

## COMMENTS

### INVESTMENT ACTIVITIES WITHIN THE LEGAL FRAMEWORK OF THE WORLD TRADE ORGANIZATION

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*This article contains an analysis of legal regulation of investment activities within the framework of the WTO. It considers factors that promote the establishment of a favorable investment climate, including the availability of special legislation, an efficient law enforcement practice and, as noted by many experts, availability and clarity of the judicial mechanism for the protection of violated rights. Recent foreign experience is analyzed and some issues of investment dispute settlement are considered. The article also deals with issues concerning the formation of competitive relations that, in their turn, also constitute an important factor of a state's investment appeal.*

*Investment activities constitute a popular type of entrepreneurial activity. Every state, regardless of where it is located or its level of economic development, aims to increase its investment activities and raise foreign investment inflow. To do this they adopt national regulatory acts and sign bilateral agreements, multilateral agreements, and execute international legal acts in the area of investment activities. This results in the need for examination of legal regulation in this area. Russia joining the WTO has resulted in regular revisions of current legal regulation, in particular in the law on foreign investments.*

*Keywords: WTO; investment climate; foreign investments; competition; national regime; investment disputes; investment agreements.*

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## 1. Features of Investment Climate Formation

The goal of legal regulation of investment activities, in the context of national legislation is to create a favorable investment climate. This is made up of multiple factors, one of which is availability of an efficient legal mechanism that regulates investment activities, protection of investor rights and the functioning of an investment infrastructure. Other factors affecting the creation of investment appeal for the economy of the Russian Federation include the lack of political stability and the absence of a well-developed institutional and market infrastructure.

In our view, an important part of a favorable investment climate is the availability of efficient competitive legal relations in various markets of goods and services. Competition is the most important element for the efficient functioning and development of market relations, as is the implementation of entrepreneurial activities by multiple subjects. Research indicates that the positive impact of competition on the economy mainly becomes apparent in the development of entrepreneurial initiative; competition promotes the use of more efficient forms and methods of management as well as rational distribution of resources, investments, etc.

Legal regulation of competition in the Russian Federation is ensured by the Constitution of the Russian Federation (Art. 34 provides for prohibition of economic activities aimed at monopolization and unfair competition); Federal Law No. 135-FZ of July 26, 2006, 'On Protection of Competition'<sup>1</sup> [hereinafter Federal Law No. 135-FZ] the Civil Code of the Russian Federation (in particular, Art. 10(1) provides for impossibility of application of civil rights for the purpose of restriction of competition); as well as other federal laws, by-laws and rules of international law.

With globalization, an increased number of transnational corporations and the development of international trade, international legal regulation of competition has become an important aspect in the development of the global economy. Some Western economists, e.g. Lloyd, note that legal regulation of competition only by national legislation does not result in sustainable economic development of the global economy for two reasons: firstly, the legal system of one state is unable to control unfair competition in other states that negatively affect its national economy; and secondly, laws of one state are not meant to protect the economic system of other states from the negative consequences of unfair competition. Due to this, the international regulation of competition issues is required. It should also be mentioned that anticompetitive business practices within one state and policy as regards to such practices might affect the global economy.<sup>2</sup>

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<sup>1</sup> Федеральный закон от 26 июля 2006 г. № 135-ФЗ «О защите конкуренции» [*Federal'nyi zakon ot 26 iyulya 2006 g. No. 135-FZ 'O zashchite konkurentsii'*].

<sup>2</sup> Peter J. Lloyd, *Multilateral Rules for International Competition Law*, 21(8) *The World Economy* 1132 f. (1998). doi:10.1111/1467-9701.00185

The need for the establishment of a legal mechanism to control global competition conditions was raised as far back as the 1920<sup>5</sup> during the Global Economic Conference of the League of Nations in 1927. In 1948, the Havana Charter<sup>3</sup> was signed. It contained some provisions on international competition in Arts. 46–52. For example, Art. 46 contained a requirement for each member of the International Trade Organization (predecessor of the World Trade Organization [hereinafter WTO]) to take relevant measures and cooperate with the Organization in order to prevent private or state owned companies from engaging in any commercial or business practices in the area of international trade that restricted competition, access to markets or increased monopolies if such business practices resulted in negative consequences for the development of production or trade. Although it was never ratified, its main ideas were included in the GATT 1947,<sup>4</sup> and in the subsequent GATT 1994<sup>5</sup> that was included in the so-called WTO package. Competition related norms are spread across various agreements applicable in the WTO. Article VI of GATT regulates issues pertaining to dumping and application of antidumping measures. The article establishes the principles for judging dumping. This can be considered to have occurred if it results or potentially results in financial damage to an industry within the area of an agreeing party or significantly delays establishment of a national industry. Antidumping measures provided by GATT give an agreeing party the right to apply to any goods supplied within the framework of dumping an antidumping fee in the amount below the dumping difference for such goods (*i.e.* the difference between internal and export prices). The precondition for application of antidumping measures is the filing of a claim and carrying out an investigation, as well as detecting in the course of investigation a connection between dumping and financial damage to the national industry and its reduced competitiveness. These provisions of the GATT are reflected in the Federal Law No. 165-FZ of December 8, 2003, 'On Special Protective, Antidumping and Compensatory Measures during Import of Goods'.<sup>6</sup> According to Art. 3, an investigation is carried out in order to detect an increase in imports to the customs area of the Russian Federation and the resulting significant damage to the Russian economy or threat of significant damage to the Russian economy; to detect

<sup>3</sup> *Havana Charter for an International Trade Organization*, in U.N. Conference on Trade and Employment, Final Act and Related Documents, U.N. Doc. E/CONF.2/78, U.N. Sales No. 1948.II.D.4, at <[https://www.wto.org/english/docs\\_e/legal\\_e/havana\\_e.pdf](https://www.wto.org/english/docs_e/legal_e/havana_e.pdf)> (accessed Dec. 10, 2015).

<sup>4</sup> General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194, at <[https://www.wto.org/english/docs\\_e/legal\\_e/gatt47\\_e.pdf](https://www.wto.org/english/docs_e/legal_e/gatt47_e.pdf)> (accessed Dec. 9, 2015) [hereinafter GATT].

<sup>5</sup> General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 17 (1999), 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994), at <[https://www.wto.org/english/docs\\_e/legal\\_e/06-gatt.pdf](https://www.wto.org/english/docs_e/legal_e/06-gatt.pdf)> (accessed Dec. 10, 2015).

<sup>6</sup> Федеральный закон от 8 декабря 2003 г. № 165-ФЗ «О специальных защитных, антидемпинговых и компенсационных мерах при импорте товаров» [*Federal'nyi zakon ot 8 dekabrya 2003 g. No. 165-FZ 'O spetsial'nykh zashchitnykh, antidempingovykh i kompensatsionnykh merakh pri importe tovarov'*].

dumping imports or subsidized imports and the resulting financial damage to the Russian economy; as well as the threat of significant damage to the Russian economy or significant delay in establishment of an industry of the Russian economy.

Article VII of the GATS<sup>7</sup> provides for a legal regime of monopolies and exclusive service suppliers' rights. GATS contains no definition for exclusive service provider. However, some research shows that this definition corresponds to the definition of monopoly service provider contained in Art. XXVII of the GATS. A monopoly service supplier means any person, public or private, that is officially or actually authorized to implement activities as a sole supplier of such service in a certain market and territory of a member state. In accordance with the GATS, the state must ensure compatibility of actions of a monopolist entity in the course of service provision with the most favorable regime, *i.e.* each member shall immediately and unconditionally provide for services and service suppliers of any other member regime no less favorable than that provided for similar services and service providers of any other state (Art. II(2) of the GATS).

Issues of competition are also considered in the TRIPS.<sup>8</sup> Article 40 establishes that use in licensing agreements of provisions to restrict competition may unfavorably affect trade. Article 10(4) of Federal Law No. 135-FZ provides that requirements on the prohibition to use dominating market position are not applicable to acts aimed at implementation of exclusive rights to results of intellectual activities and equal means of individualization. At the same time, Art. 12 on vertical agreements doesn't contain any regulation on license agreements; the legislator in this case provides only a reference to a commercial concession agreement. The dual nature of TRIPS should also be mentioned: on the one hand, it protects exclusive rights of the authors which promotes improved production, technical and scientific progress, and on the other hand, it enables domination in the market of such an exclusive right holder.

The TRIMs<sup>9</sup> implements legal regulation of financial and investment services rendered by entities from member states of the WTO. Measures under this agreement include availability of sufficient capital and profits for persons intending to implement investment activities within the international trade space; a limit on the amount of loans for investments; requirements for contents of investment portfolio, *i.e.* what

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<sup>7</sup> General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 284 (1999), 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994), at <[https://www.wto.org/english/docs\\_e/legal\\_e/26-gats.pdf](https://www.wto.org/english/docs_e/legal_e/26-gats.pdf)> (accessed Dec. 10, 2015) [hereinafter GATS].

<sup>8</sup> Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 320 (1999), 1869 U.N.T.S. 299, 33 I.L.M. 1197 (1994), at <[https://www.wto.org/english/docs\\_e/legal\\_e/27-trips.pdf](https://www.wto.org/english/docs_e/legal_e/27-trips.pdf)> (accessed Dec. 10, 2015) [hereinafter TRIPS].

<sup>9</sup> Agreement on Trade-Related Investment Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 143 (1999), 1868 U.N.T.S. 186, at <[https://www.wto.org/english/docs\\_e/legal\\_e/18-trims.pdf](https://www.wto.org/english/docs_e/legal_e/18-trims.pdf)> (accessed Dec. 10, 2015) [hereinafter TRIMs].

is used as investment resources, contributions (funds, property, securities, etc.); requirements for other assets; and requirements for protection of investment funds and investment resources of the investor.

Many WTO experts insist on the need for the establishment of common regulatory and legal acts within the framework of the WTO to fix basic and minimum legislative standards for the WTO member states to promote development of the legislation on competition as part of establishing a favorable investment climate. This document would standardize the legislation of the WTO member states in the area of competition and antimonopoly regulation. However, it should be mentioned that the WTO includes states with varying levels of economic development and so various conditions of competition. Thus, in the WTO member states with an underdeveloped market economy, the use of standardized WTO rules may result in a delay in sustainable economic development and a reduction in investment appeal as legal regulation of competition and investments is only being strengthened in such states.

Other research deems it necessary to establish an authority acting within the framework of the WTO, the activities of which are aimed at settlement of international disputes arising in the area of competition that affect the investment climate of a state. In our view, establishment of an antimonopoly authority within the framework of the WTO is the best way to legally regulate competition at the international level. However, the effectiveness of such an authority is doubtful if its competence is restricted to settlement of disputes pertaining to competition. The functions of an antimonopoly authority should include an obligation to develop recommendations on improvement of antimonopoly legislation for each member state of the WTO. This need results from the fact mentioned above, *i.e.* the varying levels of economic development of the WTO member states.

An important type of competition which affects the establishment of a favorable investment climate is banking investment. This is due to the fact that banks are obligatory participants in investment activities as well as agents of investment activities.

In terms of competition in the banking area, one should mention the importance of competition in the development of economies. Some authors believe that with the transition to the market economy, an entrepreneurial management style was established in Russia that featured important factors such as competition between economic entities in entrepreneurial activities in the course of production of goods, works and services, in particular banking services. Research has noted that the positive impact of competition on the economy mainly results in the development of entrepreneurial initiative; competition promotes the use of the most efficient forms and methods of production management as well as rational resource distribution, investments, *etc.*<sup>10</sup>

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<sup>10</sup> Ручкина Г.Ф. Государственный контроль за законностью осуществления предпринимательской деятельности // Государственная власть и местное самоуправление. 2005. № 7 [Ruchkina G.F. *Gosudarstvennyi kontrol' za zakonnost'yu osushchestvleniya predprinimatel'skoi deyatel'nosti* // *Gosudarstvennaya vlast' i mestnoe samoupravlenie*. 2005. No. 7 [Gulnara F. Ruchkina, *State Control of Legal Implementation of Entrepreneurial Activities*, 2005(7) State Authority and Local Self-Regulation]].

Efficient functioning of the Russian banking system is crucial for the social and economic development of the state. This is proven by provisions of the Concept for Long-Term Social and Economic Development of the Russian Federation through 2020.<sup>11</sup> The Concept provides that conditions of sustainable social and economic development include global competitiveness of the banking sector, financial markets, establishment of a fully-fledged financial system, and integration of banks and the financial system in the global economy.

Development of the market economy resulted in the passing of Federal Law No. 135-FZ in 2006 but this failed to give a definition for competition protection. In forming this definition, one should take into account one of the basics of the market economy, *i.e.* the reduction of the importance of the state in the regulation of economic activities and thus the increased impact of self-regulated organizations. Accordingly, the following definition of protection of competition is offered: protection of competition means having in place measures of state control and control of economic entities aimed at detection, prevention and elimination of unfair competition, as well as prevention of monopolistic activities.

The presence of strict state regulation is often considered as a negative factor affecting development of competition in the banking area. The current system of antimonopoly regulation is limited to the prevention of violations of competitive legislation.

According to research, self-regulated organizations can play an essential role in the prevention of violations of competitive legislation in the area of banking services. This regulation is aimed at reducing the importance of the state in the legal regulation of competition, which also constitutes a basic requirement of the market economy. However, self-regulation is a relatively new phenomenon in the Russian legal system, and requires improvements in legal regulation, in particular in issues pertaining to responsibility of members of self-regulated organizations. Legal issues remain in the area of protection of competition as well, namely in activities of the Federal Antimonopoly Service of the Russian Federation [hereinafter FAS] which in the view of a large list of authorities has lost its function as a body which prevents the violation of legislation. Relevant draft law on self-regulation in the banking area was introduced to the State Duma of the Russian Federation in 2012. One of the functions of a self-regulated organization in this area is the development of standards for competitive operations; this is deemed the best way to improve current standards for banking services. The draft law also provides for participation of self-regulated

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<sup>11</sup> Распоряжение Правительства РФ от 17 ноября 2008 г. № 1662-р «О Концепции долгосрочного социально-экономического развития Российской Федерации на период до 2020 года» [*Rasporyazhenie Pravitel'stva Rossiiskoi Federatsii ot 17 noyabrya 2008 g. No. 1662-r 'O Kontseptsii dolgosrochnogo sotsial'no-ekonomicheskogo razvitiya Rossiiskoi Federatsii na period do 2020 goda'*] [Order of the Government of the Russian Federation No. 1662-r of November 17, 2008, 'On the Concept of Long-Term Social and Economic Development of the Russian Federation through 2020']].

organizations in the control measures of the Central Bank of the Russian Federation (the Bank of Russia). In our view, the draft law would promote liberalization of the banking system in general and thus the establishment of efficient competition.

A specific feature of competition in the Russian banking service market is inequality among members. For example, according to FAS, *Sberbank of Russia* OJSC holds the largest share in almost all sectors of the banking service market. This issue was analyzed in the report by FAS of Russia in 2013 on the current state of competition in the Russian Federation.<sup>12</sup> In particular, the issue of the presence in certain regulatory legal acts of the Russian Federation of norms that immediately restrict competition in the bank service market was discussed.<sup>13</sup>

Article 84(2) of the Family Code of the Russian Federation contained a norm according to which payments transferred to the accounts of educational institutions should be transferred to the bank account opened in the name of a child in *Sberbank of Russia*. Due to this, the FAS developed a draft law to exclude such restrictions and provide citizens with the right to place funds in any bank, subject to the funds being insured in the system for obligatory insurance of natural person deposits.

These changes were introduced by Federal Law No. 333-FZ of November 4, 2014, 'On Amendments to Certain Legislative Acts of the Russian Federation in Terms of Exclusion of Provisions Providing for Benefits for Certain Economic Entities'.<sup>14</sup> In our view, this innovation will encourage small- and medium-sized banks to pursue activities that favorably affect their market positions and thus will promote development of the banking sector and strengthen the banking system in general.

The key shareholder and founder of *Sberbank* is the Bank of Russia. It holds 50 percent of its registered capital, which is the most important reason for the current position of *Sberbank*. As a general rule, under Art. 8 of Federal Law No. 86-FZ of July 10, 2002, 'On the Central Bank of the Russian Federation (the Bank of Russia)'<sup>15</sup> [hereinafter Federal Law No. 86-FZ] has no right to participate in the capital of credit institutions unless otherwise provisioned in the federal laws. However, this norm is not applicable to participation by the Bank of Russia in the capital of *Sberbank*.

<sup>12</sup> *Report on Condition of Competition in the Russian Federation 2013, Ch. 4: Analysis of Condition of Competition on Certain Goods Markets and in Certain Areas of Economy*, Federal Antimonopoly Service of the Russian Federation (May 30, 2014), <[http://fas.gov.ru/about/list-of-reports/list-of-reports\\_30086.html](http://fas.gov.ru/about/list-of-reports/list-of-reports_30086.html)> (accessed Dec. 4, 2015).

<sup>13</sup> *Id.* at 323–24.

<sup>14</sup> Федеральный закон от 4 ноября 2014 г. № 333-ФЗ «О внесении изменений в отдельные законодательные акты Российской Федерации в части исключения положений, устанавливающих преимущества для отдельных хозяйствующих субъектов» [*Federal'nyi zakon ot 4 noyabrya 2014 g. No. 333-FZ 'O vnesenii izmenenii v otdel'nye zakonodatel'nye akty Rossiiskoi Federatsii v chasti iskl'yucheniya polozhenii, ustanavliyvayushchikh preimushchestva dlya otdel'nykh khozyaistvuyushchikh sub'ektov'*].

<sup>15</sup> Федеральный закон от 10 июля 2002 г. № 86-ФЗ «О Центральном банке Российской Федерации (Банке России)» [*Federal'nyi zakon ot 10 iyulya 2002 g. No. 86-FZ 'O Tsentral'nom banke Rossiiskoi Federatsii (Banke Rossii)'*].

In our view, this conflicts with the basics of fair competition and the rules of the market economy. Due to this, it is deemed reasonable to introduce changes to Federal Law No. 86-FZ to prohibit participation by the Bank of Russia in the capital of all credit institutions. Functions of the Bank of Russia should be limited to bank control and supervision.

Thus, upon consideration of the legal aspects of competition in the banking service market, one may draw the following conclusions: firstly, introduction of self-regulation in the banking sector may become an additional guarantee of support for competition in the banking sector; and secondly, establishment of full prohibition for the Bank of Russia against participation in the capital of credit institutions will promote development of competition in the banking sector in accordance with the basics of fair competition. Such measures would promote the establishment of investment appeal for the Russian economy.

## **2. Investment Activities in Russia and Developed Economies**

The investment activities within the framework of the national legal regime are considered below. In addition to the various features of investment activities, their structure will also be described.

Investment activities comprise two components. The first is an economic process: the search for investment resources, investment objects and immediate investments. A person first searches and then selects resources for investment. These include funds, property, securities, financial rights, etc. In practice, subjects of investment activities most often deal with search for capital. Capital means property or funds the use of which results in profits. Then or almost simultaneously with searching for investment resources, a person searches for investment objects. Each object requires a certain amount of investments. For example, securities require a certain amount of funds, a certain amount of other securities or other securities of a certain cost (warrant, option) for investment and purchasing in ownership. The process is completed by investments when the same funds are invested in an investment object, i.e. investment. Investment provides for a certain result (effect) from implementation. For example, if funds suppose some result of investment – profits or losses – one may conclude that investment took place and funds became an investment.<sup>16</sup>

The second component is the entrepreneurial process: turnover of investments, investment management and the result of investment activities. The entrepreneurial process commences when investment resources are invested. From that point, subjects of investment activities monitor turnover of investments and send them to certain sectors of investment object. At this stage, an investor may increase the

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<sup>16</sup> Jürgen Kurtz, *The Use and Abuse of WTO Law in Investor-State Arbitration: Competition and Its Discontents*, 20(3) Eur. J. Int'l L. (2009), available at <<http://ejil.oxfordjournals.org/content/20/3/749.full.pdf+html>> (accessed Dec. 10, 2015). doi:10.1093/ejil/chp040

amount of investments, change the financing plan, specifics and types of investments; in other words, employ certain entrepreneurial instruments. It is then time to obtain the results of investment activities. The result can be obtained immediately after investment or it can take more time. This depends on whether the investments are short-, medium- or long-term.

A definition of investment activities in the US is given in the Investment Company Act.<sup>17</sup> Investment activities are defined as a type of entrepreneurial activity affected by investment and bank companies that provides for a flow of capital in certain areas of the economy. It has the following features:

- 1) in general, investment activities in certain states are similar to the definition used in the Russian Federation;
- 2) this type of activity is legally defined as entrepreneurship;
- 3) it provides for capital flow, *i.e.* investment of funds and other investment resources;
- 4) capital flow generated by banks and investment companies can be sent to various areas of the economy. It should be noted that state authorities support development of the abovementioned critical industries. Development of these industries is promoted among national investors and limited for foreign investors, as mentioned before.

American financial expert and major global investor, George Soros, provided another definition of investment activities. He stated that investment activities were entrepreneurial activities aimed at forecasting future income. The ability to make such forecasts depends on the skills of the agents of investment activities.

One may extract and generalize the following legal basics of investment activities from the Investment Company Act:

- 1) open investment policy provides that investors shall implement investment activities as fairly and transparently as possible;
- 2) lack of discrimination in investment policy in national law within the state may not provide for unreasonable restrictions or bans on subjects of investment activities;
- 3) sufficient competitiveness, *i.e.* in the area of investment activities all legal and economic connections shall be conducted at a highly competitive level;
- 4) guarantees for investors and protection of investments (it is well known that investment activities, as with any other entrepreneurial activity, are associated with risks and may result in profits, zero profits or losses);
- 5) neutral (unbiased) settlement of investment disputes, *i.e.* legal disputes in the area of investment activities are considered and settled on a neutral unbiased basis. A court may not attach any privileges in this area and shall pay no attention to the legal, economic or political status of subjects of investment activities involved in proceedings;

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<sup>17</sup> 15 U.S.C. §§ 80a-1 to 80a-64 (1940).

6) transparency and public involvement, *i.e.* activities shall be clear and accessible to anyone. This is necessary to avoid questions pertaining to its legitimacy and fairness;

7) special conditions on national security from the Foreign Investment and National Security Act<sup>18</sup> according to which the state may restrict or prohibit foreign investments arguing their national security and state immunity.

In contrast, the definition of investment activities in the UK is rather specific. A definition can be created from information in the Companies Act, Securities Act, and Financial Services and Markets Act. Investment activities are a type of financial service providing for investments in certain objects and are associated with risk. This definition is rather general but has an important feature. It is important that it is a financial service. At the same time, it is explained that a financial service can be an entrepreneurial activity as in the analyzed case. It is well known that not every financial service can provide for entrepreneurial activities. For example, electronic funds transfer is a financial service (operation) but does not allow for entrepreneurship. Thus, it is important that investment activities constitute a type of financial service that allow for entrepreneurship.

Speaking of general legal basics of investment activities, the Prime Minister of the UK, David Cameron, noted that freedom of investment activities and investments is extremely important, and is especially necessary for investments in infrastructure and power projects.

The definition of investment activities in Germany can be extracted from the Investment Company Act.<sup>19</sup> Investment activities constitute a type of economic activity providing for investment of funds that include funds and assets of the subject in a way that maximum profitability of this activity is ensured. The definition is rather specific and different from legal definitions of investment activities in other states. Specific features of investment activity are as follows:

1) it constitutes a type of economic activity. According to many scientists, all entrepreneurial activities are economic activities. However, it should be understood that this includes all legal and economic components;

2) it provides for investment of funds reserves and assets of subjects. Reserves include the funds of natural persons and reserve funds of legal persons;

3) it is aimed at maximization of profits. If this feature is compared to investment activities' features under Russian legislation – availability of certain effect of investment activities – it is clear that it is one of its aspects.

The Russian legal system mainly regulates issues of foreign investments. Foreign investments mean investment of foreign capital in the entrepreneurial activities within the Russian Federation in the form of civil rights objects belonging to a foreign

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<sup>18</sup> Pub. L. 110–49, 121 Stat. 246 (2007).

<sup>19</sup> Gesetz über Kapitalanlagegesellschaften, v. 16.04.1957 (BGBl. I S. 378).

investor if these are not withdrawn from circulation or limited in circulation in the Russian Federation in accordance with federal laws, including money, securities (in foreign currency and currency of the Russian Federation), other property, property rights, exclusive rights to results of intellectual activities assessed in monetary terms (intellectual property), as well as services and information.

### **3. Objects and Subjects of Investments in Foreign States**

A specific American characteristic under the Investment Company Act is the availability of subjects of investment activities such as mutual investment funds. Mutual investment funds are not considered in legal terms to be an investment fund. A mutual investment fund or mutual fund in economy or simply mutual fund is a set of companies of any legal form that provides for the possibility of investment activities. A specific characteristic of a set of such companies is that they specialize in investments in certain areas and certain types of assets. Thus, according to this law the following types of mutual funds exist (mutual investment funds): mutual securities funds (mutual shares funds, mutual bonds funds), mutual cash funds, mutual mixed funds and other mutual funds.

Investment activities of companies in the area of securities which are the most popular and generally profitable are investments in shares and bonds. Thus, the law separately describes in mutual security funds the mutual shares funds and mutual bonds funds. Mixed mutual funds according to the law are sets of companies specializing in investments in several types of objects, *i.e.* investing in various objects of the same type. The regulatory legal act explains that investment companies are legal persons that implement investment activities in various areas, obtain profits from the same, and may feature various legal forms.

In terms of the level of development of certain objects in the state, popularity of the same and demand for investment activities of subjects, it is possible to note that the most popular ones are investment funds, money market funds, organizations, pension funds, infrastructure, securities market, venture funds for innovations and science, and entrepreneurial objects of investment activities. A discussion on the entrepreneurial subjects of investment activities and scientific innovations is set out below.

Entrepreneurial investments enable joint investment activities of several major companies that encourage investment in certain activities. Professor V.B. Supyan notes that in practice many American companies are involved in investment activities based on entrepreneurship, which is an efficient way to avoid financial loss in the course of investments and in case of investments for object development or establishment of new infrastructure.

Another specific and well-developed object of investment activities is scientific innovations. Endowment funds, *i.e.* target capital funds, are especially worth mentioning. Most often, these are formed based on higher education institutions.

An investor transfers funds in the amount allowed by the Investment Company Act to the specific foundation of the education institution, which in turn deals with scientific and innovative developments, use and sales. An endowment fund of a university gains profits. In Germany, there are certain features of the legal status, types and subjects and objects of investment activities. The German Investment Company Act screens the subjects of such entrepreneurial activities, namely legal persons, investment companies and investment funds. In general, investment funds under the legislation of other states are investment companies.

In addition, investment companies include credit institutions. Even if an investment company is not a bank or other credit or financial organization by its nature, in the course of investment activities it is still subject to legal regulation by the Investment Company Act. This is what the said law sets out. The law also provides for such a specific category of object of investment activities as a special asset. This is an asset which an investor has invested in and may gain profits from but which is not the investor's property.

Specific features of subjects of investment activities are observed in Japan. The Foreign Exchange and Foreign Trade Law names certain subjects of investment activities that may implement direct investments. In the legislation of almost all developed states the assignment of direct status to investments depends on the amount of investments (e.g., purchasing of shares in registered capital of a certain amount) regardless of the subject implementing the same. According to the law in question, not all subjects may make direct investments. This depends on the amount of investments as well as on whether the subject is one of the following: foreign natural person; foreign legal person; Japanese corporation where foreign persons hold over 50 percent of voting shares; and any other organization where the majority of managers are foreign citizens. These categories make it clear that direct investments in the Japanese economy are available not only to foreign but also to national subjects.

In China, subjects of investment activities compared with the other considered states are limited in their investment rights to operation within their state; investors may effect investments in objects located within pilot areas.

From the above research on the legal status of subjects and objects of investment activities in foreign states, specific features of the legal status of subjects and objects in certain states, and types of the same, one may conclude that each state specifies its own legal requirements. Legislation of many of the states discussed provides some special subjects and objects that are absent in the law and practice of other states. Most often, this results from the development of rights and economic policies of a state. However, types and subtypes of subjects and objects under the legislation of these states are almost the same and this is also the case in Russia. There are also specific features of legal status of subjects of investment activities and conditions of activities in certain states. There are special areas for direct investment in Japan, special financial and credit subjects in the US, unique objects and special assets in Germany, etc. All these illustrate how investment has developed.

#### 4. Issues of Legal Regulation of Investment Activities within the Framework of the WTO and National Investment Legislation

The report of the Working Group on the Accession of the Russian Federation to the WTO, which was published in November 2011,<sup>20</sup> noted that the policy of the Russian Government was to establish conditions for the growth of national and foreign investments as well as transparent and sustainable rules for implementation of economic activities. These formed the basis for investment legislation in the Russian Federation after accession to the WTO.

Within the framework of the WTO, which details conditions for development of investment activities, is *compliance of national legislation with the WTO norms*. This feature is reflected in Art. II(2) of the WTO Agreement<sup>21</sup> which provides that agreements and associated legal documents constitute an integral part of this agreement and are obligatory for every member. At present, the legal acts regulating investment activities in the Russian Federation are: Federal Law No. 160-FZ of July 9, 1999, 'On Foreign Investments in the Russian Federation'<sup>22</sup> [hereinafter Federal Law No. 160-FZ] (aimed at raising and efficient use in the Russian economy of foreign material and financial resources, cutting-edge equipment and processes, managerial experience, sustainable conditions for activities of foreign investors and compliance of the legal regime with foreign investment norms of international laws and international practice of investment cooperation); RSFSR Law No. 1488-I of June 26, 1991, 'On Investment Activities in the RSFSR'<sup>23</sup> (aimed at efficient functioning of the state economy of the Russian Federation and equal protection of the rights, interests and property of subjects of investment activities regardless of the ownership forms); and Federal Law No. 39-FZ of February 25, 1999, 'On Investment Activities in the Russian Federation in the Form of Capital Investments'<sup>24</sup> [hereinafter Federal Law No. 39-FZ] (defining legal and economic basis for investment activities in the form of capital investments within the Russian Federation, as well as providing guarantees of

<sup>20</sup> <<http://wto.wtcmoscow.ru/common/upload/ReportOfTheWorkingParty.pdf>> (accessed Dec. 10, 2015).

<sup>21</sup> Marrakesh Agreement Establishing the World Trade Organization, Apr. 15, 1994, The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 4 (1999), 1867 U.N.T.S. 154, 33 I.L.M. 1144 (1994) [hereinafter WTO Agreement].

<sup>22</sup> Федеральный закон от 9 июля 1999 г. № 160-ФЗ «Об иностранных инвестициях в Российской Федерации» [Federal'nyi zakon ot 9 iyunya 1999 g. No. 160-FZ 'Ob inostrannykh investitsiyakh v Rossiiskoi Federatsii'].

<sup>23</sup> Закон РСФСР от 26 июня 1991 г. № 1488-I «Об инвестиционной деятельности в РСФСР» [Zakon RSFSR ot 26 iyunya 1991 g. No. 1488-I 'Ob investitsionnoi deyatel'nosti v RSFSR'].

<sup>24</sup> Федеральный закон от 25 февраля 1999 г. № 39-ФЗ «Об инвестиционной деятельности в Российской Федерации, осуществляемой в форме капитальных вложений» [Federal'nyi zakon ot 25 fevralya 1999 g. No. 39-FZ 'Ob investitsionnoi deyatel'nosti v Rossiiskoi Federatsii, osushchestvlyаемой v forme kapital'nykh vlozhenii'].

equal protection of rights, interests and property of subjects of investment activities in the form of capital investments regardless of the ownership forms). In our view, given the conditions imposed on the Russian Federation as a WTO member, Federal Law No. 160-FZ should be cancelled. This is due to the fact that the WTO agreements are aimed at application of the national regime to all agents involved in economic activities regardless of nationality. Federal Law No. 160-FZ is also questionable due to the norm provisioned in Art. 10 which states that disputes involving foreign investors that arise from implementation of investment and entrepreneurial activities within the Russian Federation are to be settled in accordance with international treaties of the Russian Federation and federal laws in the court or by international arbitration (mediation court). However, Federal Law No. 160-FZ says nothing about investment disputes (there is no definition of investment dispute in the law).<sup>25</sup>

Article 8 of Federal Law No. 39-FZ provides that connections between subjects of investment activities are based on a contract and / or state contract between the same in accordance with the Civil Code of the Russian Federation. However, such a contract is not named in accordance in the Civil Code of the Russian Federation. According to legal scientists, the list of named contracts in the legislation of any state always lags behind the needs of turnover, especially in the Russian economy which is undergoing significant changes.

Lack of legal regulation of investment contracts at federal level promoted the development of investment legislation of subjects of the Russian Federation. At present, almost all subjects of the Russian Federation have regulatory legal documents regulating a contract in the area of investment. Legal regulation of investments at the level of subjects is provisioned due to the need for the establishment of favorable conditions for investment raising, and thus the social and economic development of regions. This situation is a significant factor affecting the investment climate in Russia in general. Its complex system of regional legislation means that Russia was number 101 in the global rating of investment appeal in 2014.

Analysis of the legislation of subjects of the Russian Federation allows for the conclusion that special legal regulation is required for investment agreements with the participation of public legal entities. According to A.G. Bogatyrev, the presence of the said public legal aspect in contractual liaisons results in disputes with regard to the legal nature of investment contracts. A complex approach also exists for determining the legal nature of investment contracts, according to which, due to complexity of regulation, it is impossible to classify investment agreements / contracts as agreements / contracts with an international public legal nature or administrative and civil nature in national law directly. In our view, given the specific features of investment agreements, such obligations fall in the area of private legal regulation

<sup>25</sup> David A. Collins, *A New Role for the WTO in the International Investment Law: Public Interest in the Post-Neoliberal Period*, 25 Conn. J. Int'l L. 1 (2009), available at <[http://papers.ssrn.com/abstract\\_id=1552927](http://papers.ssrn.com/abstract_id=1552927)> (accessed Dec. 10, 2015).

that is implemented by the Russian Federation according to the Constitution of the Russian Federation. Thus, at present, federal standardization of the legislation on investment agreements is acute, which would promote an improvement in Russia's investment appeal as well as the development of civil turnover.

A specific characteristic of legal regulation of investment activities within the framework of the WTO is that the WTO package contains no multilateral investment agreement aimed at regulation of investments.<sup>26</sup> The WTO norms regulating investments are provisioned in GATS and TRIMs, as well as in the TRIPS. GATS mainly regulates trade liaisons in the area of services. Article I provides forms of service rendering, including establishment of representative offices in foreign states, which is a type of foreign investment protected by international investment agreements. Article II sets out the most favorable regime, which is also an important rule of international investment law.

Another document that regulates particular investment activities is TRIMs. In this agreement, investment measures mainly include an obligation on the state to insert into national legislation privileges required for the implementation of investment measures pertaining to trade. For example, TRIMs provides for an obligation on service providers to purchase products of national manufacturers and a limitation on their ability to buy or use imported products.

A brief analysis of the WTO norms that regulate investment activities reveal that within the framework of the WTO, legal regulation of investment activities mainly concerns access to the national markets and liberalization of the regime for foreign investments and not protection of the rights of foreign investors. The WTO norms also provide for the right of member states to independently select sectors of the economy that they may withdraw from the national regime or the most favorable regime, which may also potentially reduce the rights of foreign investors. On this basis, one may conclude that signing an investment agreement is required within the framework of the WTO to provide for a legal mechanism (based on the norms of international investment law) to protect rights of foreign investors acting within the framework of the WTO.

## 5. Certain Specific Features to Consider in Investment Disputes

A discussion of an important aspect of the establishment of an investment legal liaison, *i.e.* the settlement of investment disputes, is set out below. Issues of investment disputes are discussed in the ICSID Convention.<sup>27</sup> Russia signed this

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<sup>26</sup> Tillmann R. Braun, *Investment Protection under the WTO Law – New Developments in the Aftermath of Cancún* (= 28 Beiträge zum Transnationalen Wirtschaftsrecht) (Christian Tietje et al., eds.) (Martin-Luther-Universität 2004), available at <<http://telc.jura.uni-halle.de/sites/default/files/altbestand/Heft28.pdf>> (accessed Dec. 10, 2015).

<sup>27</sup> Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159, at <[https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc\\_en-archive/ICSID\\_English.pdf](https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc_en-archive/ICSID_English.pdf)> (accessed Dec. 10, 2015) [hereinafter ICSID Convention].

convention in 1992. However, it has still not been ratified by Russia. The said types of disputes can be settled through the International Centre for Settlement of Investment Disputes (ICSID). Russian legislation provides no such possibility. As such, Russia should ratify the ICSID Convention to ensure that there is a mechanism for the protection of investor rights that in turn would promote the establishment of a favorable investment environment in the Russian Federation as a WTO member.

The ICSID Convention is a source of legal regulation of investment activities for the US, Germany, the UK, Japan, UAE and China. The essence of the ICSID Convention is that it protects foreign investors. It protects rights of foreign investors in the area of investment activities and other entrepreneurial activities, providing for investments as a secondary element of entrepreneurial activities (*e.g.*, investments in wholesale trade and wholesale trade) from the unfavorable impact of the state. It sets out the procedure for consideration of disputes by the ICSID. Parties to a dispute have the right to settle an investment dispute in two ways: enforcement through the courts or arbitration. The complexity of settlement of international investment disputes results from multiple gaps and obstacles in the legal regulation of investment agreements, and limited access to contractual and court and arbitration practice due to the mostly confidential nature of relevant documents. In addition, the doctrine lacks a common theoretical approach to the definition of basic concepts and categories, such as the investment agreement, legal qualification of international investment activities and its diverse contents, description of stages of such activities.<sup>28</sup>

Analysis of unified and collision legal norms aimed at the legal regulation of the settlement of international investment disputes would enable detection of the main issues: first, complexity of interpretation of the definition of international investment disputes; second, determination of international justiciability under such disputes; and third, selection of applicable material law for consideration of international investment disputes.

In this connection, it should be mentioned that there is no special international court or common international procedure for consideration of investment disputes nor is there a generally accepted and applied law. As regards the definition of an international investment dispute, various foreign state legislations, as well as Russian legislation, interpret it rather broadly. For example, according to Art. 10 of Federal Law No. 160-FZ, this is a dispute involving a foreign investor arising in connection with investments and entrepreneurial activities within the Russian Federation.

According to the ICSID Convention, investment disputes include disputes that arise in connection with direct foreign investments between an agreeing state and private persons – investors of other agreeing states. These are investment disputes that result from liaisons associated with foreign investments; disputes between

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<sup>28</sup> Wolfgang Peter, *Arbitration and Renegotiation of International Investment Agreements* (2<sup>nd</sup> ed., Kluwer Law International 1995).

agreeing state and foreign private investor; legal disputes pertaining to the essence and scope of legal rights and obligations of the parties, conditions and amounts of compensation for violations of obligations under this investment contract (Art. 25 of the ICSID Convention). According to Art. 8 of the Model Agreement of the Government of the Russian Federation and Governments of Foreign States on Promotion and Mutual Protection of Investments<sup>29</sup> (approved by the Decree of the Government of the Russian Federation No. 456 of June 9, 2001) [hereinafter Model Agreement], international investment disputes are disputes between one agreeing party and an investor of another agreeing party arising in connection with investments of this investor within the territory of the first agreeing party, including disputes pertaining to scope, conditions or procedure for payment of compensation. It is also indicated that, where possible, such disputes should be settled by way of negotiations.

It is possible to classify investment disputes according to various criteria: its basis; the stage of investment activities; and the legal status of the parties.<sup>30</sup> In the last criterion, investment disputes are classified as private legal, public legal or mixed. Those classified as mixed international investment disputes are ones that result in certain difficulties: a state may use its sovereign right and refer to immunity to avoid application of the jurisdiction of another state. To avoid this and in accordance with the ICSID Convention, the ICSID was established.

International investment disputes in general can be considered by different bodies: administrative authorities, courts, courts of arbitration, etc. In accordance with Art. 8(2) of the Model Agreement, if a dispute cannot be settled by way of negotiations within six months from the date of request of either party of the dispute on its settlement by way of negotiations then at the discretion of the investor it can be transferred for consideration to either the competent court of arbitration of an agreeing party within the area in which investments were made, the court of arbitration *ad hoc* in accordance with arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL), or the ICSID established in accordance with the ICSID Convention in order to settle the dispute in accordance with provisions of this convention (given that it applies to both agreeing parties) or in accordance with Supplementary Rules of the ICSID (if the Convention is not applicable to both or one of the agreeing parties).

In this connection, certain international bilateral investment agreements on promotion and mutual protection of investment that Russia participates in

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<sup>29</sup> Типовое соглашение между Правительством Российской Федерации и правительствами иностранных государств о поощрении и взаимной защите капиталовложений [*Tipovoe soglasenie mezhdru Pravitel'stvom Rossiiskoi Federatsii i pravitel'stvami inostrannykh gosudarstv o pooshchrenii i vzaimnoi zashchite kapitalovlozhenii*].

<sup>30</sup> Крпунко С.И. Инвестиционные споры между государством и иностранным инвестором [Krupko S.I. *Investitsionnye spory mezhdru gosudarstvom i inostrannym investorom* [Svetlana I. Krupko, Investment Disputes between State and Foreign Investors]] (BEK 2002).

provide for several international authorities, the activities of which may include considering investment disputes. As a flexible instrument for regulation of transborder investment liaisons, bilateral contracts mostly provide foreign investors with the right to select a court and arbitration authorities from a list in order to settle a relevant investment dispute. A key collision rule for the determination of applicable law in case of settlement of international investment disputes is the law of autonomy of the parties' will. Specifically, Art. 42 of the ICSID Convention provides that an arbitration court should consider a dispute according to the legislation selected by the parties subject to mutual agreement. If the parties fail to apply *lex voluntatis*, the said norm of the ICSID Convention contains a subsidiary collision rule according to which arbitration applies the national law of the state that is a party to the dispute as well as the norms of international law that are applicable. Arbitration has no right to render undefined decisions with a reference to lack of clarity of legal norms. At the same time, if the parties agree so, arbitration can be free from the application of any law and may render a decision based on fairness and good faith.

As a rule, arbitration may at any time during consideration of a dispute request from the parties' provision of documents and other proof; visit sites associated with the dispute; and implement investigations. In accordance with Art. 45 of the ICSID Convention, failure of one of the parties to appear or take part in the consideration of the case results in no hindrance for consideration of the case by the court of arbitration on the request of the other party and the rendering of a decision. The court of arbitration renders a decision by a majority of arbitrator voices. The decision of a court of arbitration is executed in writing and signed by the arbitrators that voted for this decision. Each arbitrator may attach their own opinion on the decision regardless of their correspondence to the opinion of the majority of arbitrators, as well as an objection against the decision. A decision is deemed rendered on the day of sending by the Secretary General of certified copies to the parties. Authorities of a court of arbitration may not publish a decision made by arbitration without the consent of the parties, and it should be mentioned that the parties rarely consent to this.

The ICSID Convention (Art. 52(1)) provides for a set of grounds enabling modification or cancellation of an arbitration decision at the request of either party to the dispute. These grounds, in particular, include an unduly formed set of arbitrators; registered fact of corruption in activities of any court member; and insufficient grounds for a decision. In this case, the chairman of the administrative board assigns a committee of three people that may suspend implementation of the arbitration decision until consideration of such a request. In case of cancellation of an arbitration decision, the dispute is transferred to another arbitration on the request of either party.

## 6. Potential Areas for Improvement in Russian Legislation

MIGA Convention<sup>31</sup> is the main regulatory legal act of the Multilateral Investment Guarantee Agency. It is an international source of legal regulation of investment activities for the US, Germany, the UK, Japan and the UAE as these states are members of this convention (Russia is also a member). As well as the establishment of the MIGA, the aim of the MIGA Convention is the legal regulation of investment processes both in member states and at the international level with the participation of these states.

The MIGA Convention have become sources of legal regulation in the US, the UK, Germany, China and Japan and this has resulted in certain specific features in the legislation of these states concerning the subject of investment. These will be discussed below.

The first is the establishment of investment holdings. This is mostly typical found in the US, the UK and Germany. US legislation provides that if a bank or other credit organization plans to implement investment activities, it must be a member of a bank holding. This provision is contained in the Glass-Steagall Law.<sup>32</sup> This legal provision aims to provide guarantees to investors and protect them from unfavorable consequences as a result of investments in such an organization. For example, banking and insurance sectors and other institutions are rather risky objects for investors. These institutions are simultaneously objects and subjects of investment activities, *i.e.* a person invests in these in order to gain profits, and these funds are, in their turn, used as investments in other areas. In other words, risk of loss of the funds or zero profits is high for those investing in such organizations.

Such measures constitute conditions for the high inflow of investments in the considered states. Investors, both national and foreign, investing in a part of such a holding (*e.g.*, its commercial bank) are secure as they may request dividends or compensation from the entire holding and not only from such a bank. This also means that such organizations may fulfill the larger investment needs of the subjects as they are able to integrate not only similar type organizations (*e.g.*, insurance companies) but also more varied ones. Many European holdings include financial and credit organizations, insurance organizations, commercial companies, trade companies, real estate organizations and broker organizations.

The second is regimes of taxation favorable for investment. A featured example here is the UK. The tax legislation of the UK promotes foreign investments and provides for tax allowances for investors. The tax rate in these cases is reduced

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<sup>31</sup> Convention Establishing the Multilateral Investment Guarantee Agency, Oct. 11, 1985, T.I.A.S. No. 12,089, 1508 U.N.T.S. 99, at <<https://treaties.un.org/doc/Publication/UNTS/Volume%201508/volume-1508-I-26012-English.pdf>> (accessed December 10, 2015) [hereinafter MIGA Convention].

<sup>32</sup> Pub. L. 73-66, 48 Stat. 162 (1933).

and tax allowances are increased. Encouraging all investors, both national and foreign, is provisioned in many legal acts of the state in the area of taxation, e.g. in the Finance Act 2000, Finance Act 2002, Income and Corporation Taxes Act 1988 and the Guidelines on determination of innovative activities for the purpose of taxation 2004. The latter includes various documents that define conditions for reduction of tax rates for investors investing in such industries. There is a document on criteria for reduction of tax rates for investments in the area of medicine and medicine production, in the area of technology and innovations, and in the area of trade.

It is not only this state; all six states considered are appealing for investors through their taxation policy. These states have multiple bilateral treaties on avoidance of double taxation and are members of many international organizations that deal with promotion of investors in the area of taxes and duties (e.g., Organization for Economic Co-operation and Development).

All this reduces the level of taxation and tax burdens for national and foreign investors who plan to implement investment activities in these states. In contrast, in the Russian Federation the legislation that provides for such types of tax allowances for investors investing in national production or innovative objects is underdeveloped.

The third is the favorable conditions for high inflow of direct foreign investments. Such conditions in foreign states include limited control of the impact on foreign investors from state authorities in such states; openness and availability of direct foreign investments for injection in the economies of these states; lack of restrictions for foreign persons and equal conditions the same as for national subjects in investment activities.

A good example of this is Japan. There are two key reasons for the high growth in direct foreign investments that it enjoys. The first is favorable legislation. Legislation on foreign trade activities provides for equal conditions for all investors. Equal rights and opportunities are provisioned, i.e. permission to invest in the same industries in which national capitalists invest. There is also a lack of high customs fees and customs hindrances. The second reason is its well-developed infrastructure, technology and national production. It is clear that foreign persons may invest only in financial institutions (banks, exchanges, funds, etc.), but subject to availability of additional objects in the form of production and technology in a state, the amount of investments in such objects increases.

High appeal for direct foreign investments in Japan is proven by the statistics of the Japan External Trade Organization. In 2012 the economy received direct foreign investments from Swiss investors in the amount of US\$5 billion; British investors in the amount of US\$1.2 billion; Singaporean investors in the amount of US\$975 million; Hong-Kong investors in the amount of US\$873 million; and other European investors in the amount of US\$873 million.

In the Russian Federation, conditions for inflow of direct foreign investments is also rather favorable. However, these are mostly ensured by the bank, energy, gas and oil sectors. National production and innovative activities are not as developed as in Japan.

The fourth area is elimination of financial pyramids, financial frauds and strict legal responsibility for the same. It is clear that investors in any state require investing in an investment fund and not in a so-called financial pyramid. In this context, the foreign states considered are quite reliable and feature almost no elements that encourage investment outflows. The reason for this is the presence of controlling financial authorities that fight such frauds, as well as direct prohibition of the establishment of such institutions in the legislation. Such direct prohibition is provisioned in the US, the UK, Japan and Germany. For example, in the US such a prohibition is provisioned in the Money Laundering Control Act of 1986.<sup>33</sup>

However, there were cases in the US also when investment funds turned out to be large financial pyramids. For example, there is the well-known case of Madoff Investments with which American investor Bernard Madoff managed a financial investment pyramid.<sup>34</sup> Since 1960 (the year it was founded) until 2011 it was considered the most reliable investment fund in the world, and major companies and investors invested in it. Even in a state where there is direct prohibition and the investment area is reliable, there was an investment pyramid of such a scale.

As a result of these efforts and strict legislation, such pyramids have almost been entirely eliminated and the number of investment funds is high. Thus, this measure is a precondition for high inflow of investments of national and foreign investors in the investment funds of the states considered.

In the Russian Federation, legal responsibility and measures aimed at elimination of financial pyramids and frauds have been formed only recently, thus such cases are still possible. After the collapse of the Soviet Union, there were multiple well-known cases when financial pyramids in Russia existed at an all-state level.

A further specific feature is acceptable tariffs in investment industries. Usually, in order to implement an investment program, the state increases tariffs in certain industries. For example, to implement an investment program aimed at road building, tolled roads are introduced or tariffs for such roads are increased. This is to ensure investor involvement and provide payments to the latter. According to practice, such measures fail to attract national investors that are citizens of the state and subject to such tariffs. In the foreign considered states, foreign investments result in no increase of service tariffs for the population of the state but instead incentives are ensured by tax, customs, financial and legal means. This promotes investments from investor citizens of the state.

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<sup>33</sup> 18 U.S.C. §§ 1956–57 (1988).

<sup>34</sup> Ray August, *International Business Law: Text, Cases, and Readings* (4<sup>th</sup> ed., Prentice Hall 2004).

In the Russian Federation, in most of the cases, investment activities result in high tariffs for the investment object. This causes a negative perception of such investment activities and its results both among citizens and among foreign persons.

The sixth feature is mutual economic connections with other states. Each of the foreign states considered has well-developed economic connections with foreign states. This results in mutual import and export and, thus, mutual investments in imports. Such liaisons are possible because of the availability of agreements on trade, investments and promotion of imports between such states. Germany has multiple agreements on promotion of mutual imports with foreign states, which results in the large inflow of investments into German imports and, thus, in the state. In terms of capital import in German exports and, thus, in Germany, the leaders are the US, the UK, Luxembourg, France and Holland. Inflow of investments from the latter state is approximately €80 billion per year. The dynamics of foreign investment inflow in Germany due to investments in German imports is significant. The Russian Federation has well-developed economic connections both with European states, and the rest of the world. However, these are mostly based on liaisons in the area of energy and mining while liaisons in other areas are not that developed.

The seventh feature is economically developed export oriented companies and favorable conditions for import. This is an advantage for national and foreign investors, and a reason for investment in economies of the states with such orientation. In this case, examples include the US, the UK, Germany, Japan, China and the UAE, *i.e.* all the states considered. Subject to availability of such conditions, national investors invest in national companies and not abroad. This is about well-developed national manufacturing companies that are in demand in the global market. The states considered pay most attention to financing and support of national manufacturers, and the provision of large budgetary loans for investors investing in the same.

Favorable conditions are created for foreign investors to invest in companies oriented towards imports in such states by way of elimination of tax and customs restrictions for imports. This is especially attractive for foreign investors dealing with trade. Exports of the Russian Federation are mostly oriented towards the abovementioned sectors of the economy as well as the military sector.

In each of the states considered, the level of national production development is rather high. Well-developed national production and economies generate new objects of investments. The larger the number of national manufacturers in various sector of the economy, either in mining, in the area of machine building or IT, the larger the number of investors and amounts of investment in the same. To ensure a high level of investment appeal in a state, it is necessary to ensure a large amount of objects of investment activities. Otherwise, national and foreign investors have nothing to invest in such a state. China and the US exceed Russia by approximately 10 times in terms of scope of national production. In the Russian Federation, national

production and gross national product are not at the same high level as in these states. GNP and GDP are mostly ensured by profitable export.

The ninth feature is free economic zones. In all the above states, including socialist China, there are zones released from state investment restrictions for national and foreign investments. In China, such zones are established by the Circular on 'Pilot Zones'.<sup>35</sup> Their establishment promotes the inflow of national investments as investments in objects within such zones are released from limits in terms of investments. This is not to say that within such areas legislation is not applicable, but often all objects there are private, economically developed and profitable. Thus, if a state has such zones, an investor would not only benefit from investments in objects within the zones but would also not be limited by the state in terms of amount of investments and the purchased amount of share.

In the Russian Federation, economically favorable zones for investments, entrepreneurial activities and implementation of business projects are also well-developed. Most often, such zones are established in regulatory legal acts of the Ministry of Finance.

The final feature is the development and the financial and legal promotion of innovations. Innovations as well as national manufacturers in a state generate new objects of investment activities which draw national and foreign investments into the state. This is the case in the considered foreign states. In the UK, innovators and national investors developing innovative objects are subject to allowances – tax and financial as well as legal benefits are created. This positively affects the investment climate of the state as national capitalists tend to make investments in innovations due to such allowances, and when the innovative object is established, foreign investors tend to invest in it in order to obtain higher profits. Everything results in the inflow of investments to the state. In the UK expenses and investments of investors in innovations are called R&D expenses. If a person bears expenses in this category, they obtain the following allowances: reduced tax rate, tax deductions, compensation in case of negative results of investment and compensation for expenses for the research of the innovative object.

In the Russian Federation, development and support of innovative activities also takes place, as well as investments, scientific activities, endowment funds and venture funds. However, the legislation of the state provides for no high incentive allowances for innovator investors. This makes this area more risky and reduces legal and financial support for investors.

Thus, the key reasons and conditions for a high level of investment inflow in the above foreign states in terms of legal regulation are: availability of economically developed export oriented companies and favorable conditions for import;

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<sup>35</sup> Circular the State Administration of Foreign Exchange No. 36 of July 15, 2014, on Relevant Issues Concerning the Pilot Reform of the Administration of the Conversion of Foreign Equity Capital of Foreign Invested Enterprises in Certain Areas.

availability of mutual economic connections with other states; acceptable tariffs in investment industries; elimination of financial pyramids, financial frauds and strict legal responsibility for this; favorable conditions for high inflow of direct foreign investments; appealing investment regimes of taxation; establishment of investment holdings; development of national production, industry, infrastructure and economy; availability of free economic zones; development, financial and legal promotion of innovations; and a high level of privatization. All these benefits are supported by legislation.

## **7. Ways to Improve Russia's Investment Appeal**

Sooner or later, an investor implementing investment activities in any area will start to obtain profits or certain payments, interests (depending on investment object) that are subject to several taxes – income tax and VAT. If investment activities are implemented in the area of mining or the purchase of land lots and immovable property, these are subject to mining operations taxes, land tax and immovable property tax. Under such a tax burden, the willingness of national and foreign investors to pursue entrepreneurial activities in such areas will dissolve, which will result in investment outflow from the state and not inflow.

To counter this, it would be beneficial to apply American and British practices where all taxes exist but significant allowances are provisioned for certain categories of investors. These are investors that deal with innovations, develop national production, develop and establish useful and especially important areas for the state and society, such as medicine, education, science and sports, and invest in strategic areas.

A further area is the lack of significant support given by the state to entrepreneurs during times of crisis, such as times of economic crisis, high levels of inflation, political crisis, force majeure events in specific areas, etc. In case of such problems for entrepreneurs and investors, it would be preferable to obtain guarantees of support from state authorities. Support is provided in the form of tax allowances, customs allowances, bonuses and tariff reductions.

It is possible to conclude that investment appeal would improve by addressing the problems that limit investment activities: corruption and bureaucracy; high level of investment profit taxation; lack of significant support of the state during crisis times for entrepreneurs; increased consumer prices as a result of investments in production and consumption areas; low level of national production; low support for innovations; high tariffs; low amount of reliable investment companies; medium level economic diversification for investments; and lack of systematization of investment legislation.

The situation would also improve through the introduction in the Criminal Code of the Russian Federation and the Code of Administrative Offences of the Russian

Federation in the chapter on economic crimes of an article on illegal implementation of investment projects and programs as a result of illegitimate actions, the passing of the Plenum of the Supreme Court of the Russian Federation a regulation focused on crimes in the area of investment activities; establishment of tax allowances for certain categories of investors; provision of guarantees of reduction in tax or customs burden during crisis times and adoption of government regulations on this issue; improvement of antimonopoly legislation, exclusion of violator investors from the list of taxpayers subject to allowances; implementation of state support and development of the national production and innovations; restriction of the tariff increase as a result of investments; and the systematization of investment acts.

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