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National Treatment at Investment at Different Levels of Public Administration: Considerations for Policy Makers*

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ABSTRACT

The article has identified the right subnational interpretation of the principle of national treatment (NT) as a cornerstone determining the policy flexibility of subnational authorities. The purpose is to analyse measures of national and subnational authorities affecting the application of the principle of NT vis-à-vis the foreign investor, which allows to recommend certain approaches to investment policy making at the subnational level. The following issues are discussed in the article: concepts of foreign investors and foreign investment in the Russian Federation; NT in bilateral investment agreements; NT of investment in the context of the WTO agreements; a framework for the description of NT at the subnational level; classification of exceptions from NT; exceptions from NT according to GATS obligations; NT at the subnational level. In the Russian Federation the foreign investor has full legal protection equal to the protection of local firms if it is a legal entity in which the foreign shareholder owns at least 10%, but no more than 20% of the authorized capital, or if the foreign investor does not create a new legal entity, but opts for a branch or a representation office. The model bilateral investment treaty of the Russian Federation follows approaches similar to those of developed countries. Questions were identified which should be answered during the investment policy making at the subnational level: For what kind of investors and how is market entry regulated? What represents post-establishment? Is it possible to expand NT for affiliated and dependent firms? In our opinion, nothing prevents the extension of support to small and medium sized enterprises to the entities with 100% (but not 49%) participation of the foreign equity. At the same time it is that type of exceptions from NT which practices in developed countries as well.

KEYWORDS

national treatment, investments, investment agreements, WTO, GATS, subnational, horizontal obligations, sectoral obligations, exceptions

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Национальный режим в инвестициях на различных уровнях государственного управления: соображения для политиков

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РЕФЕРАТ

В статье интерпретируется принцип национального режима (НР) как краеугольного камня, определяющего гибкость политики субнациональных властей. Цель состоит в анализе мер национальной и субнациональной политики, влияющих на применение принципа НР по отношению к иностранному инвестору, который позволил бы рекомендовать определенные подходы к формированию инвестиционной политики на субнациональном уровне. В статье обсуждены следующие вопросы: понятия иностранного инвестора и иностранной инвестиции в РФ; НР в двусторонних инвестиционных соглашениях; НР в инвестициях в контексте соглашений ВТО; структура описания НР на субнациональном уровне; классификация исключений из НР; исключения из НР согласно обязательствам по ГАТС; НР на субнациональном уровне. В РФ иностранный инвестор получает полную правовую защиту, равную защите местных фирм, если это — юридическое лицо, в котором иностранному акционеру принадлежат, по крайней мере, 10%, но не больше, чем 20% акций или уставного капитала, или если иностранный инвестор не создает нового юридического лица, а выбирает форму филиала или представительства. Модельное двустороннее инвестиционное соглашение РФ придерживается подходов, принятых развитыми странами. Были идентифицированы вопросы, на которые нужно ответить, формируя инвестиционную политику на субнациональном уровне: Для каких инвесторов и каким образом осуществляется допуск на рынок? Что представляет собой НР после допуска инвестора? Можно ли расширять НР, предоставив гарантии и льготы для дочерних и зависимых обществ? На наш взгляд, ничто не мешает расширить поддержку малых и средних предприятий, распространив ее на предприятия со 100% (а не 49%) участием иностранного капитала. В то же время, это тот тип исключений из НР, который практикуется даже в развитых странах.

КЛЮЧЕВЫЕ СЛОВА

национальный режим, инвестиции, инвестиционные соглашения, ВТО, ГАТС, субнациональный, горизонтальные обязательства, секторальные обязательства, исключения

Introduction

In federal country regulation of foreign investments in the competence of both federal and subnational authorities.

In their investment policies both levels aim at promoting social and economic development; such development can have very specific goals at the subnational level. To maintain sufficient policy space at the subnational level, it is necessary to understand the tools, restrictions and the modes inherent in investment policies, and in particular identify those areas in which the subnational authorities retain discretionary power.

This article has identified the right subnational interpretation of the principle of national treatment (NT) as a cornerstone determining the policy flexibility of subnational authorities. It is argued that it is more relevant than the two other general standards of treatment of foreign investors (most-favoured nation treatment, and fair and equitable treatment) as the main aim of regional and local authorities is to support certain types of local entities, which raises the issue of limits to positive discrimination.

The purpose of this work is to analyse measures of national and subnational authorities affecting the application of the principle of national treatment (NT) vis-à-vis the foreign investor, which would allow us to recommend certain approaches to investment policy making at the subnational level.

Concepts of foreign investors and foreign investment in the Russian Federation

In the Russian Federation¹ the foreign investor has full legal protection equal to the protection of local firms if it is a legal entity in which the foreign shareholder owns at least 10%, but no more than 20% of the authorized capital, or if the foreign investor does not create a new legal entity, but opts for a branch or a representation office. If the local firm is an associate (with the foreigner owning between 20 and 50% of shares) or a subsidiary (if the foreigner owns at least 50% plus one share), it is considered to be a dependent company and does not have the same protection; however it can enjoy the guarantees offered to foreign investors at subnational level (figure 1).

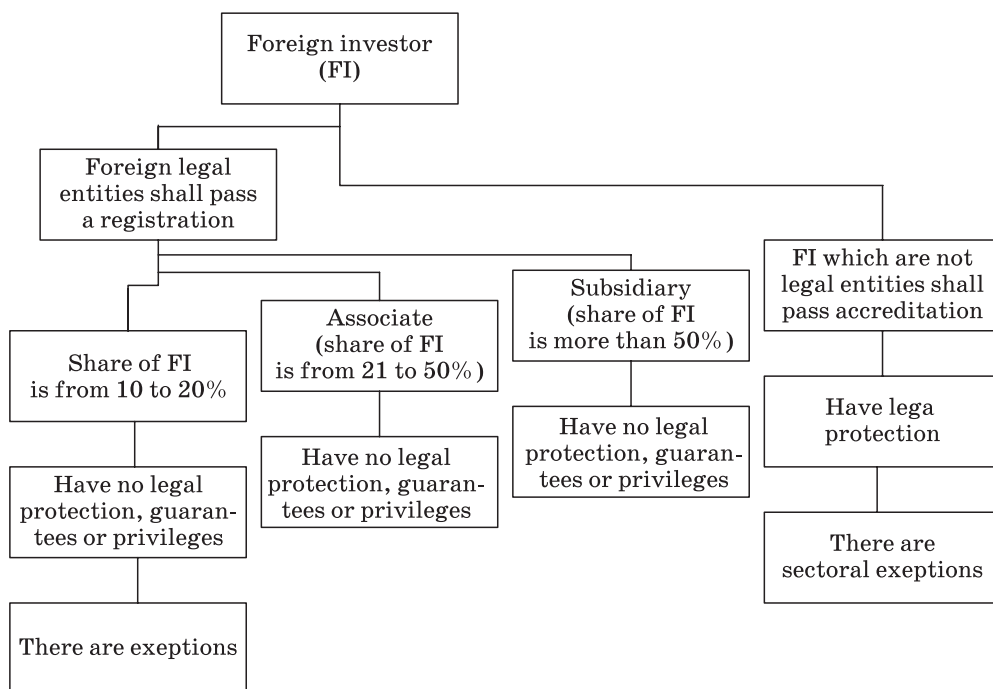


Figure 1. Foreign entities that have or not legal protection in the Russian Federation

¹ About foreign investments in Russian Federation: [Federal law from 09.07.1999r. №160-ФЗ]. URL: <http://www.consultant.ru>

National treatment in bilateral investment agreements

Bilateral investment treaties (BITs) signed by the majority of countries of the world offer the following essential features of national treatment¹:

- NT is provided in general only in the post-establishment phase;
- regional agreements have the right to make an exception of the NT principle; in practice the EU is the only grouping that applies a general policy in this regard;
- host countries reserve the right not to provide NT to investors below a certain level of investment (India) or to carve out strategic sectors from the NT principle (Russian Federation). In the BITs of the Russian Federation there are various other exceptions to the NT principle, including on those investors that have no considerable business presence;
- if it is not stipulated in exceptions, the privileges provided to local small and medium-sized enterprises (SMEs) are formally in breach of the NT principle; however, in practice, there are legal ways to justify them;
- there are privileges provided to multinational enterprise that formally break the NT principle, in this case in favour of the foreign investors, such as access to investor-State dispute settlement. Thus in general, the model BIT of the Russian Federation follows approaches similar to those of developed countries.

National treatment of investment in the context of the WTO agreements

The requirement not to change legislation or actual conditions of competition is a key provision of NT in GATS². In addition, NT in the TRIMS means that performance requirements shall not be imposed on foreign investors if they are not imposed on local ones.

A framework for the description of national treatment at the subnational level

In this article, we have attempted to create a framework for the description of NT at the subnational level, with the aim of stimulating further research. It has parallels with the structure of GATS and the model agreement of India, and it includes: the spheres covered by the standard of the relation, the formulation in which the mode is expressed; general exceptions, exceptions for safety reasons and others (figures 2–4).

Classification of exceptions from NT

Following UNCTAD's classification³, it is possible to identify four types of exceptions:

1. General exceptions.
2. Exceptions specific to a subject.
3. Exceptions specific to industries.
4. Exceptions for the purpose of development.

In the case of the Russian Federation, it is possible to speak about three types of exceptions, as the country does not (yet) use the exception for the purpose of development.

¹ National treatment // UNCTAD series on issues in international investment agreements. New York and Geneva. 1999. URL: <http://unctad.org/en/docs/psiteiidt11v4.en.pdf>

² The General Agreement on Trade in Services (GATS): objectives, coverage and disciplines. URL: https://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm

³ About foreign investments in Russian Federation: [Federal law from 09.07.1999r. №160-ФЗ]. URL: <http://www.consultant.ru>

Exceptions from NT according to GATS obligations

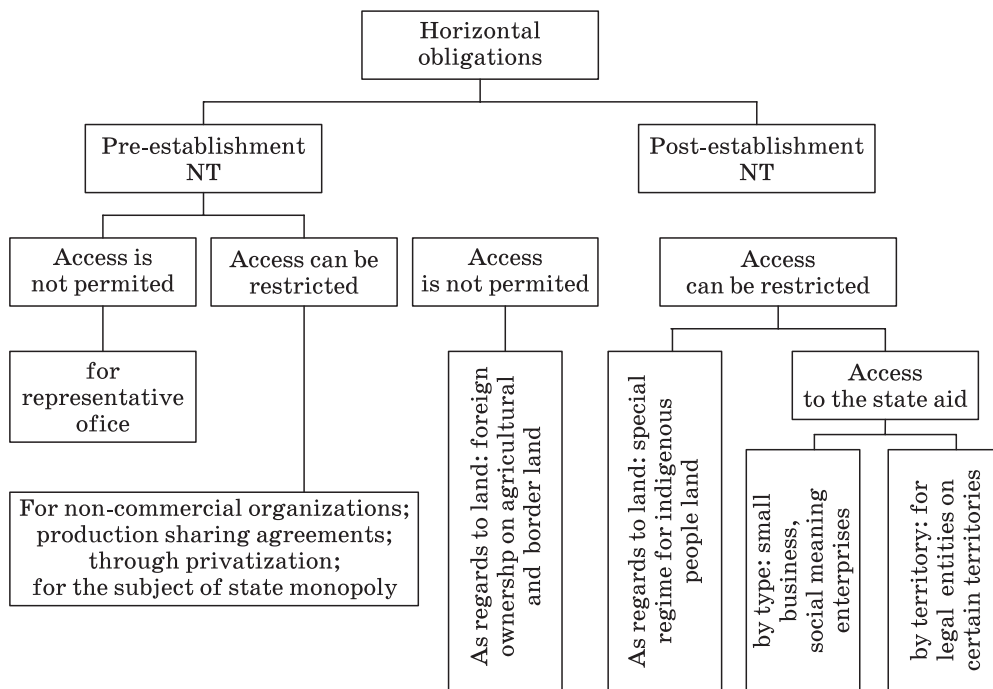


Figure 2. Horizontal obligations of Russia in GATS in the form of a commercial presence

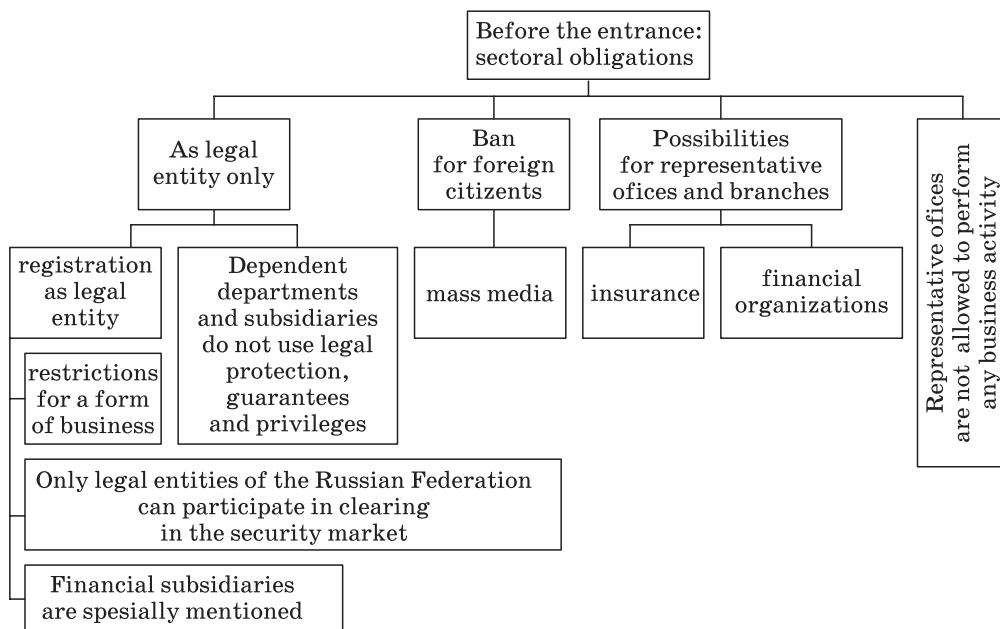


Figure 3. Pre-entry sectoral obligations in GATS

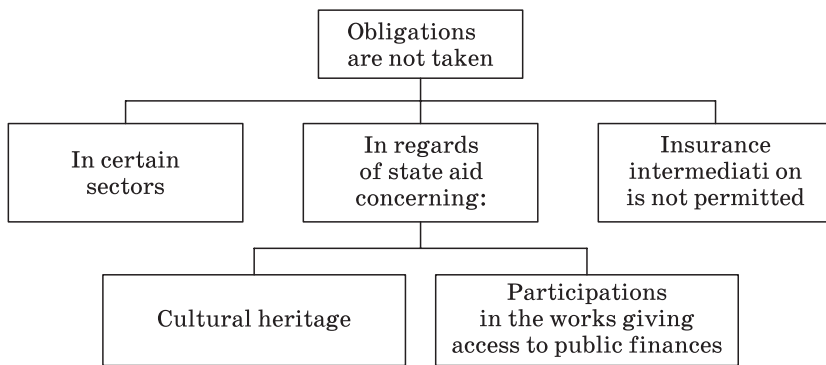


Figure 4. Post-entry exceptions from NT according to obligations of the Russian Federation to the WTO on GATS

National treatment at the subnational level

In order to determine whether a national treatment is modified or not upon transition from federal to subnational level, we researched legal acts of fifteen territorial subjects of the Russian Federation which contain the regulations governing the relation to the foreign investor.

Areas in which NT is guaranteed slightly differ between territorial subjects of the Russian Federation. It can cover:

- the legal regime of activities;
- the modalities for property, property rights;
- the use of profits;
- the management and control of investment.

At the same time in the model agreement of the Russian Federation management and control of investment is covered, too.

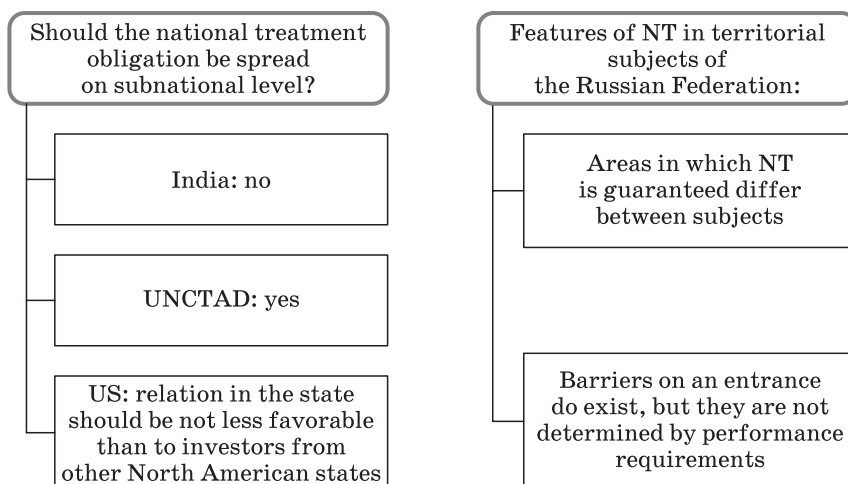


Figure 5. Features of a national treatment in investments at the subnational level

Conclusion

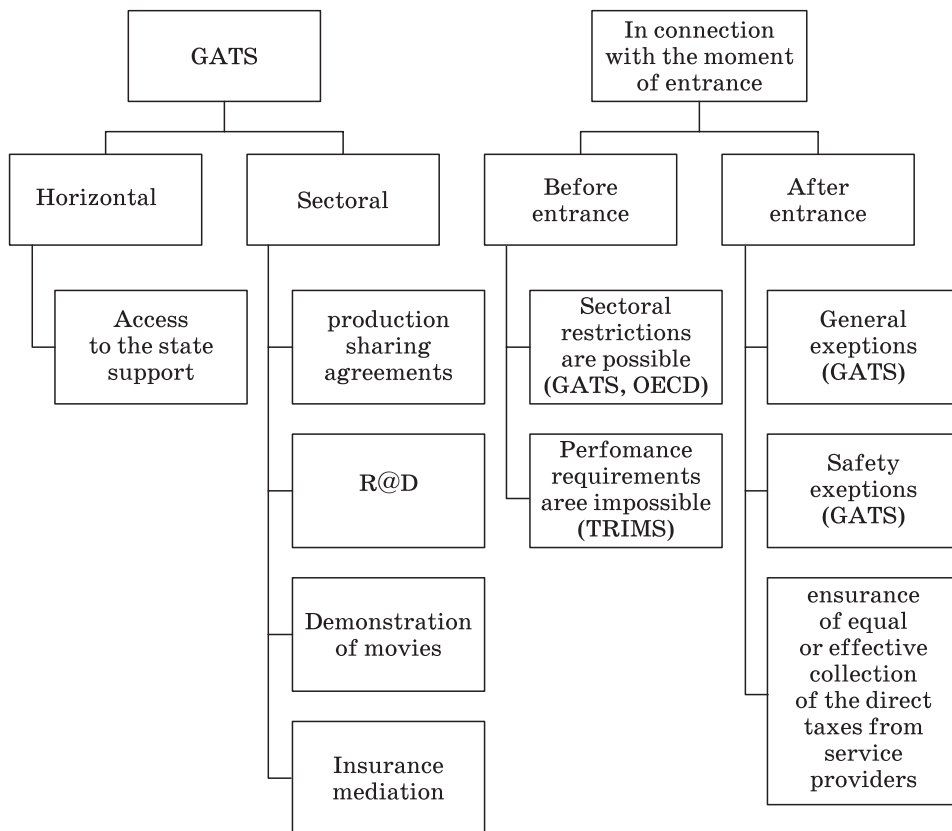


Figure 6. Suggested forms of presentation for exceptions from NT

Investment policy making at the subnational level has to answer the following questions:

- For what kind of investors (dependent, subsidiaries, branches, representations, non-profit organizations) and how (for example, through privatization, under production sharing agreements) is market entry regulated?
- What represents post-establishment NT (whether there is an exception for the protection of the land of indigenous people, or restriction on access to social services such as hospital services)?
- Is it possible to expand NT to the acts of subnational authorities, for example, having provided guarantees and privileges for affiliated and dependent firms?

In our opinion, nothing prevents the extension of support to small and medium sized enterprises to the entities with 100% (but not 49%) participation of the foreign equity. Support of SMEs is subnational responsibility. At the same time it is that type of exceptions from NT which practices in developed countries as well.

It is important that the laws of territorial subjects of the Russian Federation include an extended definition of foreign investors and investment, covering SMEs.