On property in the RSFSR" of 24th December 1990 provides that: "Foreign juristic persons have the right to own on RSFSR territory industrial and other types of enterprise, buildings, and other structures, and any property required for business and other activities" (Article 28).

The silence of the foreign investment laws on the property rights of foreign investors reflects the influence of the communist fundamentalist ideology, which held that ownership of the means of production was the basis of the economic and political structure of society.[2] In the light of this, the direct acknowledgement in another law that foreign investors can acquire ownership over enterprises, buildings, other structures and so on appears to be the official seal of approval on the change of the entire economic and political structure of society by means of foreign investment.

On the other hand, from the point of view of communist fundamentalism, leasing property to foreign investors does not appear to attract such consequences. Ownership over the leased property remains with the state, and the lease itself has a finite duration. Of course, the concession which the laws have granted to communist fundamentalism is a concession in terminology. But it is nevertheless a concession.

---

2 See *The Butler Commentaries on Soviet Law. The Law on Ownership in the USSR*, London and Moscow 1991, pp.5-6.

The way in which the legislation deals with the problem of nationalisation is of particular importance. Different laws approach it in different ways.

It should be remembered that the Soviet Union was a country which had presided over the most sweeping nationalisation programme in the entire history of mankind. As Soviet literature put it, "nationalisation of the tools and means of production is one of the most fundamental tasks of the socialist revolution". Nationalisation represented "not simply a change in the persons who have the right of ownership, but the end of the right of private property and the beginning of a completely new right of state socialist ownership".[3] The right to implement nationalisation was acknowledged as the state's most important right, its sovereign right.[4] This whole network of ideas and preconceptions is connected with the views of the founders of marxist doctrine, who believed that the development of Western society at that time was leading inevitably to what they termed the "expropriation of the expropriators", that is to the universal nationalisation of private property. In their thinking, this would open the way for mankind to enter a bright future.

In reality, the sweeping measures used to nationalise property in the Soviet Union after 1917 led to the creation of a totalitarian economy, and latterly led the country first into deep crisis, and then to the brink of collapse.

The legislation on foreign investment was adopted at a time when the consequences of nationalisation had become fully apparent. And all the different legislative organs approached the problem of nationalisation rather differently.

---

3 M. M. Boguslavskii, *Immunitet gosudarstva,* Moscow 1962, p.107.

4 S. N. Lebedev, *Mezhdunarodny arbitrazh i problema zashchity inostrannykh investitsii, Pravovye problemy inostrannykh investitsii v SSSR. Tezisy dokladov nauchnoprakticheskoi konferentsii,* Moscow 1991, p.95.

The first series of laws banned the nationalisation of foreign investments. This represented a radical departure from the traditional tenets of communist fundamentalism. In line with this, states were rejecting the very opportunity to nationalise private property, at least the property of foreign investors. Such provisions were contained in the Uzbek and Kazakh laws. The first of them proclaimed that "foreign investment in the Uzbek SSR may not be nationalised" (Article 11). A similar provision can be found in the Kazakh legislation. To begin with, Lithuania avoided this question by remaining silent. But in February 1992, the final version of its own law on foreign investment banned its nationalisation.

The second series of laws does not make a complete break with previous ideology, although to a certain extent they also depart from its basic preconceptions. These laws provide that compensation must be paid in cases where the property of foreign investors is nationalised. According to communist fundamentalism, the goal of nationalisation is the eradication of the class of private owners. Therefore it is not appropriate to pay them compensation.

With regard to the central issue, however, these laws remain the prisoner of the old attitudes towards the nationalisation of foreign investment. The Ukrainian and Byelorussian versions of the laws are much closer to orthodox traditions, in that they provide that "investments may not be nationalised without payment being made". In principle, therefore, investments may be nationalised.

The "Fundamental Legislation on Foreign Investment in the USSR" begins with a directly contradictory declaration: "Foreign investments in the USSR may not be nationalised" (Article 10). However, a further proviso makes an exception for cases "where it is carried out in accordance with the legislation of the USSR and the Republics" (Article 10). In effect, this exception restores the orthodox view of nationalisation: any legislative act can nationalise foreign investments.

The layout of the Russian law is similarly structured. It also begins with the declaration that "foreign investments in the RSFSR may not be nationalised" (Article 7), followed by the proviso "except as provided in separate legislation" (Article 7). This group of laws has a special place in the history of Soviet law. They have become the first

laws to provide in general terms for the nationalisation of property by the state. Over the course of more than seventy years, a huge amount of legislation on nationalisation was enacted in the Soviet Union. However, no law ever provided in general terms that the state had the right to nationalise. And now just such general rules are appearing. Of course it was hardly the intention of the Russian legislature to create them. But this is exactly what has happened. The Russian Federation law proclaims: "Decisions on nationalisation are taken by the Supreme Soviet of the RSFSR." (Part 2, Article 7).

History has treated the final laws of the former Soviet Union with a certain degree of irony. General regulations on the right to nationalise foreign investments have appeared at the very moment when the country is in urgent need of an injection of foreign capital, and they have been included in the very laws which regulate foreign investment.

History, however, has demonstrated not only irony, but also sarcasm. The Russian and Soviet laws have declared that the state has the right to nationalise investments made by foreign investors. But elsewhere the very same laws proclaim the right of foreign investors to take part in the privatisation of state property. On the one hand foreign investments are converted into state property, and on the other state property is converted into foreign investment. Two directly contradictory processes have been created. They are governed by the same laws. The reason for this is that one of these processes belongs to the past, and the other to the future. It is to be hoped that the legislators in the states of the former Soviet Union, in their hesitation between past and future, will not be like the ass in the Russian fable which perished from hunger as it stood between two identical bales of hay.

LEGISLATION OF THE RUSSIAN FEDERATION ON THE STATUS OF FOREIGN INVESTORS

A. Yu. Kabalkin

As Russia makes the transition to a market economy and the commercial sector develops, there is increasing awareness of the need to attract and establish free investment in the different branches of the country's economy. There is a pressing need for the wide-scale use of foreign material and financial resources, advanced foreign technology, scientific and technical know-how and management experience. Accordingly, more attention is being paid to the problems connected with the legal regulation of the varied relations inherent in existing foreign investments, and those which arise through the investment process. One of these problems concerns the clarification of the legal status of investors who decide to channel their capital, as a loan or a direct investment, in the form of finance, physical assets or intellectual property, into business schemes.

The law passed on 4th July 1991 in the Russian Federation, "On Foreign Investment in the RSFSR",[5] sets out a fairly wide range of persons who may invest. The following may become foreign investors in Russia: foreign juristic persons including, in particular, any companies, firms, enterprises, organisations or associations, formed and authorised to make investments in accordance with the legislation of their country of origin; foreign citizens, individuals without citizenship, and citizens of the Russian Federation permanently resident abroad, on condition that they are registered for business in the country of which they are citizens or in which they are permanently resident; foreign states, and various international organisations.

The list is exhaustive in that it mentions all categories of legal persons. It is significant that a USSR law passed on the following

---

5 *Vedomosti s'ezda narodnykh deputatov RSFSR i Verkhovnogo Soveta RSFSR* 1991, No.29, Item 1008.

day, namely the "Fundamental Legislation on Foreign Investment in the USSR", suggested that certain categories of foreign associations which invested in the USSR did not have the rights of juristic persons.

The legal status of the foreign investor in the former USSR at the present time has changed substantially. It is significant that even in the post-war period, the legislation regulating the status of foreign juristic persons in the USSR was regarded as having historical, but no practical significance. It was only with the specific authorisation of the government that such persons were allowed to participate in commercial activity. A procedure for obtaining authorisation was established for all foreign firms, and for individual foreign businessmen. As suggested by S. N. Bratus, this rule protected the Soviet economy from being penetrated by foreign capital.[6] As things now stand, such a view hardly requires comment.

The legal status of foreign investors is now determined by the recent legislation which can be divided into two categories.

The first is the national legislation of the state on whose territory the investments are made. The second relates to the relevant international agreements (for the most part, bilateral). Thus the RSFSR laws of 26th June 1991, "On Investment in the RSFSR",[7] and "On Foreign Investment in the RSFSR",[8] refer not only to other RSFSR legislation, but also to international agreements.

The question arises, whether legislation of the former USSR is effective in the RSFSR and, in particular, the decree of the Council of Ministers of 13th January 1987, "On the Procedure for the Creation on the territory of the USSR and the Activities of Joint Ventures, with the participation of Soviet Organisations and Firms from Capitalist

---

6 S. N. Bratus, *Subekty grazhdanskogo prava*, Moscow 1950, p.235.

7 *Vedomosti s'ezda narodnykh deputatov RSFSR i Verkhovnogo Soveta RSFSR* 1991, No.29, Item 1005.

8 Ibid

and Developing Countries." This is a complex question. Many of the provisions of this decree are reproduced in these two laws. However, there are other provisions which conflict with the laws, and which are outwith their framework, for example those which concern the formation of subsidiaries of joint ventures as separate juristic persons. Article 31 of the Russian Civil Code deals with this situation by according a juristic person the right to form subsidiaries following the procedure established in the legislation. A similar rule is to be found in Clause 12 of the Law on Foreign Investment.

As in other areas, it is necessary to decide what application Soviet legislation has within the Russian Federation to the law concerning the legal status of foreign investors. The decree of the RSFSR Supreme Soviet of 12th December 1991 which ratified the Minsk Agreement established that the legislation of the former Union of SSR should apply until superseded by Russian legislation. The existence of a specific Russian law on foreign investments means that the all-union legislation with the same name no longer applies. There may, however, be the question of other legislation and delegated legislation. If such legislation was passed within the scope of the authority, granted to the union by the Russian Federation, then they apply within its territory, according to the RSFSR law of 24th October 1990, "On the application of legislation enacted by Union organs within the territory of the RSFSR".[9] Under no circumstances, however, must they contradict the Constitution and Laws of the Russian Federation.

As regards international agreements, there is a special rule which gives their provisions priority over Russian legislation. If an agreement effective in the RSFSR contains different rules from those contained in the legislation of the Russian Federation, the rules of the international agreement in question must apply.

The legal status of foreign investors varies according to the administrative and legal form of the business. Enterprises with foreign investment can be formed and can operate in the form of

---

9 *Vedomosti s'ezda narodnykh deputatov RSFSR i Verkhovnogo Soveta RSFSR* 1990, No.21, Item 237.

joint-stock companies and other commercial companies and associations. These may be enterprises in which the foreign investor takes a share (joint ventures); enterprises belonging entirely to foreign investors, and subsidiary enterprises and branches of both; and also subsidiaries of foreign juristic persons.

The placing of foreign investment in businesses in the Russian Federation does not require permission from the state. Foreign investors may use the right which they have in various ways. The majority of these are set out in the Law. In addition, any kind of activity is permitted which is not prohibited by the legislation (including the grant of loans and the transfer of property for any reason). The secure legal status of the foreign investor has been set out in the law in detail. However, by no means all the rules are necessarily concerned with strengthening the rights and interests of the investor.

The provisions offering foreign investment full and unconditional legal protection, as guaranteed in the Law itself, other legislation and international agreements, seem very convincing at first sight. Moreover, the Law proclaims that the legal regulation of foreign investment, and likewise the activity of foreign investors in accordance with it, should not place them in a less advantageous position than juristic persons and private individuals in the Russian Federation. However, the Law does not stop at this. It goes on to refer to various exceptions. As a result, the definition of legal protection as full and unconditional, signifying the highest degree of safeguard, loses much of its meaning. Unfortunately, all of this from the foreigner's point of view materially undermines the efficacy of these Laws, which represent the national regulatory system for foreign investors.

The legislator did not manage to avoid contradictory formulae in setting out state guarantees for the rights of potential investors, and the extent of protection for investments.

Article 7 of the Law on Foreign Investment stipulates that such assets should not be subject to nationalisation and should not be requisitioned or confiscated, but there are rather different provisions elsewhere. The first of these is included in the same Article 7: "Except for exceptional circumstances, as provided in legislation,

when these measures may be taken in the interests of society." The meaning of the imprecise wording in question remains obscure. Two further provisions in Article 7 are set out as separate paragraphs: decisions on nationalisation are taken by the Supreme Soviet of the RSFSR, and decisions on requisition and confiscation are taken according to the procedure set down in RSFSR legislation.

It is a delusion that other provisions can be effective, whereby the decisions of government bodies on the confiscation of foreign investments (and only on such) may be appealed to the courts of the RSFSR, and whereby, in the event of nationalisation or requisition, the investor is to be paid swift, adequate and effective compensation. This last formulation is very obscure, in so far as it has never yet been applied in the domestic law of the former Soviet Union. There is, unquestionably, practical value in granting foreign investors rights regarding compensation for losses (including lost profits), suffered because state organs issue orders which conflict with the current legislation, or because such organs or their officials do not fulfil their duties in relation to the foreign investor or enterprise with foreign investment.

According to the law "On Investment in the RSFSR", which sets out to guarantee the equal protection of the rights, interests and property of all participants in investment activity, including foreign investors, the state guarantees the protection of these rights. Such a statement indicates the importance of such rights. However, as is evident from the subsequent text of this law, it places in doubt the stability of the rights which it proclaims: "In the event that legislation should be passed which restricts the rights of potential investors, the relevant provisions of these acts may not come into force sooner than one year from the time of their promulgation." But if the aim of guaranteeing the secure position of these rights is to be taken seriously, it is essential to exclude the very introduction of these destabilising acts, rather than merely to delay their application.

The shortcomings described are to a lesser extent inherent in the international agreements which were signed in 1989-90 and came into effect in mid-1991. These agreements are based on a fairly broad conception of capital investment, and they grant protection to all kinds of assets connected with the investment of capital and to the rights associated with these assets. Moreover, one can identify a

tendency to expand the list of property assets which may be encompassed within the term "capital investment". A number of the agreements include under this heading trademarks and business names, whilst other agreements include commercial know-how.

The rules on the legal nature of property belonging to joint ventures, foreign citizens, juristic persons, states and international organisations are concentrated in a particular section of the law "On Property in the RSFSR"[10]. Investment in Russia may be applied for any purposes which the legislation does not prohibit for such investments. This would include investment in the equity and working capital of businesses in all branches of the economy, securities, specific projects, scientific and technological developments, and rights relating to property and intellectual property. It is of the utmost importance that the provisions which relate to the property of citizens in the Russian Federation apply equally, as a general rule, to the property of foreign citizens and individuals without citizenship, situated on its territory.

The law "On Foreign Investment in the RSFSR" provides for the existence of property belonging to foreign investors in Russia, but sets apart the mixed forms of property in which the property of foreign and Russian persons is combined. Article 26 allows joint ventures with the participation of Russian juristic persons and individuals, and foreign juristic persons and individuals, to be created in the form of companies, partnerships or other business organisations. They may own property essential for the management of the business, as provided in the foundation documents (the agreement relating to the formation of the enterprise, and its regulations).

As far as the activities of foreign investors are concerned, in general terms, an enterprise with foreign investment has the right to engage in all kinds of business which correspond with the objects set out in the enterprise's regulations. There is an exception for activities of the kind prohibited in the territory of Russia (Article 20 of the Law on Foreign Investment). Such forms of investment may come into being

---

10 *Ekonomika i zhizn* No.3, 1991.

as enterprises belonging entirely to foreign investors, and also subsidiaries of foreign juristic persons (Article 3). This would also include those kinds of business which are required by the law to have special authorisation from the relevant government body. In order to engage in insurance and brokering connected with the negotiation of securities, an enterprise with foreign investment must receive authorisation from the Ministry of Finance, and for banking-related business, one from the Central Bank of Russia. The government has the right to decide that other types of business require special authorisation (Article 20).

The law refers also to a number of property relations which arise on the basis of a particular contractual relationship. Such relations may arise when the right of use, rather than ownership, is granted or when state-owned property is transferred for a finite period and with a definite purpose for; example, natural resources with the right to extract valuable minerals.

Foreign investors have the right to acquire shares and other securities issued by enterprises situated in Russia, and the shares may be acquired in exchange for roubles, which the investor has received as revenue from Russian or CIS sources, and also in exchange for foreign currency.

There are separate rules for foreign investors involved in the privatisation of state and municipal enterprises. The most important of these provides that the conditions governing their participation in auctions and competitive tendering for such assets are determined by separate Russian legislation (Articles 35-37).

The right of foreign investors to use natural resources and other property is granted in accordance with the Law on Foreign Investment, and further special legislation (Articles 38-39). The right to use land and other natural resources, including leasehold rights, is regulated by the general Code on Land Law. The transfer of the right to possess and use property other than natural resources is governed by the law applicable to leases. Leases may therefore be granted to joint ventures, international associations and organisations with the participation of Soviet and foreign juristic persons, and also to foreign states, international organisations, foreign juristic persons and individuals.

Foreign investors can acquire certain rights on the basis of the concessionary agreements, negotiated with the Russian government. Investors can exploit renewable and non-renewable natural resources, and engage in commercial activity using state property which has not been transferred to the management or control of other enterprises, institutions or other organizations. In the event that concessionary agreements include conditions which conflict with the relevant legislation, they must be ratified by the Russian Supreme Soviet (Article 40).

Free economic zones are being formed in Russia in order to attract foreign capital, advanced foreign technology and administrative know-how and to develop export potential. Within these regions favourable conditions apply for foreign investors and enterprises with foreign investments involved in commercial activity. The law provides that the legislation may yet be expanded to include further rights and guarantees for such investors.

THE RUSSIAN LAW CONCERNING BUSINESSES FINANCED BY FOREIGN CAPITAL

N. I. Solovyanenko

In recent years, there has been significant reform of the Russian legislation governing foreign investment, the way in which it can be attracted, and in which it is used. The overall intention is to improve the climate for investment, and also to assist scientific and technical progress by allowing access to the experience of the rest of the world. It is hoped that this will facilitate the construction of new production facilities and the modernisation of existing ones. It will make foreign investment and know-how available to enterprises and projects involving industry, commerce, science, culture, and the media.

More than 2600 enterprises involving foreign capital have been registered to date in the Russian Federation, representing firms from more than 60 countries. The total capital invested in these enterprises from Russian and foreign sources amounts to more than six billion roubles. The amount invested from abroad totals just over two billion roubles. Western investors account for more than 80% of foreign contributions, including 45% invested by firms from the USA, Germany, Finland, Italy, France, and Britain. These are, in the main, small and medium-sized firms. However, various large corporations are also represented. Around 130,000 people are employed in joint ventures in Russia. The energy invested and the extent of their activities are remarkable. According to the statistics issued by the Russian State Statistics Bureau, *Goskomstat*, by the middle of 1991, they were producing 10% of telephone apparatuses, 7% of computers, 4% of machinery for the textile industry, and 2.3% of footwear. The quality of production by joint ventures, as a rule, is higher than that by similar state or co-operative enterprises.[11] The main feature of the investment climate in Russia, from a legal point

---

11 V.V. Ranenko "*Sovmestnoe predprinimatelstvo v Rossii*" *Economicheskaya gazeta* No. 5, February 1992.

of view, is the legislature's determination to maintain uniformity in the rules regulating commercial activity, whether or not they relate to nationalised businesses, or to companies within which foreigners have a stake. This is clearly reflected in the *Memorandum on Economic Policy in the Russian Federation*,[12] which expresses the government's intention to remove obstacles to the creation of new businesses, (including those presented by legal regulations).

The Russian law "On Enterprises and Business Activity"[13] lays the foundation for a single legal framework to govern the management and activities of all types of company. It establishes the general legal basis for the formation of businesses in Russia in conditions which permit different forms of ownership. It sets out the various administrative and legal forms which enterprises in Russia may follow. It regulates the rights and responsibilities of those engaged in businesses. The law is binding upon all such persons, including juristic persons and foreign nationals, irrespective of who owns the property involved, and what sort of activity is entailed.

This represents a complete change from the previous situation, in which the Soviet legislature allowed the parallel development of legislation on businesses on the one hand, and special regulations for foreign investment in the country's economy on the other. This is illustrated in the series of decrees by the USSR Council of Ministers regulating the activities in the USSR of joint ventures with partners from the socialist, capitalist, and developing countries. The rules for taxation of the profits of joint ventures and taxation of the individual parties involved, and also accounting procedures, were governed by special union government legislation. A special procedure was established for the registration of joint ventures and so on. Legislation on foreign investment existed even before there was any kind of legal basis for private enterprise in the broader sense of the word. The law did not therefore deal with ways in which private

---

12 *Economika i zhizn* March 1992, No.10.

13 *Vedomosti s'ezda narodnykh deputatov RSFSR i Verkhovnogo Soveta RSFSR* 1990, No.30, Item 481.

Russian capital could become involved in production, or with the administrative and legal form of businesses backed by such capital.

The situation perhaps became slightly clearer with the introduction of a series of Union laws and subordinate legislation, consisting of: the USSR "Law on Enterprises", the "Regulations on Joint Stock Companies and Companies with Limited Liability" issued by the USSR Council of Ministers, the "Law on Investment Activity in the USSR", and the "Law on the Taxation of Enterprises". However, where they touch upon the formation and management of businesses backed by foreign investment, they refer to special USSR government legislation.

The Russian Federation legislation does not distinguish in principle between companies backed by foreign capital on the one hand, and those which are purely Russian on the other. It includes both categories in a single system of businesses operating on Russian territory. Therefore, the RSFSR "Law on Foreign Investment" of 4th July 1991[14] supplements the Russian law "On Enterprises", the Russian Council of Ministers' company law provisions brought into force by the decree of 25th December 1990,[15] and the RSFSR law "On Investment" of 26th June 1991[16].

Thus, the following categories of foreign investor are permitted in the Russian Federation:

(a) foreign juristic persons, including any companies, firms, enterprises, associations or organisations, already in existence and empowered to invest, in terms of the legislation of their country of origin;

---

14 *Vedomosti s'ezda narodnykh deputatoku RSFSR i Verkhovnogo Soveta RSFSR* 1991, No. 29, Item 1008.

15 *Sobranie postanovlenii Pravitelstvo RSFSR* 1991, No.6, Item 92.

16 *Vedomosti s'ezda narodhykh deputatov RSFSR i Verkhovnogo Soveta RSFSR* 1991, No.29, Item 1005.

(b) foreign citizens, or persons without citizenship, who are permanently resident abroad, on condition that they are registered to trade in the country of which they are citizens, or in which they are permanently resident;

(c) foreign states;

(d) international organisations.

Foreign investors are entitled to invest in Russia by various means. They may acquire a stake in enterprises formed in collaboration with juristic persons and Russian citizens. Alternatively, enterprises, or subsidiaries of foreign businesses, may be formed entirely under the ownership of foreign investors. Foreign investors may acquire enterprises in their entirety, property, buildings, equipment, part-holdings in enterprises, shares, debentures, and other securities. They can obtain rights to use land and other natural resources, and other property rights.

At the present time, joint ventures with foreign partners are not the only channel for investment in Russia. Companies which are 100% owned by foreign capital, subsidiaries of foreign companies, and also foreign juristic persons can also set up in business in Russia.

Investors are free to make their own decisions regarding the level, direction and use of their investments, irrespective of the form of property used in the business, whether state property, private property and so on.

An enterprise with foreign capital can either be formed from scratch, or it can be set up as a result of a foreign investor acquiring a share in an existing Russian-owned enterprise, or by its taking over such an enterprise in its entirety.

The Russian Law (in contrast with the Byelorussian law, for example) does not prescribe a minimum level for the foreign investor's contribution towards the initial capital fund of joint ventures. Article 15 of the Russian "Law on Foreign Investment" provides that the contributions to an enterprise's initial capital fund are fixed by agreement between the contributing parties on the basis of prices on the world market. If there are no such prices, the level of such contributions is determined by agreement between the parties.

The valuation can be in Russian currency, or in foreign currency with reference to the value of the rouble at the current foreign trade exchange rates. The contributions may be made in foreign currency, in roubles received as profits or in exchange for currency, and also in kind; in the form of machinery, equipment, technology, buildings, other structures, and rights to use land and natural resources.

When an enterprise is formed using foreign investment, and large scale construction or reconstruction is involved, the necessary surveys must be carried out beforehand. In some cases, the necessary services from the public utilities have to be provided and specialist environmental surveys have to be carried out. All types of survey are carried out and official authorisations are issued according to the general procedure set out in Russian legislation. Moreover, when an enterprise is being formed in which the level of foreign investment exceeds 100 million roubles, the authorisation of the Russian Council of Ministers must be obtained. The Council of Ministers is obliged to issue its authorisation, or to give the applicant reasons for refusing to do so, within two months of receiving the application.

Special authorisation (or a licence), is also required to set up an enterprise involving foreign investment if certain kinds of activity are envisaged. Thus, if it is proposed to conduct insurance business, or the business of an agent dealing in the sale of securities, a licence must be obtained from the Russian Ministry of Finance. Similarly, banking businesses require a licence from the Russian Central Bank.

However, as a whole, such enterprises can undertake any form of business, as long as it conforms with the objects set out in their articles (with the exception of any business forbidden by Russian legislation).

Despite the fact that investors have considerable freedom to choose in which type of business they wish to invest, closer analysis would suggest that around one third of all Russian joint ventures, and a quarter of total investment, are concentrated upon the service industry (shops, catering, tourism, hotel and restaurant services, health care, light industry, film production, printing). Around 20% of joint ventures (10% of investment), are registered to provide various business services (engineering, consultancy work, staff development, advertising, brokering). According to their registration

documents, more than half of all joint ventures have as their object the provision of services to the public and to the business community. There has been a dramatic increase in the number of joint ventures, and thus also in the scale of investment, involving the construction industry. There is a further significant group of joint ventures registered to deal in computers, involving the production of personal computers, and other forms of computer technology, and also computerised security. The joint ventures in this category produce 40-50% of the total output of all active joint ventures, although they represent only 13% of the total number of joint ventures. Joint ventures are slowly building up their presence in Russia's basic industries, machine building, the fuel and energy industries, metallurgy, forestry and the chemical industry. These account for only 18% of the total number of Russian joint ventures, and 32% of the total amount invested in the initial capital funds of joint ventures.

According to Article 126 of the Russian Federation Civil Code, all juristic persons have legal capacity from the moment they are registered. Enterprises in which foreign capital is invested are registered at the Ministry of Finance or any other authorised state organ.

In Moscow, for example, all enterprises, irrespective of the form they take, or the classification of the property involved in the business, must register at the special Registry in the city. This was set up by joint decision of the various agencies involved in the Moscow city administration. The Moscow Registry holds a single register of enterprises covering the whole area under its jurisdiction. This register can be consulted by state and municipal enterprises and organisations, which are involved in audit procedures, official inspections or in preparing statistical returns (in other words, the State Committee for Statistics, various financial bodies, and the State Tax Inspectorate). The information derived from the registration of enterprises is communicated by the Registry to the Moscow City Tax Inspectorate; to the Russian State Computer Centre so that a data bank can be established; and also to the Ministry of Finance in the Republic so that the enterprise can be entered on the state register. The regulations governing the procedure for registering enterprises in Moscow (affirmed by the Decree of the Moscow city

administration of 17th September 1991) provide that enterprises which do not have the necessary registration documents from the Moscow Registry are not permitted to trade in Moscow. Any proceeds derived from trading by an unregistered enterprise may be confiscated by the court and transferred to local government funds.

Enterprises in Moscow involving foreign investment must also be registered at the Moscow Registry. This is in line with Russian government regulations which provide for the phasing in of state registration of such enterprises at local level, in the light of the reform of executive organs.

In order to complete the registration process, those seeking to form an enterprise must present the documentation which the Law requires.

(1) For joint ventures, this comprises: a written application with a request that registration of the new enterprise should be completed; copies of the foundation documents in duplicate; the appropriate certificates that inspections have been carried out where this is required by law; where Russian juristic persons are involved in the venture, a form of consent by the owner of the property involved to the formation of the enterprise, or a form of consent by an authorised body; and also copies of the foundation documents for each Russian enterprise participating in the joint venture. Moreover, a document must be produced as evidence of the foreign investor's solvency, issued by its bank (with an authenticated translation into Russian). The application should be accompanied by an extract from the Companies or Trading Register of the country of origin, or other equivalent proof of the legal status of the foreign investor in terms of the law of that country, with an authenticated translation into Russian.

(2) The equivalent documentation is required for the formation of an enterprise which is entirely owned by a foreign investor.

(3) In addition, if a subsidiary of an enterprise in which foreign capital is invested, or a subsidiary of a foreign organisation, is being set up, evidence must be produced that the appropriate

body within that organisation took the decision to proceed on this basis.

The "Law on Foreign Investment in the RSFSR" provides that the documents listed above must be notarised. However, this provision may change. On 4th March 1992, both Chambers of the Russian Supreme Soviet issued a Resolution removing the need to notarise the documents required to re-register an existing enterprise.[17] The body which carries out registration must restrict itself to collecting the passport details of the persons whose signatures are on the articles and other official papers of the enterprise being formed. The Russian government has been instructed to bring the Regulations on Joint Stock Companies, approved by the Russian Council of Ministers on 25th December 1990, into line with the Resolution of 4th March 1992. Clearly such simplification of registration procedures will also be extended to companies in which foreign capital is invested.

The Russian Ministry of Finance or other authorised state organ is obliged to register the enterprise in which foreign capital is invested or to give its reasons for refusing to do so, within 21 days of the application being lodged. When an enterprise is registered, it is given a certificate of registration in a standard format. Registration can be refused only where the procedures for the formation of an enterprise required by Russian law are not observed, or when the registration documents do not meet the legal requirements. If registration is refused, an appeal can be lodged through the courts.

In total, it takes around four or five months to set up an enterprise (for example in Moscow). The actual registration procedures take around 15% of that time. This does not include the time and the resources expended by the promoter of the enterprise on preparing the foundation documents, and also on obtaining the official documents to certify the legal address of the enterprise, or the lease of its accommodation. In Moscow at the moment, incidental to the registration procedure itself, a whole set of other documentation is required. The process lacks co-ordination and direction. In the

---

17 *Finansovaya gazeta* 1992, No.12, p.3.

Moscow Registry the same type of forms, certificates, and official cards have been introduced for all types of enterprise. The Registry and its branches have been empowered to certify copies of enterprises' foundation documents after state registration. Ways of simplifying significantly the procedure for registering juristic persons are being considered at the moment.

All this would appear to indicate that the legislature and the executive organs are working towards more favourable conditions for businesses in general, including those in which foreign capital is invested. They are aware of foreign investors' natural interest in broadening their presence in Russia, and in re-investing the profits in the Russian economy.

In order to secure such conditions, the legislator must create a degree of stability and permanence in the legal system within which enterprises are formed and operate thereafter. This aim is of course extremely difficult to reconcile with the transitional period from union to republican legislation. Thus, for example, tens of thousands of enterprises were formed and registered in accordance with the June 1990 Resolution by the USSR Council of Ministers "On Joint Stock Companies and Companies with Limited Liability". However, in December of the same year, the Russian Parliament enacted the RSFSR Law "On Enterprises and Business Activity", and following from this, the RSFSR Council of Ministers issued the "Regulations on Joint Stock Companies". Both the Law and the Regulations purport to be effective on all Russian territory, and joint stock companies formed before these laws took effect were to be registered by 1st April 1991 in accordance with the Russian legislation. Nevertheless, even now, thousands of joint stock companies and companies with limited liability (known in the Law as joint stock companies of the closed type), are still operating without having met this requirement. They are functioning perfectly well, and some are even flourishing; but nevertheless the legal position of such enterprises in these circumstances would seem to be rather precarious. A number of joint stock companies have received warnings about possible liquidation, since they are, strictly speaking, violating the Russian law which is now in force. The Russian legislature and judiciary take the same view on this issue: from a legal point of view, these businesses may be considered to have ceased to exist; their accounts can be closed,

and their premises closed. Similarly, if a case came to court involving a joint stock company which had not complied with the appropriate registration procedures, it could be adjourned pending an investigation into non-compliance with government regulations.

It could be argued that the legislative changes occasioned by the political transformation in Russia should take into account existing business interests. In view of the extreme variations which have affected the legal system to date, an attempt should be made to provide a stable, sympathetic regime.

THE LEGAL PROCEDURE GOVERNING FOREIGN INVESTMENT IN THE FREE ECONOMIC ZONES

L. B. Maximovich

At the end of the 1980s, there was increased interest in various regions of the USSR in the formation of free economic zones "(FEZ)", or, as they are otherwise known, free enterprise zones. At that time, given the slow progress of economic reform throughout the whole country, the creation of the FEZ raised hopes of a more rapid transition towards the market and effective interaction with foreign capital, albeit confined within the individual regions. In general, the initiators behind the formation of the FEZ were the most reformist of the local government leaders. Against this background, the initiative taken by local bodies frequently came up against the absence of a secure legislative basis or at least a clear conception of the FEZ, which applied nationwide.

Within the All-Union legislation, one of the first indications of the feasibility and expediency of creating FEZ in the different regions of the country was in the Presidential Decree of 26th October 1990, "On Foreign Investment in the USSR".[18] However, it was not until April 1991 that the USSR Cabinet of Ministers specifically ordered a number of USSR government departments to work on the idea of the FEZ. As a result of the well known events of August 1991, and the ensuing break-up of the USSR, this order lost any practical significance.

At the present time, the legal regulation of the FEZ in the independent states, within the former USSR, is achieved in different ways. There are therefore two legal models for the FEZ, i.e. the standard model (as, for example, in Kazakhstan) and the individual model (as, for example, in Russia).

---

18 *Vedomosti s'ezda narodnykh deputatov SSSR i Verkhovnogo Soveta SSSR* 1990, No.44, Item 944.

The Russian legislation on FEZ is not standardised, and the legal procedure governing each of the twelve established Russian FEZ is determined in special regulations made by the government of the Russian Federation. There are virtually no standardised rules for the Russian FEZ, and one can only point to the similarity of certain rules, laid down separately for each of the FEZ.

The legal regime governing the FEZ in Kazakhstan is set out differently, in that a consolidation statute "On Free Economic Zones in the Kazakh SSR"[19] was enacted on 30th November 1990. This serves as the sole legislative basis for all nine FEZ, both those existing and those which may be created in the long term, in this independent state.

In spite of the differences between the rules governing the FEZ in the different independent States, the former Republics of the USSR, they share much in common. In point of fact, the concept of a special legal regime for FEZ comes down to a list of privileges and advantages, available to business and other organisations and also to individuals in the region concerned. This can be set against the general rules governing the conduct of businesses, primarily foreign and investment businesses within the state in question. Against this background, the privileges and advantages relate to a fairly wide, but fully defined series of issues associated with, in particular, the procedure for the formation and management of businesses, currency and tax regulations, the export and import of goods (labour, services), the provision of credit and payments, entry into and exit from the territory of the FEZ, and so on.

As a general rule, the decision on the formation of FEZ on the territory of one or another region is taken by the Supreme Soviet (or a similarly high-ranking government body) of the independent state, or former republic of the Soviet Union. Moreover, the day-to-day management of the FEZ is in the hands of specially constituted local government bodies.

---

19 *Vedomosti Verkhovnogo Soveta KazSSP* 1990, No.49, Item 455.

In Russia, such bodies which manage the FEZ may be authorised by the government of the Russian Federation with the agreement of the local Councils of People's Deputies. In practice, these bodies have different names. Thus, the Leningrad zone of Free Enterprise (LZFE), is managed by a special Management Committee[20], and in the free economic zone of "Sakhalin" - by the Administration of the FEZ[21]. In Kazakhstan, the management bodies governing the FEZ are the corresponding Administration Councils. The chairmen of the Councils are approved by the Supreme Soviet of Kazakhstan, on the basis of the state government's nomination, and with the agreement of the local Councils of People's Deputies.

The bodies administering the zones are usually responsible for the registration of enterprises involving foreign investment which are formed there (and joint ventures, international business organisations and so on) and also subsidiaries and representatives of foreign enterprises and organisations. They also are in charge of the registration of the Russian participants in foreign businesses.

The Administrative Councils of the FEZ in Kazakhstan take responsibility for bringing foreign capital into the area, chiefly on a competitive basis. They direct policy relating to finance, tax and credit, and the visa and customs rules. They grant licences and fix quotas for the export and import of goods, services and natural resources.

The regulations on the LZFE and the FEZ of "Sakhalin" stipulate that, within the territories of these FEZ, Soviet and foreign juristic persons and individuals may form enterprises, branches and representatives, which carry out any form of business in accordance with the legislation of the Russian Federation. Within the territory of the LZFE, there is no restriction on the formation of enterprises with foreign investment in the banking and insurance spheres. (As a

---

20 Polozheniye o Leningradskoi zone svobodnogo predprinimatelstva". Zakonadatelstvo i ekonomika 1990, No.11, p.6.

21 *"Polozheniye o svobodnoi ekonomicheskoi zone "Sakhalin". Zakonadatelstvo i ekonomika* 1991, No.12, p.43.

general rule, in the rest of Russia the formation of such businesses requires the permission of the relevant Central Bank, or the Russian Ministry for the Economy and Finances.)

Questions regarding the formation of joint enterprises are decided by the administrative bodies of the FEZ independently of any ministries or departments, whose agreement is usually required outwith the boundaries of the FEZ. The Kazakh law provides that, within the territories of the FEZ, all forms of business and commercial activity involving Soviet and foreign juridical persons and individuals are permitted, with the exception of production for a directly military purpose, and also those types of business which are prohibited by Kazakh legislation.

The Russian legislation on FEZ lists the forms which foreign investment may take within the FEZ. These would include the shared participation by foreign investors in enterprises and organisations formed in conjunction with Soviet juristic persons and individuals; the formation of enterprises or subsidiaries belonging entirely to foreign investors; the acquisition of property, shares and other securities; the acquisition of the rights to use land, including long leases, and so on.

As a general rule, land in the territories of the FEZ may only be leased. The law of Kazakhstan provides explicitly that land in the FEZ may not be sold. Any infringement of the terms of a lease which requires the land and any natural resources to be used efficiently, may lead, therefore, to termination of the right of use, with a requirement that any damage should be made good, and the land should be restored to its previous environmental condition. The Administrative Councils of the FEZ have the right to allocate leases over land, mineral deposits and other natural resources.

In the Russian legislation there is no direct prohibition on the sale of land in the territories of the FEZ, but such prohibition is implied in the Regulations relating to these areas, made by the government. The local Councils of People's Deputies of the Sakhalin Region have the right to permit enterprises with foreign investment to take long leases (for periods of up to 50 years) of land, fishing grounds and other natural resources. The maximum rates of rent for the land are laid down in the LZFE by the local Councils of People's Deputies.

Alteration of the terms of leases over land and other resources by foreign investors is permitted with the mutual agreement of the parties or by decision of an Arbitration Court.

Enterprises in the territory of the FEZ may on an agreed basis be granted tax credits for a period, for example, up to five years (LZFE) or up to seven years ("Sakhalin" FEZ). Within the framework of such a "tax credit", lower (or maximum) rates of tax or tax benefits may be established. For example, tax on the profit of an enterprise in the "Sakhalin" FEZ cannot exceed 30%. In the LZFE, it cannot exceed 30% in the first five years of operation of the LZFE. Enterprises shall not be subject to a higher tax on profit which would exceed the limits of standard profitability fixed by the government.

Enterprises with foreign investment situated within the LZFE, in which the foreign share comprises more than 30% of the prescribed capital, enjoy the following tax advantages:

- The tax on profits cannot exceed 20%, with the exception of that part of the profits which is transferred abroad.

- There is no tax on profits, or on the part of the profit which is transferred abroad, for a period of up to three years after the enterprises become operational.

In the "Sakhalin" FEZ, enterprises with foreign investment, where the proportion of foreign element in the initial capital fund is greater than 30%, the tax on profits cannot exceed 10%. In the case of foreign enterprises involved in the extraction of valuable minerals, and in fishing and fish processing, this tax cannot exceed 20%. Over and above these benefits in the "Sakhalin" FEZ, enterprises with foreign investment exceeding 30% of the initial capital fund may be granted additional tax advantages:

- Full exemption from payment of tax on profits in the first five years after the enterprise becomes operational (with the exception of enterprises involved in the extraction of valuable minerals, fishing and fish processing).

- A 50% reduction in tax charged on profits received in the first five years of business where it involves agriculture, the

production of consumer goods, building materials or equipment for the construction of housing, social, cultural or entertainment purposes, and also the construction and reconstruction of ports, airports and facilities for communications.

- Full tax exemption on dividends received from debentures and other securities, issued by the executive committees of local Councils of People's Deputies and by the "Sakhalin" Administration of the FEZ.

- Enterprises with foreign investment, like Russian enterprises, are exempt from payment of tax on all profit, which is reinvested in the development of production or for social purposes, or which is invested in the initial capital funds of joint enterprises being formed in the FEZ and other regions of Russia.

According to the Kazakh law on FEZ, the following tax advantages apply:

- Exemption from tax on profits for a period of two to five years after the enterprise becomes operational.

- Exemption from tax on profits reinvested in Kazakhstan for the production of consumer goods, production of scientific significance, medical technology and medicines.

- Exemption from tax in respect of wages paid to a local labour force.

- Exemption from payment of tax on goods, manufactured in the zone for resale in Kazakhstan.

Apart from the favourable tax position, other advantages may be provided. For example, subsidies and grants may be made available for the completion of work carried out on contract within the framework of state programmes to develop natural resources; subsidies may be made available to create new employment; guarantees may be offered for loans and credits acceptable to banks and other juristic persons, situated in the FEZ; permission may be

given to issue debentures which would finance directly construction of new enterprises ("Sakhalin" FEZ).

After taxes have been paid, there is no obstacle to foreign investors transferring abroad profits received in foreign currency. They have an unlimited right to transfer, place on deposit, export and terminate investments (LZFE). When they decide to pull out of the business, or the enterprise goes into liquidation, they have the right to sell all or part of their share in the initial capital fund of the enterprise.

In terms of the Russian legislation, the export of goods manufactured in the zone, and also the import of goods into the zone may not be restricted by quotas and licences, with the exception of goods specifically mentioned in the legislation. An item is considered to have been manufactured in the FEZ, if the processing costs exceed 30% of the whole. In exceptional circumstances, export quotas may be established by decision of the FEZ administration.

Goods and articles imported into Russian FEZ, or exported from them, must be declared. Exports which are manufactured in the FEZ and imports used in the FEZ for the production of exports or to produce goods which take the place of imports, are exempt from customs duty. The Kazakh law specifically includes in this category, machinery, materials, and other components, which may be used for export, and the production of goods to take the place of imports.

The legal guarantees made to foreign investors are one of the most important characteristics of the legal procedure governing the FEZ. The regulations for the Russian FEZ provide that foreign investors on their territory enjoy the same legal protection as Russian juristic persons and individuals and the rules for them cannot be less advantageous than those for their Russian counterparts. There must be no discrimination against enterprises with foreign investment in an enterprise zone. The Kazakh law on the FEZ guarantees protection for the rights and interests of Russian and foreign individuals, enterprises, associations and organisations, operative in the FEZ.

The Russian legislation on foreign investment only allows foreign investment to be frozen following a court order. Furthermore, the

sequestration (compulsory retention) of invested property is only permitted on a temporary basis following a court order which allows property to be removed pending settlement of the debtor's liabilities.

The Kazakh law provides that the state may not nationalise property belonging to Soviet and foreign individuals, enterprises, associations and organisations, operative in the FEZ. If any loss is caused in the Kazakh FEZ by unjustified action on the part of the state or public organisations or officials, compensation must be paid by the organisation involved. This represents a significant guarantee for the rights and interests of individuals and juristic persons.

Thus, in the independent states which were formerly part of the USSR, special legislation on the FEZ has been enacted and is in force. Its purpose is to create favourable conditions for foreign businesses and investment in the regions concerned. However, in practical terms the FEZ have not yet become important in relation to the attraction of foreign capital, at least in Russia.

This may be explained partly by the fact that the new legislation on the FEZ is incomplete, having been for many years practically non-existent in the USSR. The more fundamental reason why the FEZ have made little impact is that, following the events of August 1991, the general legislation in the Russian Federation on businesses including foreign and investment businesses began to develop rapidly in the direction of ever greater freedom of enterprise.

Thus, for example, according to the All-Russian legislation, all enterprises can now engage in foreign economic activity without any special authorisation. Several other measures have been taken, facilitating the establishment of foreign business and investment in Russia as a whole.

As a result, the legislation on the FEZ is becoming less attractive in comparison with the legislation for Russia as a whole on foreign businesses and investment, whilst in some respects it even lags behind the All-Russian legislation. In order to restore the former relative benefits of the FEZ, it will be essential to achieve further liberalisation of the rules for economic activity in the FEZ, in comparison with the latest All-Russian legislation.

The David Hume Institute

The David Hume Institute was registered in January 1985 as a company limited by guarantee: its registration number in Scotland is 91239. It is recognised as a Charity by the Inland Revenue.

The objects of the Institute are to promote discourse and research on economic and legal aspects of public policy questions. It has no political affiliations.

The Institute regularly publishes two series of papers. In the **Hume Paper** series, now published by Edinburgh University Press, the results of original research by commissioned authors are presented in plain language. **The Hume Occasional Paper** series presents shorter pieces by members of the Institute, by those who have lectured to it and by those who have contributed to 'in-house' research projects. From time to time, important papers which might otherwise become generally inaccessible are presented in the **Hume Reprint Series**. A complete list of the Institute's publications follows.

Hume Papers

1 Banking Deregulation (out of print) *Michael Fry*

2 Reviewing Industrial Aid Programmes:
(1) The Invergordon Smelter Case *Alex Scott and Margaret Cuthbert*

3 Sex at Work: Equal Pay and the "Comparable Worth" Controversy *Peter Sloane*

4 The European Communities' Common Fisheries Policy: A Critique *Anthony W Dnes*

5 The Privatisation of Defence Supplies *Gavin Kennedy*

6 The Political Economy of Tax Evasion *David J Pyle*

7 Monopolies, Mergers and Restrictive Practices: UK Competition Policy 1948-87 *E. Victor Morgan*

Published by Aberdeen University Press

8 The Small Entrepreneurial Firm
Gavin C Reid and Lowell R Jacobsen

9 How should Health Services be Financed? *Allan Massie*

10 Strategies for Higher Education—The Alternative White Paper
John Barnes and Nicholas Barr

11 Professional Liability *Roger Bowles and Philip Jones*

12 Deregulation and the Future of Commercial Television *Gordon Hughes and David Vines*

13 The Morality of Business Enterprise *Norman Barry*

14 Copyright, Competition and Industrial Design *Hector MacQueen*

15 Student Loans *Nicholas Barr*

16 Agathotopia: The Economics of Partnership *James E Meade*

17 Beyond the Welfare State *Samuel Brittan and Steven Webb*

Published by Edinburgh University Press

18 Public Broadcasters: Accountability and Efficiency *Robin Foster*

Hume Occasional Papers

1 What to Do About the Over-Valued Dollar *Ronald McKinnon*

2 The Political Economy of Pension Provision *Alan Peacock and Norman Barry*

3 The Regularities of Regulation *George J. Stigler*

4 How Safe is the Banking System? *Richard Dale*

5 Economic Issues in Merger Policy (out of print) *E. Victor Morgan*

6 The Regulation of the Telecommunications Industry *Bryan Carsberg*

7 The Novelist's View of the Market Economy *Allan Massie*

8 Understanding Mrs Thatcher: Conservative Economic Policy 1979-1987 *David Simpson*

9 Adam Smith and Economic Liberalism *Andrew Skinner*

10 Long-term Savings in an Enterprise Economy: A Case Study of the Principles and Practice of UK Economic Policy *Jack Wiseman*

11 Contemporary Problems in Commercial Litigation *David Edward, Lord Ross with a Commentary by Catherine Montgomery Blight*

12 Industry, Money and Markets: A Means to Irish Unification *W Duncan Reekie*

13 The Future of Legal Systems *Thijmen Koopmans*

14 Mergers and Takeovers: Short and Long-Term Issues *Sir Gerald Elliot*

15 The Takeover Boom: An International and Historical Perspective *Graham Bannock*

16 The Regulation of the Water Industry. The Office of Water Services: Structure & Policy *Ian Byatt*

17 Corporate Takeovers and the Interests of Regions and Local Communities *Brian Ashcroft and James H. Love*

18 Evidence Submitted to the Inquiry into Corporate Takeovers in the United Kingdom, Vol 1

19 Takeover Activity and Differential Returns to Shareholders of Bidding Companies *Robin Limmack*

20 Finance and Takeovers *David Gowland*

21 The U.K. Panel on Takeovers and Mergers: An Appraisal *W.A.P. Manser* (out of print)

22 Efficient Markets and the Rationale of Takeovers *Gavin C Reid*

23 Corporate Takeovers - The Need for Fundamental Rethinking *Allen Sykes* (out of print)

24 The Stock Market and Mergers in the United Kingdom *E. Victor Morgan and Ann D. Morgan*

25 Investment Managers and Takeovers: Information and Attitudes *E. Victor Morgan and Ann D. Morgan*

26 Taxation and Mergers Policy *John Chown*

27 Evidence from, The Scottish Office, The Edinburgh University Centre for Theology and Public Issues and Mr D. Henry

28 The Building of the New Europe: National Diversity versus Continental Uniformity *J.E. Meade*

29 The Control of Mergers and Takeovers in the EC *Robert Pringle*

30 How Level a Playing Field does Company Law Provide? *Robert Jack*

31 The Nestlé Takeover of Rowntree *Evan Davis and Graham Bannock*

32 The Power of the Lobbyist: Regulation and Vested Interest, *Michael Casey*

33 Takeovers and Industrial Policy: A Defence, *Graham Bannock and Alan Peacock*

34 The Contemporary Relevance of David Hume, *Robert Pringle*

35 The Remuneration Committee as an Instrument of Corporate Governance, *Brian Main and James Johnston*

36 Asset Classes in a Changing World, *(with the World Gold Council)*

Books

The Deregulation of Financial Markets
edited by Richard Dale, Woodhead-Faulkner, London, 1986

Governments and Small Business
Graham Bannock and Alan Peacock, Paul Chapman, London, 1989

Corporate Takeovers and the Public Interest
Graham Bannock and Alan Peacock, Aberdeen University Press, 1991

Social Policies in the Transition to a Market Economy: Report of a Mission to the Russian Federation organised by the United Nations January 1992
Michael Hay and Alan Peacock, Alden Press, Oxford, 1992

Hume Reprints

1 The 'Politics' of Investigating Broadcasting Finance *Alan Peacock*

2 Spontaneous Order and the Rule of Law *Neil MacCormick*

Further details of publications may be obtained from:

The Secretary, The David Hume Institute, 21 George Square, Edinburgh EH8 9LD, Tel 031 650 4633: Fax 031 667 9111.

THE DAVID HUME INSTITUTE

HONORARY PRESIDENT (1992-1995)
Judge David Edward CMG, QC, European Court of Justice

PAST HONORARY PRESIDENTS
Professor George Stigler (1984-1987), Nobel Laureate in Economics
Judge Thijmen Koopmans (1988-91) European Court of Justice

HONORARY VICE-PRESIDENTS
Dr. Samuel Brittan
Professor James Buchanan, Nobel Laureate in Economics
Senator Professor Francesco Forte
Lord Grimond of Firth
Professor Neil MacCormick, FBA
Mr. Allan Massie

BOARD OF TRUSTEES
Mrs Catherine Blight
Sir Gerald Elliot, FRSE (Chairman)
Mr. R. A. Hammond-Chambers
Lady Mackenzie Stuart
Mr Alan McLean
Dr. Hector L. MacQueen
Professor John Murray Q.C.
Professor Sir Alan Peacock, FBA, FRSE
Mr. H. L. I. Runciman CBE
Professor Jack Shaw CBE

EXECUTIVE DIRECTOR & SECRETARY: Dr. Hector L. MacQueen

PERSONAL ASSISTANT: Kathryn Mountain

CONSULTANT ECONOMISTS: Professor Gordon Hughes
Professor Sir Alan Peacock

ADVISORY COUNCIL

Professor Norman Barry	Buckingham
Professor Richard Dale	Southampton
Professor Bruno Frey	Zurich
Professor Lord Griffiths of Fforestfach	London
Professor Keith Lumsden	Edinburgh
Professor Paul Macavoy	Rochester, NY
Professor Donald Mackay	Edinburgh
Professor Anthony Ogus	Manchester
Professor Charles Rowley	Fairfax, VA
Professor Pedro Schwartz	Madrid
Professor Andrew Skinner	Glasgow
Mrs Linda Whetstone	Atlas Foundation

REGISTERED OFFICE
21 George Square, Edinburgh EH8 9LD
(Registered in Scotland No. 91239)
Tel: 031-650 4633. Fax: 031-667 9111
Enquiries should be addressed to The Secretary