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## Formation and Development of the Legal Regulation of Foreign Investments in Russia

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**Abstract:**

*The article's purpose is to study the formation and the development of the legal regulation of foreign investment in the Russian Federation.*

*During the research, the authors analyzed the legal mechanisms for creating an enabling environment for attracting foreign investments in Russia.*

*The authors concluded that it is necessary to systematize Russian legislation in the field of foreign investments and to bring Russian legislation into line with the norms of international law.*

*They also came to the conclusion that it is necessary to develop legal regulation of foreign investments within the framework of the integration space of the Eurasian Economic Union.*

**Keywords:** *foreign investments, investment activity, legal regulation of foreign investments, legal regime of foreign investments.*

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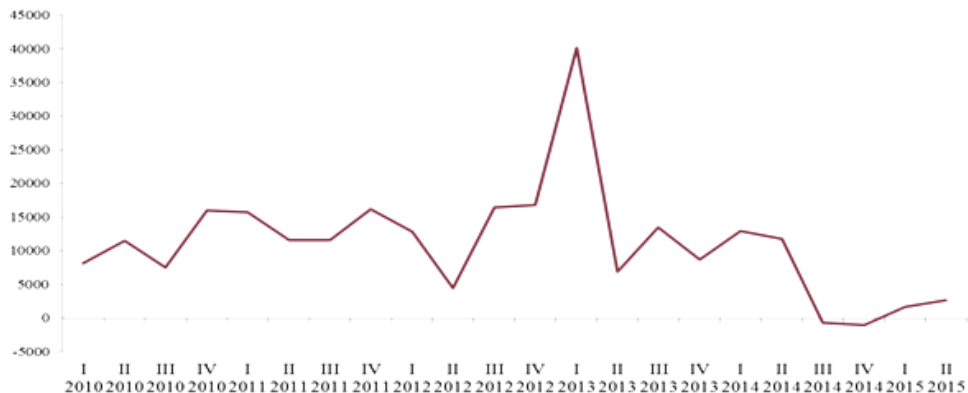
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## 1. Introduction

The strategy of Russia's long-term social and economic development, whose overall goal can be expressed as giving greater dynamics and sustainability to economy, requires not only the most effective use of national resources, but also attracting foreign investment. At the present stage of the development of the world economy, the role of foreign investment for individual states and the economic growth of the international community as a whole is difficult to overestimate. That is why it is so important to create an effective regulatory framework in the field of legal regulation of foreign investment (Shekhovtsov *et al.*, 2017; Emelkina, 2016).

Nevertheless, the inflow of foreign investment in the Russian economy has significantly decreased according to the Central Bank of the Russian Federation data. The outflow of foreign investment in the Russian economy began in 2014, after the introduction of sanctions and departure of large foreign companies from the domestic market of Russia. In 2015, the low exchange rate and the further deterioration in the international relationship (Figure 1).

**Figure 1.** Foreign investment in the Russia 2010-2015 (billion dollars)

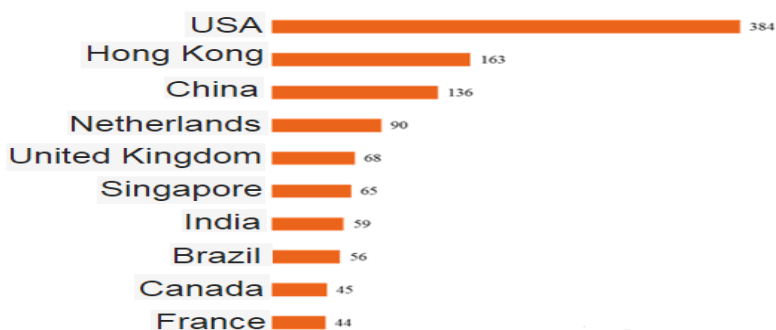


**Source:** Bank of Russia.

However, the world investment in 2015, according to UNCTAD data, was increased by 36% to 1.7 trillion dollars, the highest level since 2007. Developed countries were the main recipients of this foreign investment (Figure 2).

Decisive role in it was played active foreign policy, as well as growing growth of dollar against other currencies in the background of oil prices. Nowadays 55% of the total world investment is accounted for developed countries. That is why Russia was staying far behind in the global investment market. The total volume of investments in Russia in 2015 was about 1.7 billion dollars compared to 20.95 billion dollars in 2014, according to UNCTAD estimates.

**Figure 2.** 10 countries leaders on the inflow of foreign investment in 2015 (billion dollars).



*Source:* UNCTAD.

The relevance of this research is due of the importance of foreign investment for the development of the Russian economy. The creation of an attractive investment climate in Russia must increase the volume of investments in the Russian economy. This work is based on the hypothesis of the need to create an effective regulatory framework for foreign investments, which serves as the basis for the attractiveness of the Russian economy for foreign investors. The article aims to investigate the formation and the development of a system of legal regulation of foreign investments in Russia.

To achieve this goal a number of tasks must be analyzed; to characterize the system of the national investment legislation of the Russian Federation, to consider international legal acts in the sphere of legal regulation of foreign investments and to formulate proposals for improving Russian investment legislation. As an object of this research, public relations in the field of foreign investments in Russia are advocated. The subject of the study is the national and the international rules of law governing foreign investment in the Russian Federation. As an object of this research are the public relations in the field of foreign investments in Russia.

## 2. Literature review

Traditionally, foreign investments are treated as investments made by persons of one state in the territory of another (receiving) state (Lisitsa, 2015). Foreign Direct Investment (FDI) is considered a reliable indicator of economic globalization in general and the globalization of specific national economies in particular (Basedov, 2016; Mavlutova and Olevsky, 2015; Fernandez and Bilan, 2013).

According to a number of authors, the amount of money transferred between state borders in connection with investment projects is at least as high as that associated with foreign trade transactions (Anufrieva, 2016). In connection with this, the provision of a favorable investment climate in the country is of particular

importance for the development of the national economy, creating favorable conditions for innovative development, including in the commercialization of intellectual products (Shatkovskaya *et al.*, 2017).

The state is always interested in attracting investments, both domestic and foreign. In this regard, it faces the challenge of creating a favorable investment climate, providing investors with some protection and guarantees, and direct government support sometimes. At the same time, the state seeks to protect national interests, which also necessitates the use of prohibitions and restrictions in certain areas of investment activity (Gubin and Lakhno, 2017). The creation of a system for the legal regulation of foreign investment in Russia should be based on effective state policy, based on correlation of private and public interests (Shatkovskaya and Epifanova, 2016). The concept of "legal regime of foreign investment" can be defined as a combination of legal means and methods of legal regulation of investment legal relations, including legal principles and legal provisions that determine the special rules for foreign investors (Veselkova, 2016).

Recently, new forms of legal regulation have emerged in the sphere of foreign investment inflow in Russia, including the introduction of such mechanisms as special investment contracts. As practice shows, this tool found its recognition among other large automakers and has actually earned now (Zelenin and Stepanischeva, 2017).

The unification of the legal regulation of foreign investment plays an important role at the international level. Such unification is carried out through the adoption of international treaties. Depending on the subject composition of international treaties, universal, regional and bilateral unification are singled out (Alimova *et al.*, 2016).

Based on the results of a review of the literature on the topic of this study, it can be concluded that the degree of study of the problem is quite high. At the same time, there are no comprehensive studies of the system of legal regulation of foreign investment in Russia, covering also the issues of its formation within the framework of the Eurasian Economic Union. In most studies, a limited range of social relations serves as an object, which does not allow a sufficient study of this topic and, accordingly, be a prerequisite for the research conducted in this article.

### **3. Methodology**

The research process is based on general scientific formal logical methods of cognition (analysis, synthesis, induction, deduction, etc.), as well as special scientific methods; system-structural, comparative-legal. The formal-logical method is manifested in connection with the need to analyze legislation regulating foreign investment in Russia. The system-structural method is applied when considering the system of general norms of legislation and its correlation with private rules of law governing investment activity. The comparative legal method is used to conduct a

comparative analysis of the norms of Russian and international law in the field of foreign investment.

#### **4. Results**

##### *1. Characteristics of the system of legal regulation of foreign investment by internal Russian legal acts:*

In the Russian Federation, Federal Law № 160-FZ "On Foreign Investments in the Russian Federation" dated 09.07.1999, which contains a legislative definition of the notions of foreign investment, a foreign investor, etc., it establishes the principle of the national regime with respect to foreign investment activities, establishes a system of guarantees for the rights of foreign investors. So, in accordance with page 2 of the said normative legal act *"foreign investment - the investment of foreign capital in the object of entrepreneurial activity in the territory of the Russian Federation in the form of objects of civil rights belonging to a foreign investor, if such objects of civil rights are not withdrawn from circulation or are not limited in circulation in the Russian Federation in accordance with federal laws, including money, securities (in foreign currency and the currency of the Russian Federation), other property, property rights that have a monetary value exclusive rights to the results of intellectual activity (intellectual property), as well as services and information."*

Nowadays, in Russia other internal legislative acts have been adopted and are in force, the norms of which are the legal regulation of foreign investments. So, in order to ensure the country's defense and state security, Federal Law № 57-FZ by April 29, 2008 *"On the procedure for foreign investment in business entities of strategic importance"* was adopted.

A special place in a number of sources of legislation on foreign investment is taken by Federal Law № 395-1 by 02.12.1990 *"On Banks and Banking Activities"* and the Law of the Russian Federation by 27.11.1992 № 4015-1 *"On the organization of insurance business in the Russian Federation"*, since the Law on Foreign Investments expressly refuses to regulate the investment of foreign capital in credit and insurance organizations, declaring it the prerogative of legislation on banking and insurance activities respectively. The Federal Law by 25.02.1999 № 39-FZ *"On investment activity in the Russian Federation carried out in the form of capital investments"* and other normative legal acts regulating investment activity in Russia also apply to the sphere of regulation of foreign investments.

In the last few years in Russia have been marked by the rapid development of regulatory and legal regulation in the field of stimulating investment, which includes a number of new tools and mechanisms that promote the creation of new industries and the emergence of new players in the market. Federal Law № 488-FZ dated December 31, 2014 *"On Industrial Policy in the Russian Federation"* introduced new cooperation mechanisms that are beneficial for foreign investors, in particular a

special investment contract, which is currently one of the main instruments for attracting long-term and large-scale investment projects. Under a special investment contract, the investor, within the terms provided by the contract, will either create or modernize and (or) master the production of industrial products on the territory of Russia, on the continental shelf of the Russian Federation, in the special economic zone of the Russian Federation. Russian Federation or a subject of the Russian Federation is the other side of the contract, which within the prescribed period undertakes to implement measures to stimulate activities in the sphere of industry provided for by legislation at the time of signing a special investment contract. The State Fund for the Development of Industry is the operator when concluding a special investment contract.

One of the effective and justified ways of attracting foreign investors, provided for by Federal Law № 488-FZ dated December 31, 2014 *"On Industrial Policy in the Russian Federation"* is the creation of industrial parks in Russia. Industrial park is a set of industrial infrastructure objects intended for the creation of industrial production or modernization of industrial production and managed by a management company - a commercial or non-commercial organization established in accordance with the legislation of the Russian Federation.

In a fact the industrial park for investors is a kind of entrepreneurial activity, in which the entrepreneur assumes non-core functions for industrial companies - development of the territory and industrial real estate. At the same time, the efficiency of the industrial park is achieved due to the synergy effect resulting from the activities of all its residents (Zelenin and Stepanischeva, 2017). The structure of industrial parks is similar to the structure of special economic zones.

However, special economic zones provide investors with a more preferential treatment not only from the point of view of taxation, but also from the point of view of customs regulation. At the same time, such a regime is fixed both in the Tax Code of the Russian Federation and in the Federal Law № 116-FZ by 22.07.2005 *"On Special Economic Zones in the Russian Federation"*.

Thus, in modern Russia there are various legal mechanisms for attracting foreign investors, which are constantly supplemented by new ones. But at the same time there is a significant number of national regulations, through the norms of which certain aspects of implementation are regulated investment activity. Such extensive investment legislation, in our opinion, does not contribute to the creation of clear and transparent investment conditions and attraction of foreign investments to the Russian economy.

On the other side, we should pay attention to the existing contradictions in the tax norms of the all-Russian investment laws and norms relating directly to the taxation of foreign investments, inadequate elaboration and frequent changes in various legal norms in the field of investing foreign capital, the inconsistency of a number of

provisions of Russian acts with regulations in force abroad foreign investments, in particular the application of administrative and legal methods of regulation. All this does not allow bringing the actions of the market participants in a competitive manner, including ensuring free access to the national market for foreign goods and capital, and free movement of resources from one state to another.

After the adoption of the Federal Law dated 09.07.1999 № 160-FZ *"On Foreign Investments in the Russian Federation"* and Federal Law № 39-FZ dated 25.02.1999 *"On Investment Activities in the Russian Federation, implemented in the form of capital investments"* we should pay attention to the deterioration in the quality of legal regulation of foreign investment, pointed out by well-known experts in area of legal regulation (Doronina and Semilyutina, 2012). On the basis of the above, we believe that it is necessary to systematize Russia's investment legislation and develop a national system of legal regulation based on the norms of international law.

## *2. System of international legal acts governing foreign investment in Russia:*

The resolutions of the UN General Assembly have a huge importance in regulating question of the regime of foreign investments in which the right of the state to nationalization is upheld and compensation is provided to the owner of the nationalized property. To a large extent, international organizations are concerned with this issue, whose member countries are actively engaged in foreign investment. These include the OECD Capital Flows of Liberalization Code, the OECD Current Operations Liberalization Code and the International Bank for Reconstruction and Development's Foreign Direct Investment Regulation.

International agreements of the Russian Federation are of great importance in the field of legal regulation of investment activity with the participation of foreign investors. Among them, bilateral agreements on the avoidance of double taxation are common. At the same time, regarding the usefulness of bilateral tax agreements in the doctrine, there are different points of view. In particular, Kashin (1998) expresses an opinion with which one cannot but agree that the countries participating in the tax agreement are most likely interested in supporting export of their capital. The general tax agreements, in the form in which they are recommended by the OECD, are tailored to protect the interests of the capital exporting countries. The capital importing countries, including Russia, have very little interest in concluding such agreements, if they have any, and can effectively defend their interests without any tax agreements, solely as a result of the appropriate development and adaptation of their domestic tax legislation.

On the other hand, the tax regime formed under the influence of the norms of national tax legislation and international law, and it is an important factor influencing the choice of jurisdiction for investment, as well as choosing of the legal investment design by the economic agent (Donchenko, 2016). That is why to attract foreign investors to Russian markets, it is necessary to create an effective legal and

regulatory framework for foreign investors in the field of taxation, through the conclusion and effective implementation of agreements in the field of avoiding double taxation. In the meantime, the norms of international agreements directed to protect the taxpayer from double taxation, discrimination on the part of national legislation and ensure the inviolability of the income received in the conditions of market relations are applied in Russia in a distorted manner, which worsens the overall investment climate.

Particular mention should be made of bilateral agreements on the promotion and mutual protection of investments. Almost all developed states act as a party to such agreements. The Russian Federation is no exception. These agreements aimed at the promotion and protection of investments is actively used in international treaty practice of Russia since the late 1980s. To date, Russia has signed and ratified more than 60 such agreements (Veselkova, 2015). We believe that in order to improve the investment climate, Russia should follow the path of liberalization of investment legislation and conduct further work to develop measures to protect the investment of foreign investors.

The key act governing international investment relations is the Convention on the Settlement of Investment Disputes between States and Natural or Legal Persons of Other States (ICSID) (concluded in Washington on 18.03.1965). To date, the Washington Convention has been signed, but not ratified by Russia. But despite this circumstance, the International Center for the Settlement of Investment Disputes (specialized investment arbitration) established in accordance with this Convention serves as an effective way to resolve international investment disputes, including those involving Russian companies. This became possible on the basis of the 1979 Additional Protocol, which allowed the Center to settle the dispute and if one of the parties to the dispute - the state or the state of the other party to the dispute (investor) - is not a party to the Washington Convention (Buslayeva, 2008 ). We believe that Russia should join the Convention on the settlement of investment disputes between states and individuals or legal entities of other states, which will increase the investment attractiveness of the domestic economy.

Another important international document regulating investment relations is the Convention on the Establishment of the Multilateral Investment Guarantee Agency (MIGA) (concluded in Seoul in 1985). MIGA is currently providing international guarantees against non-commercial risks in relation to foreign investment. The relationship between MIGA and the foreign investor - the owner of the guarantee - arises from the conclusion of a guarantee agreement between them, according to which the owner of the guarantee undertakes to pay MIGA a cash prize, and MIGA - upon the request of the owner of the guarantee to compensate for his losses as a result of one or more non- investment activity in another state. After payment of compensation to the owner of the MIGA guarantee, rights or claims related to guaranteed investment are assigned. Such MIGA rights are subject to recognition by all parties to the Seoul Convention. This allows, in the final analysis, to transfer



investment disputes between foreign investors and receiving states from private law to the international legal sphere, the subjects of which are states and international organizations, including MIGA.

Taking into account Russia's accession to the WTO, the agreements operating under the GATT / WTO are important. For example, the Agreement on Trade-Related Investment Measures (TRIMs) (concluded in Marrakech on April 15, 1994), included in the terms of the Uruguay Round agreements of 1986 - 1994. It seems that an important direction in the development of the legal regulation of foreign investment in Russia is its creation within the framework of the Eurasian Economic Union (EEA), which has replaced the Eurasian Economic Community (EurAsEC).

The main forms of economic integration within the framework of the EAEC as the most perfect configuration of economic integration are the Customs Union and the Single Economic Space, formed in the structure of the Eurasian Economic Community. Currently, the Treaty on the Eurasian Economic Union (Signed in Astana on May 29, 2014) contains Section XV *"Trade in Services, Establishment, Operation and Implementation of Investments"*, which contains the basic principles of mutual cooperation of the participating States in the investment sphere. We believe that the issues of investment and investment protection within the framework of the integration space of the EAEC should be resolved in more detail.

## **5. Discussion**

The result of this research shows the importance of creating a favorable legal regime for attracting foreign investment into the Russian economy. It is necessary to overcome negative trends in the sharp decline in the inflow of foreign investments into the Russian economy.

To achieve these results, it is necessary to create a simpler and more transparent system of regulatory and legal regulation of investment activities in the Russian Federation. It is necessary to avoid the current system of legal regulation of certain spheres of innovation activity by the way of a large number of normative legal acts. As it was shown, the national regulatory and legal regulation of investment activities should be based on the norms of international law providing for various guarantees for investors protecting their investment. In particular, an important factor influencing the choice of jurisdiction for investment, as well as the choice of the legal formalization of investment by the economic agent, is the taxation regime, and Russian legislation should provide mechanisms for avoiding double taxation. Also, one should take the path of creating effective measures to protect the investment of foreign investors.

An important direction in the development of the legal regulation of foreign investment in Russia is the expansion of the legal regulation of investments within the framework of the Eurasian Economic Union.

## **6. Conclusion**

The results of the conducted research allow making a conclusion about the necessity of creating a favorable legal environment for attracting foreign investments to the Russian Federation. It is necessary to improve the national regulatory framework for foreign investment as follows:

- Publication of a comprehensive regulatory and legal act regulating investment activities in Russia, which will create a unified, simple and transparent system of legal regulation of investment activities;
- To improve tax legislation in order to create conditions for avoiding double taxation of foreign investments;
- Liberalize Russian legislation in the field of foreign investment with a view to overcoming the inconsistency of the provisions of Russian acts with the regulations on foreign investment regulation in force abroad;
- To strengthen legal mechanisms of protection foreign investment in the Russian economy;
- To ratify the Convention on the settlement of investment disputes between states and individuals or legal entities of other states;
- To expand the system of legal regulation of investments and investment activities in the EAE space.

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