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RUSSIAN DRAFT LAW ON SPECIAL ECONOMIC ZONES—A STEP FORWARD, BUT NOT FAR ENOUGH

Valentin A. Povarchuk

Abstract: The situation in the Russian Far East epitomizes the acute need for economic reform and development in Russia. The region boasts an enormous wealth of metals, oil, gas, coal, timber, and marine resources, but has long suffered from excessive dependence on the central government’s administration and its accompanying historical neglect. Taking a cue from China’s successful use of special economic zones as a means to encourage economic reform, some Russian policy-makers have proposed special economic zones as a means to encourage development. Russia’s early laws establishing special economic zones, however, did not produce self-sustaining results due to a lack of appropriate legal and physical infrastructures, as well as political and economic instability. In addition, concerns over corruption and the imbalance of power between local and central authorities contributed to their failures.

A Draft Law on Special Economic Zones proposed in 2003 by the Russian Ministry of Economic Development and Trade demonstrates the newly increased sophistication in Russian economic planning. Contrary to the criticism levied by its opponents, the Draft Law is not likely to conflict with Russia’s future World Trade Organization obligations. As presently drafted, however, the Draft Law may not satisfy the development needs of the Russian Far East. Specifically, the Draft Law provides for excessive centralization of authority and fails to clearly allocate rulemaking responsibilities among various levels of government. In addition, it contains overly strict criteria for establishing special economic zones, and has the potential to disrupt some existing special economic zones. Accordingly, Russian legislators should revise the Draft Law to remedy these deficiencies.

I. INTRODUCTION

Kim Iskyan, the author of a recent article posted on the Internet service Slate, proposed that Russia divest itself of its vast Far East region in favor of the People’s Republic of China (“China”).¹ He suggested that “[t]he [Russian Far East’s] poor manufacturing base, crumbling physical infrastructure, high transportation costs, and small natural markets discourage local enterprise” and that the region thus lends itself to “a Far East version of the Louisiana Purchase.”² While the current level of Russian nationalism obviates serious contemplation of this suggestion,³ the comparison of the Russian Far East (“RFE” or “Far East”) to America’s

² Id. at *1.
“Wild West” unfortunately rings true.

By increasing economic development in the RFE, Russia could vastly improve the lives of many of its own inhabitants, and establish a firmer economic foothold in its territories, thereby reducing the temptation for neighboring nations to do so. Proponents of the new Draft Law on Special Economic Zones (“Draft Law”) cite the promotion of development in economically depressed regions, such as the RFE, among the Draft Law’s main objectives. However, the Draft Law is not Russia’s first attempt to promote development through the establishment of special economic zones (“SEZs”), and prior attempts produced only marginal results. Therefore, it is appropriate to question whether the new Draft Law is in fact capable of promoting development in the RFE.

This Comment analyzes the failures of the previous Russian SEZ legislation and the likelihood of success of the new Draft Law by comparing Russia’s SEZ experiences to China’s. Part II of this Comment traces the economic problems of the RFE to longstanding mismanagement and neglect by the central government and demonstrates that despite being one of the poorest regions in Russia, the RFE has remarkable development potential. In light of the comparison between the Chinese and Russian experiences with SEZs, Part III asserts that SEZs can serve the development needs of

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4 Iskyan, supra note 1, at *1.
5 The strategic security of the RFE and its territories is beyond the scope of this Comment. However, the lands of the RFE have had varying owners in the past three centuries, and have been subject to much contention and warfare between Russia and its neighbors. See generally John J. Stephan, The Russian Far East: A History (1994). While it appears unlikely that any of the Russian neighbors in the Far East would once again resort to military force against the RFE, such a scenario is not entirely beyond contemplation. See generally Tom Clancy, The Bear and The Dragon (2000) (contemplating a demoralized and poorly equipped Russian military being quickly overrun by Chinese forces, ironically well-equipped with the latest Russian military technology).
7 Note that economic planners, legislators, and academics in Russia have used three different terms: special economic zones (“SEZs”), free enterprise zones, and free economic zones (“FEZs”). The use of these terms likely reflects an evolution in the thinking about the zones: Russia’s earlier normative acts contemplated the creation of FEZs, while the later draft laws referred to SEZs. Because the term “SEZ” can be understood as a generic, representing a diverse range of economic regulatory phenomena, see infra Part II.C, this Comment utilizes this term throughout for the sake of consistency.
8 See O printsipakh sozdaniia i funktsionirovaniia osobykh ekonomicheskikh zon [On principles of creation and function of special economic zones], at *4, http://www.economy.gov.ru/merit/167.htm (last visited Oct. 24, 2003) [hereinafter Note on Principles of Creation of SEZs]. This document is provided at the web site of the Russian Ministry for Economic Development and Trade along with the new Draft Law as an explanatory note by the drafters describing their research findings, as well as the objectives of the Draft Law.
depressed regions under stable political, legal, and economic conditions. Part IV analyzes Russia's new Draft Law, arguing that it is a more sophisticated approach to SEZ formation than in the past and is not likely to conflict with Russia's future obligations to the World Trade Organization. Finally, Part V considers the more salient defects of the Draft Law and suggests corresponding remedies.

II. RUSSIA SHOULD STRIVE TO CREATE FAVORABLE CONDITIONS FOR DEVELOPMENT OF THE FAR EAST

The RFE is currently among Russia's least-developed regions, despite its wealth of natural resources. The region's current economic woes are an outgrowth of historical neglect and mismanagement by Russian central authorities and the economic turbulence of the 1990s. Given the region's immense endowment of natural resources, however, its potential for development remains great. Within the RFE, the Kuril Islands—which boast generous marine resources and close proximity to Japan—are one area where the right approach to development, including a well-planned SEZ, could produce tangible economic improvements.

A. The Russian Far East's Economic Setbacks Stem from Historical Mismanagement and Neglect

The RFE suffers from traditional neglect and mismanagement by the central Russian authorities. During the Soviet years, the region was heavily dependent on external goods and subsidies from the central government. The government offered inducements to individuals in the

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9 Judith Thornton & Charles E. Ziegler, The Russian Far East in Perspective, in The Russia's Far East: A Region at Risk 11 (Judith Thornton & Charles E. Ziegler eds., 2002). In fact, the standard of living in the RFE is substantially more depressed than the already low all-Russian average. Id.
13 For example, "[d]uring seventy years of Soviet rule, the RFE served primarily as a frontier outpost and raw-materials base for the rest of the country." Thornton & Ziegler, supra note 9, at 4; see also Davis, supra note 10, at 8-22 (describing the historical development of the RFE as primarily a system of military outposts, prison colonies, and raw-material supplies for European Russia); Economic Survey, supra note 11, at 58-76 (demonstrating that for most of the RFE's historical development, investment of capital in economic development was not a high priority).
14 More than half of the food, consumer goods, and energy during this period were imported from elsewhere in the Soviet Union and ninety percent of its products were exported to other regions of the USSR. Thornton & Ziegler, supra note 9, at 6.
form of higher wages to encourage resettlement to the Far East and to compensate for the harsh climate and difficult living conditions. As a result, after many years of Soviet central planning, the RFE entered the reform era of the 1990s with distorted structures of costs and production. As the Soviet regime collapsed, subsidies were dramatically reduced or eliminated, the flow of supplies to the RFE was disrupted, transport costs rose exponentially, and inflation skyrocketed. The RFE lost its traditional goods and services suppliers, as well as its markets. Entire industries that owed their existence to state subsidies and distorted prices downsized. Curbed demand for military equipment—the major industrial export of the RFE—reduced regional machinery production to a fraction of its former levels. Although such economic dislocations occurred nearly everywhere in Russia during the 1990s, their effects were especially grave in the RFE.21

The disproportionate decline of economic activity in the RFE resulted in a corresponding decrease in the region’s standard of living. Although the RFE’s average per capita income still exceeds Russia’s national average, cost of living increases far outpaced those in the rest of the country. Thus, real earnings in the RFE have declined more than in other regions of Russia. The Far East has become one of Russia’s most expensive regions with the poorest living conditions. It is not surprising, therefore, that the RFE’s population declined nine percent between 1991 and 1997.27

The Russian government has not entirely ignored the region’s

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15 DAVIS, supra note 10, at 60.
16 For example, the RFE bought energy and sold raw materials at low domestic prices, acquiring consumer goods and industrial equipment at relatively high prices, as if it faced implicit import tariffs on manufacturers and implicit export taxes on its raw materials exports. Id.
17 Id.
18 Id. at 63.
19 A 1996 study estimating the apparent competitiveness of each Far Eastern industrial sector at world prices revealed four sectors—fishing, forest products, light industry, and the chemical industry—to be negative value-added at world prices, and three additional sectors—agriculture, ferrous metals, and coal—to be unprofitable. See Thornton & Ziegler, supra note 9, at 6.
20 DAVIS, supra note 10, at 61-62; Thornton & Ziegler, supra note 9, at 6-7. Overall industrial production has declined so much that in the year 2000 it was 44.8% of what it had been in 1990. Nadezhda Mikhaeeva, Social and Economic Differentiation in the Russian Far East, in THE RUSSIA’S FAR EAST: A REGION AT RISK 88 (Judith Thornton & Charles E. Ziegler eds., 2002).
21 DAVIS, supra note 10, at 61.
22 Mikhaeeva, supra note 20, at 97. Although the effects of economic dislocations within the RFE were highly differentiated, with southern regions retaining more capacity for vital economic activity, the RFE has seen an overall decline of the living conditions greater than the rest of Russia. See id. at 85-115.
23 See id. at 97.
24 See id. at 98.
25 Id. at 97.
26 DAVIS, supra note 10, at 62.
27 Id.
suffering and its need for economic development. As early as 1992, then President Boris Yeltsin visited the RFE and, appalled by its poor living conditions, launched a regional economic development program. Yet neither then, nor in 1996 when the idea was revived during the presidential election, did the funding needed for such development materialize. In July 2000, President Vladimir Putin also acknowledged the RFE’s acute need for development, but at the same time recognized that of the fourteen billion rubles (approximately US$ 503 million) allocated to the region in the 1999 Russian Federation budget, only 1.5 billion rubles (approximately US$ 54 million) were actually spent for the region’s benefit.

While the Russian economy experienced some overall growth after the financial crisis of 1998, recovery in the RFE was fragile. Economists partially attribute this sluggish recovery to the region’s weak consumer sector and geographical distance from European Russia. Yet many additional factors also explain the slow recovery, including the absence of an independent court system to uphold contracts, unpredictable and unstable laws and regulations, confiscatory taxation, widespread public and private sector corruption, as well as the lack of physical, energy, financial, and communications infrastructures.

Thus, the Russian central government’s traditional neglect of the RFE continued well into the 1990s. This pattern suggests that “Russia’s Far Eastern Provinces are the most logical candidates for autonomous development and decentralized governance.”

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28 Id.
29 Id.
30 President Putin remarked with characteristic nationalism that “[i]f we don’t make a real effort to develop Russia’s far east, then in the next few decades, the Russian population will be speaking mainly Japanese, Chinese, and Korean.” Thornton & Ziegler, supra note 9, at 7.
32 Thornton & Ziegler, supra note 9, at 9.
33 Id. at 11.
34 See id. at 27; DAVIS, supra note 10, at 63; Sharif M. Shuja, Russia’s Northeast Asia Policy: Challenges and Choices for the 21st Century, MARYLAND SERIES IN CONTEMP. ASIAN STUD. 17-18 (No. 159, 2000).
35 Menon & Ziegler, supra note 3, at 43. The authors of this conclusion do not advocate separatism. Rather, they observe that European Russia lacks the necessary resources to develop the RFE’s transportation infrastructure or to invest in modernizing industrial production or the extractive industries and argue that the region’s economic future depends on cooperation with the states of Asia and the Pacific, including the United States. Id. at 47.
B. The RFE Merits Investment and an Active Approach to Development

Theoretically, the RFE’s economic potential is great. A vast region covering 6.2 million square kilometers, or thirty-six percent of the territory of the Russian Federation, it is home to only 7.5 million people, or five percent of Russia’s total population. Although the full potential of the RFE’s natural resources has not been thoroughly studied, it boasts some of the world’s richest marine resources, oil, gas, other minerals and nonferrous metals, and timber, as well as unique opportunities for outdoor recreation. Finally, the RFE’s borderland proximity to China, Japan, Korea, the United States, and important Pacific Rim land and ocean routes naturally make the development and servicing of international trade an area of great potential for the region.

In light of its generous resource endowment, the RFE is a great candidate for regional economic development. As Judith Thornton and Charles Ziegler argue, “[a] future based on economic openness and capital market integration could link Russian energy and raw materials with Japanese capital, U.S. food, technology, and know-how, and Chinese labor in the transformation of what is potentially the most dynamic region of the world economy.” Such aspirations, however, require an active approach and a serious commitment to promoting investment and development. Creation of SEZs could well be a part of a serious commitment to development.

36 DAVIS, supra note 10, at 3.
37 ECONOMIC SURVEY, supra, note 11, at 30.
39 Russia possesses the largest supply of natural gas in the world and a great share of the world’s oil, much of which is located in the RFE. Deborah K. Espinosa, Comment, Environmental Regulation of Russia’s Offshore Oil & Gas Industry and Its Implications for the International Petroleum Market, 6 PAC. RIM L. & POL’Y J. 647, 648 n.10 (1997).
40 See generally ECONOMIC SURVEY, supra note 11, at 30-42; Sheingauz et al., supra note 38, at 119-27; DAVIS, supra note 10, at 84.
42 Thornton & Ziegler, supra note 9, at 3.
C. Special Economic Zones Are Well-Established Worldwide as Economic Catalysts

The concept of SEZs defies easy definition. Various terms, including free enterprise zone, free economic zone, international enterprise zone, special enterprise zone, export-processing zone, empowerment zone, technological development zone, and others are often used to designate SEZs. These terms are not accidental, but rather reflect different philosophies, objectives, and means of achieving them. Worldwide, there are between 500 and 1500 SEZs, many of which are located in the United States. Most zones have certain characteristics that identify them as “special” or “free.” Typically these zones distinguish themselves from other regions by their relaxed tariff, taxation, and administrative regimes. One early definition of the SEZ concept provided:

the term [special economic zone] means a part of the territory of a State where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs territory and are not subject to the usual Customs control.

Therefore, the term SEZ is best understood as generic, representing a diverse range of economic regulatory phenomena. In light of this, the most apt definition of SEZs is that they are “geographically insulated but economically open areas, where special and flexible economic policies are carried out primarily to promote foreign investment, technology transfer, and

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45 See Note on Principles of Creation of SEZs, supra note 7, at *1.
46 See Shao, supra note 44, at 14.
exports." Such areas are popular because they can serve as catalysts for economic development, empowering communities with tools to identify solutions for local needs and to improve the lives of their people.

D. The Kuril Islands Are Ideal Candidates for an Experimental SEZ

Within the RFE region, the chain of tiny islands stretching between the Kamchatka peninsula and the Japanese island Hokkaido provides an especially vivid example of the need for economic development. First, Russia has an interest in maintaining well-developed settlements as a result of an ongoing territorial dispute with Japan. Second, the islands are surrounded by some of the richest fishing grounds in the Pacific. Yet development in the Kuril Islands is virtually non-existent and the life of the residents is unquestionably meager.

Some Russian policy-makers have already suggested creation of an SEZ to develop the Kurils. In 2001 the Russian legislature ("Duma")

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49 WEIPING WU, PIONEERING ECONOMIC REFORM IN CHINA'S SPECIAL ECONOMIC ZONES: THE PROMOTION OF FOREIGN INVESTMENT AND TECHNOLOGY TRANSFER IN SHENZHEN 1 (1999).
50 See Shao, supra note 44, at 15-16.
51 The Kuril chain is a part of the Sakhalin Region of the RFE, but control of the four southernmost Kuril Islands—Etorofu, Kunashiri, Shikotan, and the Habomai group—has been hotly contested by Japan since the Soviet Union seized them in 1946. The author’s research of the historical and legal dimensions of this territorial dispute led to the conclusion that Russian and Japanese legal claims to the islands are equally strong. Valentin A. Povarchuk, The Unresolved Dispute Over the Northern Territories/Southern Kurils and Russo-Japanese Relations 79 (2000) (unpublished Senior Honors Thesis, Cornell University) (on file with author & Cornell University Library). However, uninterrupted possession of a territory and dedication of resources for its development can solidify a nation’s territorial title. See NORMAN HILL, CLAIMS TO TERRITORY IN INTERNATIONAL LAW AND RELATIONS 156-57 (1945).
52 HARA, supra note 12, at 13.
53 In the early 1990s the Kuril Islands were described as a colony, isolated by several days of travel from the mainland, nearly devoid of roads, with ports in bad disrepair, and extremely poor housing conditions. See OLEG BONDARENKO, NEIZVFSTNYE KURiLY [UNKNOWN KURILS] 128, 141, 157, 159 (1992). Remarkably, the situation has only worsened in recent years. After experiencing a devastating earthquake in 1994, the region received very little aid for reconstruction. See TSUYOSHI HASEGAWA, THE NORTHERN TERRITORIES DISPUTE AND RUSSO-JAPANESE RELATIONS 488-89, 491 (1998).

In 2001, the Russian Duma adopted an unusually frank resolution, in which it acknowledged the poor state of affairs in the Kuril Islands. See Postanovlenie Gosudarstvennogo Duma Federal’nogo Soveta Rossiskoi Federatsii: O sotsial’no-ekonomicheskoi obstanovke na Kuril’skikh ostovakh (Sakhalinskaya oblast’) [Resolution of the State Duma of the Federal Assembly of the Russian Federation: On social-economic situation in the Kuril Islands (Sakhalin region)], Sobr. Zakonod. RF 2001, No. 20 available at http://vff-s.narod.ru/kur/pr/pr02.html (last visited Sept. 6, 2003) [hereinafter Resolution on Socio-Economic Situation in the Kurils]. The resolution recognized that the socio-economic situation in the islands was critical, most fishing and fish-processing enterprises were inoperable, post-1994 earthquake reconstruction was inadequate, healthcare, educational, and housing services were non-existent, and the government’s measures dealing with this crisis were episodic, and not backed up by sufficient funding and other resources. Id. at *1-2. In addition, Kuril residents suffer from an extremely poor telecommunications network. See O. Aleksandrov, Kak dozvonit’sia do Kuril? [How can one reach the Kurils?], SOVETSKII SAKHALIN No. 165 (Sept. 17, 2003), at http://vff-s.narod.ru/kur/pr/pr06.html#1 (last visited Jan. 2, 2004).
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proposed that the government develop SEZs in the Sakhalin Region, including a zone in the Kurils. In the same resolution the Duma also emphasized the importance of fully implementing the Federal Program of Socio-Economic Development of the Kuril Islands of Sakhalin Region for 1994-2005 and recommended reconsideration of Kuril Island budgetary allocations, as well as other measures, to support the local fishing industry and to curb foreign poaching.

Indeed, the Kuril Islands region may be an ideal candidate for an SEZ. Much of the seafood currently extracted from the regional waters is immediately exported in its raw form. In 1998, the region's catch value exceeded US$ 1.5 billion, but according to some estimates it could have reached US$ 7 billion had it been processed there. Valuable kelp, which can be processed for food, pharmaceutical, and cosmetic products, lines the shores of the Kuril Islands, untouched. A reconstruction of ports, modernization of the Kuril fishing fleet, and investment in seafood processing facilities on the Kurils could greatly boost the region's income. An SEZ on the islands could also provide favorable conditions for development and help to reinvigorate the fishing, processing, and shipping industries, thus realizing the advantages inherent in the region's proximity to abundant resources and the border with Japan.

See Resolution on Socio-Economic Situation in the Kurils, supra note 53, at *2.

At the same time, however, it is important to recognize that merely designating the area an SEZ will not ensure its success. In order for a Kuril SEZ to become a reality, Russian policy-makers must first resolve the sensitive issue of administrative control over such a zone—a problem that hampered the previously-proposed SEZ. They must also provide an appropriate legal and physical infrastructure. See infra Part III.B(3).

Data on the relative shares of raw versus processed seafood exports is currently unavailable. This may be attributable to widespread underreporting of catches, revenues, and profits in the fishing industry. See Tony Allison, Crisis of the Region's Fishing Industry: Sources, Prospects, and the Role of Foreign Interests, in THE RUSSIA'S FAR EAST: A REGION AT RISK 148 (Judith Thornton & Charles E. Ziegler eds., 2002). However, there are indicators that processing of marine products is low. See id. at 150 (reporting a regional industry conference's finding of inadequate level of technology in fish processing as the reason for the failure to provide competitive seafood products for the export market). In addition, much of the seafood harvest avoids RFE ports, and therefore processing, due to widespread illegal fishing. See Sabrina Tavernise, A Violent Death Exposes Fish Piracy in Russia, N.Y. TIMES, June 27, 2002. Finally, because of dilapidated port facilities and fishing fleets, the Kuril fishermen's share in the catch is minimal. See Mosvka – Kurily – Moskva, ili kak obustroi't' Kurily? [Moscow – Kurils – Moscow, or how to develop the Kurils?], SEVERNAIA PATSIIFiKA No. 1(7) (1999), at *1, at http://www.npacific.ru/np/magazin/1-99_r/np7012.htm (last visited Jan. 2, 2004).

III. **Special Economic Zones Can Serve as Successful Vehicles for Development When Provided With Stability and Autonomy**

A number of countries have used SEZs to successfully promote development. In China, for example, SEZs have proved to be invaluable in attracting foreign direct investment ("FDI") and hastening economic reform. Policy openness and the ability of local authorities to develop comprehensive and sophisticated regulations tailored to local conditions have greatly contributed to the success of SEZs in China. Although the future of Chinese SEZs is uncertain due to World Trade Organization ("WTO") accession commitments, they are likely to remain major centers of economic activity. In Russia, too, creation of SEZs has been conceived as a means of promoting regional economic development. Yet the Russian SEZs thus far have produced only token economic improvements, if any. A comparison of the Chinese and Russian SEZ experiments isolates the primary shortcomings of the Russian SEZ approach—lack of stability and inadequate administrative autonomy.

A. **China's Special Economic Zones Have Been Relatively Successful**

China has established dozens of SEZs since the early 1980s, attracting billions of dollars of FDI and generating enormous exports. The Shenzhen SEZ, one of the first in China, owes its success in large part to its openness to FDI and policy autonomy accorded to the local SEZ leaders. Although the Chinese government may soon have to revoke preferential tax and customs treatment in its SEZs, the SEZs are expected to remain major development centers. Thus, the Chinese SEZ experiences can provide valuable lessons on the utility of SEZs as regional development tools.

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60 Shao, *supra* note 44, at 5, 8-9.  
61 **WU, supra** note 49, at 7.  
64 See Note on Principles of Creation of SEZs, *supra* note 7, at *1.  
65 **BUTLER, supra** note 8, at 611-12.  
67 **WU, supra** note 49, at 127. *See infra Part III.B(2), on the meaning of "policy openness and autonomy."*  
68 **SEZs After China's Entering WTO, supra** note 63, at *3.  

1. **The Chinese Approach to SEZs Has Led to the Creation of Dozens of Zones and Successes in Attracting FDI**

China first designated four SEZs along its southern coast in early 1980 with the primary purpose of experimenting with Western technology and management techniques. In the initial stages of implementation, during which local governments had limited authority in approval and supervision of foreign investment, FDI flows remained relatively limited. As the Chinese central government gradually relinquished control and provided a legal framework for attracting FDI and the local authorities gained experience in attracting FDI, investment in the SEZs quickly increased. In the 1990s, further improvements to the legal environment and a more open foreign investment policy helped China to become the second largest recipient of FDI in the world.

Today, there are dozens of SEZs in China. The four original national-level SEZs—Shenzhen, Zhuhai, Shantou, and Xiamen—and a fifth, Hainan, are the major zones today. The Shenzhen SEZ transformed from an undeveloped rural community to China's most modern city and a model of economic efficiency. In terms of attracting FDI, the Shenzhen SEZ performed beyond central and local government expectations. It enjoyed double-digit growth of industrial output value and, due to relatively high wages, became a highly desirable place to work. While not without some weaknesses, the SEZ successfully stimulated regional economic activity and represented a positive experiment in capitalism.

2. **The Success of the Shenzhen SEZ Is In Part Attributable to the Openness and Autonomy of Policy**

The primary reason for the significant growth of FDI in Shenzhen has

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69 Zhou, supra note 66, at 52. The first four SEZs in China were Shenzhen, Zhuhai, Shantou, and Xiamen. Id.
70 Wu, supra note 49, at 1.
71 This amount was US$ 1.6 billion between 1979 and 1982. Zhou, supra note 66, at 52.
72 Id. at 54-57.
73 Id. at 60.
74 Walton, supra note 66, at 24.
75 SEZs After China's Entering WTO, supra note 63, at *3.
76 Wu, supra note 49, at 7.
77 Id. at 27.
78 Id. at 123.
79 See id. at 122, 126 (reporting little meaningful technology transfer, no substantial net exports, lack of significant domestic linkages, and some labor abuses).
been physical, economic, and cultural proximity to Hong Kong. In addition, policy openness and autonomy, relaxed ownership controls, labor market flexibility, and preferential fiscal incentives proved to be significant draws in Shenzhen.

In Shenzhen, policy openness and autonomy have translated into relative freedom in policy-making and socio-economic plan development by local zone authorities. For example, allowing this type of autonomy permitted local retention of SEZ fiscal revenue for investment in infrastructure and in investor services. The SEZ administration also retained authority to develop an advanced independent regulatory scheme. One author cites the development of such a unique local regulatory regime as an example of successful local solutions to local problems. Such policy openness and autonomy, in fact, characterized other Chinese SEZs as well. SEZ laws and regulations occupy an important place in the hierarchy of Chinese legislation. Thus, the role of policy openness and autonomy in the success of the SEZs cannot be overestimated.

3. China’s SEZs Will Likely Remain Centers of Development Despite WTO Accession

The future of Chinese SEZs is somewhat uncertain due to China’s WTO accession. Several commentators have suggested that after China opens its investment regime, as required by the terms of its WTO accession, the SEZs’ status will no longer be “special.” Indeed, China plans to abolish the tax and customs preferences given to newly-established foreign-

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80 See id. 49-50.
81 Id. at 127. Policy openness and autonomy appear second in the list of attractive factors, while fiscal incentives are toward the end of this list. Although the author does not explicitly rank these factors of investment attractiveness, their sequential discussion throughout the book strongly suggests that the list of factors is hierarchical.
82 WU, supra note 49, at 56-57.
83 Id. at 56.
84 Over time, the zones have actually acquired a complete system of policies and regulations similar to those in a market system. Id. at 57.
85 Peerenboom, supra note 62, at 255.
86 See Zhou, supra note 66, at 153 n.66.
87 In the official hierarchy of Chinese legislation, SEZ laws and regulations occupy a fourth place out of six, right after administrative regulations passed by the State Council, and before the rules passed by the provincial governments. See Peerenboom, supra note 62, at 264 n.216.
88 SEZs After China’s Entering WTO, supra note 63, at *1.
89 See id. (reporting a debate among economists and Chinese government officials on whether SEZs can continue to be “special” after China’s entry into the WTO); WU, supra note 49, at 132; Walton, supra note 66, at 54; George O. White III, Enter the Dragon: Foreign Direct Investment Laws and Policies in the P.R.C., 29 N.C. J. INT’L L. & COM. REG. 35, 55-56 (2003).
funded firms and financial companies located in SEZs.\textsuperscript{90} China’s preferential tax and customs policy readjustments seek to ensure uniformity of domestic law rather than eliminate the SEZs altogether. Under the relevant WTO obligations contained in its Accession Protocol, China is obligated to apply all its laws, regulations and other measures of the central and local governments in a uniform, impartial and reasonable manner, and to revise its local laws and regulations to conform to the WTO Agreement and the Protocol.\textsuperscript{91} Specifically, the Protocol’s subsection on Special Economic Areas requires China to notify the WTO of all laws, regulations and other measures relating to such areas, and to apply the same import restrictions, customs and tariff charges to products introduced into special economic areas as to other parts of its customs territory.\textsuperscript{92} The Protocol, however, does not prohibit preferential SEZ arrangements per se, but rather requires China to observe the principles of non-discrimination and national treatment in their implementation.\textsuperscript{93}

Thus, China’s obligations to readjust preferential SEZ tax and customs policies stem from special commitments in its Protocol of Accession, rather than generally applicable WTO law. It is unclear whether generally applicable WTO law prohibits the provision of preferential tax and customs treatment in SEZs. Nonetheless, the Chinese government and certain commentators do not believe that the revocation of tax and tariff preferences will completely disrupt Chinese SEZs.\textsuperscript{94} Behind this optimism is their recognition of the SEZs as leaders in market reform, investment attractiveness, and technological innovation, and the expectation of flexibility in redefining their roles and adapting to new circumstances.\textsuperscript{95}

\textsuperscript{90} See MOF to Annul Preferential Tax Policy on Newly Established Foreign Firms in Special Economic Zones, INTERFAX NEWS AGENCY, Apr. 13, 2001, LEXIS, Nexis Library, INFAX File; SEZs After China’s Entering WTO, supra note 63, at *3.

\textsuperscript{91} See Accession of the People’s Republic of China, WTO Doc. No. WT/L/432 (Nov. 23, 2001), available at http://docsonline.wto.org/DDFDocuments/lWT/L/432.doc (last visited Jan. 2, 2004) [hereinafter Protocol]. Under the subsection on Uniform Administration, the Protocol provides: “The provisions of the WTO Agreement and this Protocol should be applied to the entire customs territory of China, including border trade regions and minority autonomous areas, Special Economic Zones, open coastal cities, economic and technical development zones and other areas where special regimes for tariffs, taxes and regulations are established (collectively referred to as ‘special economic areas’).” Id. at *2.

\textsuperscript{92} See id. (“Except as otherwise provided for in the Protocol, in providing preferential arrangements for enterprises within such special economic areas, the WTO provisions on non-discrimination and national treatment shall be fully observed.”)

\textsuperscript{93} See id. (“\textsuperscript{94} See SEZs After China’s Entering WTO, supra note 63, at *1 (“If in the future, the five SEZs... expect to maintain the posture of spearheading technological innovation and industrial upgrading”); Wu, supra note 49, at 132-36 (discussing the post-WTO-accession future of Shenzhen SEZ).

\textsuperscript{95} See SEZs After China’s Entering WTO, supra note 63, at *3.
4. **Chinese SEZs Demonstrate that SEZ’s Can Successfully Promote Development**

The experience of Chinese SEZs demonstrates that local economic development is a byproduct of SEZs. Chinese SEZs were originally established to experiment with Western technology and management techniques. But the massive inflow of FDI that SEZs such as Shenzhen attracted led to enormous increases in economic activity and creation of relatively high-paid employment. Indeed, the Chinese experiment with capitalism turned into a major boon to the local economy.

**B. Russian SEZ and SEZ Proposals to Date Have Not Been Successful Due to Inadequate Infrastructure and an Unstable Legal, Political, and Economic Climate**

The Soviet Union and the predecessor of the Russian Federation, the Russian Soviet Federated Socialist Republic ("RSFSR") began establishing SEZs in the RFE in the early 1990s. By 1996, eighteen SEZs had been legislatively established, but the great majority of them were never functional. In fact, Nakhodka and Kaliningrad were the only two zones that operated on a significant scale. The failures of the Russian SEZs have been attributed to the lack of customs legislation and conflicts between normative acts used to establish the zones and certain other Russian laws. While undoubtedly true, these technical reasons do not fully account for the reasons why most Russian Far East SEZs never gained momentum.

As attempts to create SEZs in Nakhodka, Sakhalin, and the Kuril Islands demonstrated, the absence of an open and predictable legal infrastructure, political and economic instability, and inadequacy of physical infrastructure also assist in explaining these failures. The first Russian SEZ
in Nakhodka still formally exists today, but continues to furnish little economic progress, primarily due to unstable legislation on its tax and customs benefits and poor infrastructure.\textsuperscript{102} The Sakhalin SEZ failed to materialize because the enabling legislation failed to provide numerous critical details, including its territorial scope.\textsuperscript{103} In addition, there was much uncertainty about its economic feasibility and desirability, and little political commitment to its establishment.\textsuperscript{104} Finally, the draft law proposing the establishment of the SEZ in the Kuril Islands fell victim to political struggles for control.\textsuperscript{105}

1. The Nakhodka SEZ Failed Due to the Instability of Legislation and the Absence of Necessary Legal and Transportation Infrastructure

The Soviet Union's first SEZ was in Nakhodka.\textsuperscript{106} There were persuasive justifications for its establishment: Nakhodka and its adjacent territories constituted the largest transportation hub in the RFE, containing major commercial cargo, oil-loading, and fishing ports.\textsuperscript{107} The Nakhodka SEZ was created by the Resolution of the Supreme Soviet of the RSFSR of October 24, 1990\textsuperscript{108} and the Decision of the Council of Ministers of the RSFSR that promulgated its regulations.\textsuperscript{109}

\textsuperscript{102} See \textit{ECONOMIC SURVEY}, supra note 11, at 258-59.
\textsuperscript{103} See generally FEZ Sakhalin Regulations, supra note 44, at 7.
\textsuperscript{107} Russian economic planners of the early 1990s viewed Nakhodka as a “window” to the Asian-Pacific region. See \textit{ECONOMIC SURVEY}, supra note 11, at 258-59. Nakhodka handled sixty-five percent of the annual cargo turnover in the Far East, and had rail and road links to the Trans-Siberian Railway and major parts of the RFE. See id. at 259.
\textsuperscript{108} Resolution of the Supreme Soviet of the RSFSR of October 24, 1990 on the Creation of a Free Economic Zone in the Area of Nakhodka, Primoriye Territory, Oct. 24, 1990, LEXIS, GARANT 10000563. This document merely proclaimed the creation of the Free Economic Zone “with tax rebates and customs facilities and a simplified procedure for export and import operations,” purported to guarantee investors’ rights against nationalization, and delegated the responsibility for approving FEZ regulations to the Council of Ministers of the RSFSR. See id. at *1-2.
\textsuperscript{109} Decision of the Council of Ministers of the Russian Federation No. 540 of November 23, 1990 on Priority Measures to Develop the Free Economic Zone in the Area of Nakhodka (Nakhodka FEZ) of the Primoriye Territory, Nov. 23, 1990, LEXIS, GARANT 10001122 [hereinafter FEZ Nakhodka Regulations]. The FEZ Nakhodka Regulations and the decision promulgating it are relatively brief documents, containing, respectively, twelve and thirty-three paragraphs that delegate responsibilities for submitting proposals for new procedures, developing regulations, and assisting each other in setting up the FEZ to twenty USSR-level, Russian Federation-level, and local administrative bodies.
Unfortunately, the success of Nakhodka SEZ remains limited. By 1996, the majority of Russian and foreign experts noted that there had been no major changes in the social and economic development of the zone or in its impact on the economy of the entire Far East. Nakhodka's ports experienced a sharp decline in cargo turnover and most piers converted to timber export. Towards the end of the 1990s, however, the zone boasted almost four thousand enterprises, including over three hundred foreign and joint Russian-foreign companies. Two large-scale economic projects were initiated and received some investment: a Russian-Korean technology park, and a Russian-American industrial complex. Nevertheless, U.S. State Department analysts maintain that, while the current Nakhodka SEZ continues to exist on paper, it has had no economic impact.

The Nakhodka SEZ has not produced the anticipated economic growth for a number of reasons. First, the region's existing infrastructure needs significant improvements. For example, only thirteen percent of the roadways have an improved hard surface. In addition, many railways consist of only a single set of tracks and also require improvements. Yet infrastructure upgrading depends primarily on the SEZ's own funds and funds from abroad.

In addition to the poor infrastructure, the transport rates from the Nakhodka SEZ on the Trans-Siberian railroad rose significantly during the 1990s. The rises were partially attributable to the imposition of customs duties in derogation of the Nakhodka SEZ Regulations. Shippers have also suffered from long travel times, theft on the Trans-Siberian railroad, and an uncooperative customs service. Threats to the personal security of business people have also plagued the region.

The primary cause of the Nakhodka SEZ's failure to produce its

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110 See ECONOMIC SURVEY, supra note 11, at 258.
113 ECONOMIC SURVEY, supra note 11, at 264.
115 See ECONOMIC SURVEY, supra note 11, at 259.
116 See id.
117 See id.
118 See id. at 260.
119 See id. at 258.
120 See id.
121 Whitehouse, supra note 111, at *1.
122 ECONOMIC SURVEY, supra note 11, at 263.
desired economic effects is the lack of stability in the legislation and regulation of the zone itself.\textsuperscript{123} Several significant shifts in policies and legislation have negatively affected the SEZ.\textsuperscript{124} The Russian government’s frequent vacillations about granting benefits to the Nakhodka SEZ’s enterprises reflects its concern about the uncontrolled proliferation of free economic zones that developed in the mid-1990s.\textsuperscript{125} This concern may have been well-founded in the case of Nakhodka. Through much of the 1990s, Primorskii Krai, the territory in which the zone is located, was governed by Evgenii Nazdratenko, who earned a reputation as one of the most corrupt governors in the Russian Federation,\textsuperscript{126} and refused to support any SEZ measures that did not directly enhance his political standing.\textsuperscript{127} Even after President Yeltsin’s decree on development of the Russian-Korean industrial complex,\textsuperscript{128} the project languished for several years due to corruption and political infighting between Nazdratenko and the former administrator of the zone Sergei Dudnik.\textsuperscript{129} Thus, corruption and infighting made Russian lawmakers extremely wary of extending significant benefits to the zone and contributed to its lack of administrative and regulatory stability.

\textsuperscript{123} See id. at 258.

\textsuperscript{124} In January 1992, the Russian Duma effectively cancelled the joint enterprise tax benefits by enacting a law “On the Fundamentals of the Tax System.” See A. V. Samokhvalov, Svobodnyie ekonomicheskie zony v Rossiiskoi Federatsii: problemy sozdaniia i funktsionirovaniia [Free Economic Zones in the Russian Federation: The problems of creation and operation], table 1, (1997) (unpublished thesis, Financial Academy of the Government of Russian Federation) at http://antitax.ru/offshorerus/info/ref04.html (last visited Oct. 24, 2003). Then, in 1993, the Duma eliminated the custom tariff preferences and effectively eliminated all tax benefits retroactively, beginning to assess taxes for the previous two years. See id.; ECONOMIC SURVEY, supra note 11, at 258. In 1994, however, the Russian government instructed the Ministry of Finance to grant tax credits to the local authorities until the year 2000, and requested a number of ministries to consider the proposals of the local authorities regarding the creation of free customs zones and industrial complexes. See Decision of the Government of the Russian Federation No. 1033 on Some Measures to Develop the Nakhodka Free Economic Zone, Sept. 8, 1994, LEXIS, GARANT 10001648 [hereinafter Nakhodka Development Decision]. The following year the law “On financing of state expenditures” once again cancelled all the tax benefits, and a later law cancelled all benefits for participants in international trade. See Samokhvalov, supra, table 1. Finally, in 1996, after an official visit to South Korea, President Boris Yeltsin decreed that his government sign an agreement with Korea regarding the establishment of a free trade zone with the possibility of free customs regime in Nakhodka. See Decree of the President of the Russian Federation No. 345 on Some Measures for Promoting the Investment Activity in the Free Economic Zone Nakhodka, Mar. 9, 1996, LEXIS, GARANT 10005929.

\textsuperscript{125} Whitehouse, supra note 111, at *2.

\textsuperscript{126} See DAVIS, supra note 10, at 53.

\textsuperscript{127} EVANGELISTA, supra note 105, at 116.

\textsuperscript{128} See Nakhodka Development Decision, supra note 124.

\textsuperscript{129} See Elizabeth Wishnick, Regional Dynamic in Russia’s Asia Policy, in RUSSIA’S FAR EAST: A REGION AT RISK, supra note 3, at 308.
2. The Sakhalin SEZ Failed Due to Inadequate Legislative Provisions, Doubts About its Economic Feasibility and Desirability, and Lack of Political Commitment

Although the Council of Ministers of the RSFSR decided to create an SEZ in the Sakhalin Region in 1991, the zone never formally materialized for a variety of reasons. First, the SEZ Sakhalin Regulations merely provided a skeletal framework for the establishment of a free economic zone. Absent from this document are detailed provisions on further rule-making procedures, administrative governance, and even precise territorial limits of the zone. Still loyal to the long-standing traditions of central planning, the SEZ Sakhalin Regulations entrusted the development of these provisions to a large number of administrative bodies, many of which were subsequently embroiled in radical transformation. It is not surprising, therefore, that many of the determinations, rules, proposals, and procedures necessary for the functioning of this SEZ were never developed.

To a great extent the Sakhalin SEZ's fate was originally sealed by doubts about its economic feasibility and subsequently about its very economic desirability. Such doubts arose soon after the proclamation of the Sakhalin SEZ. In the early-to-mid-1990s, the Sakhalin Region was ill-prepared to become a bustling center of economic activity due to poorly developed infrastructure, hyperinflation, the prevalence of barter as a primary payment system, and no system of private ownership of the means of production. Later in the 1990s, however, Western oil and gas

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130 See FEZ Sakhalin Regulations, supra note 44. The decision of the Council of Ministers that promulgated regulations for FEZ Sakhalin contains nineteen paragraphs, most of which distribute responsibilities for providing further legislative and regulatory framework among numerous federal-level bureaucracies, sometimes in cooperation with local Sakhalin authorities. See id. The regulations consist of forty-three articles attached to this decision. Among other things, these articles describe the purpose of FEZ Sakhalin (art. 2), provide for a preferential tax and customs treatment (art. 4), assign administration responsibilities to FEZ Sakhalin Administration (art. 6), specify tax rate concessions (arts. 18-20), and provide for a tax credit to Sakhalin Region (art. 28). See id.

131 See generally id.

132 Id.

133 FEZ Sakhalin Regulations named twenty-three administrative and policy-making bodies, twenty of which were RSFSR (national) level bodies. Id.

134 See Robert Skidelsky, The State and Economy: Reflections on the Transition from Communism to Capitalism in Russia, in POST-COMMUNISM: FOUR PERSPECTIVES 77, 80 (Michael Mandelbaum, ed., 1996) (noting that many institutional features of the modern capitalist state have had to be invented from scratch in the new Russia).

135 See Babak, supra note 104 (reporting high consumer prices, growing shortages, and lack of investor interest).

136 The author resided on Sakhalin Island until mid-1992 and can vividly recall long lines, lack of electricity, small entrepreneurs buying construction equipment with rubbing alcohol, roads washed out by typhoon-like rains, and the surprise of people at the idea of private ownership of a truck or an apartment.
producers began seeking links to the newly privatized Russian oil companies and the rich hydrocarbon deposits off the Sakhalin shelf. Despite the great degree of uncertainty generated by Russia's vague property rights, lack of law enforcement, and unclear guidelines on compliance with environmental standards, several large Western oil companies contributed hundreds of millions of dollars into Sakhalin's offshore oil projects, believing that "the biggest risk is the risk of not being there." As a result, Sakhalin today is one of the largest FDI recipients in the Russian Federation. Due to the allure of Sakhalin's oil and gas, the late Sakhalin Governor Igor Farkhudinov successfully extracted investors' concessions to build a new highway, onshore processing plants, pipelines, improved port facilities, and to train Russian engineers. One scholar argues that Sakhalin has good economic prospects and will fare better than much of the RFE because oil, gas, and substantial investment will provide jobs, incomes, and taxes for the region. Given that these benefits are the typical products of a successful SEZ, one could question whether an SEZ encompassing the entire region is even necessary for its development.

The failure to define a limited territorial scope of the would-be Sakhalin SEZ, however, was likely its most fatal flaw. The first governor of the region sent mixed signals about his intent to develop an SEZ, and was criticized for his failure to submit a detailed plan for the SEZ. By the time the regional administration submitted such a proposal in 1994, it was too late. The proposal was rejected, likely due to the same fear of losing control and lack of commitment to the SEZ concept that prompted the central government to revoke the tax privileges of Nakhodka SEZ.
The Draft Law on SEZ Kurils Was Never Enacted Because It Was a Victim of Political Struggles for Control

The Draft Law on SEZ Kurils finds its genesis in the Federal Program of Socio-Economic Development of Kuril Islands. Although it represented a somewhat more sophisticated drafting effort than regulations for the Nakhodka and Sakhalin SEZs, and enjoyed the support of the Duma deputies from the Sakhalin Region, it remained in its draft form, and was never considered by the entire Duma.

The Draft Law on SEZ Kurils fell victim to a political control struggle. The second governor of Sakhalin, Igor Farkhudinov, opposed the creation of the SEZ, insisting that the SEZ cover the entire Sakhalin Region. He argued that creating a special status for the Kurils was a prelude to partitioning the region and eventually ceding the disputed territories to Japan. But Farkhudinov also expressed his blunt disagreement with the idea that the SEZ should be administered from Moscow. Thus, a veritable struggle over control of the Sakhalin Region's territories ensued and became the major factor obstructing the adoption of the Draft Law on SEZ Kurils.
and any action on the Sakhalin SEZ.¹⁵¹

C. Comparison of Chinese and Russian SEZs Reveals That China's Model Provides Greater Stability, More Autonomy, and Better Infrastructure

While direct comparisons between SEZs are difficult, several key differences between the Chinese and Russian SEZs explain their contrasting levels of success. To discover such differences it is important to disregard the unique factors that attract investors in each SEZ. Aside from its proximity to Hong Kong, the Shenzhen SEZ in China—unlike its Russian counterparts—enjoys relative legal, economic, and political stability. The Chinese government clearly signaled its commitment to market-oriented policies within the SEZs, and legislatively mandated that local authorities develop their own policies and regulations.¹⁵² Chinese SEZs, such as Shenzhen, escaped the hyperinflation, barter, and economic dislocations of perestroika, which enabled them to serve as catalysts for China's steady economic growth.¹⁵³ Their economic success enabled significant infrastructure development, thereby increasing their investment allure.¹⁵⁴

In contrast to the Chinese SEZs, Russian Far East SEZs lacked stability and infrastructure. They arose during a period of major Russian social, economic, and political upheaval.¹⁵⁵ Their enabling laws and regulations were incomplete, leaving most details to be filled in by numerous bureaucracies and resulting in an unclear division of powers in the

¹⁵¹ Fear of losing control of the regions apparently played an important role in preventing the realization of the SEZs in the RFE. See supra Parts III.B(1), III.B(2). Throughout the 1990s it was feared that the RFE may move toward re-establishment of the Far Eastern Republic, an independent state that existed briefly in the RFE during the 1920s. See DAVIS, supra note 10, at 15, 58. Thus, maintaining the territorial integrity of the Russian Federation became a vital security concern for Russian politicians across the political spectrum. Menon & Ziegler, supra note 3, at 45. In response, President Vladimir Putin has made significant efforts to recentralize power after its devolution to the regions during the Yeltsin administration. See DAVIS, supra note 10, at 57. However, fear of secession is not a legitimate objection to the establishment of SEZs. Matthew Evangelista argues persuasively that the Far Eastern regions as well as other regions of Russia presumed by politicians to be at risk for secession were in no great rush to secede. See EVANGELISTA, supra note 105, at 113-23. Other commentators agree that the exercise of certain autonomy by the RFE regions is unlikely to threaten Russia's integrity. See Menon & Ziegler, supra note 3, at 46; DAVIS, supra note 10, at 58. Rather, Putin's attempts to recentralize power seem to have done little more than add another layer of bureaucracy. See DAVIS, supra note 10, at 32.

¹⁵² Zhou, supra note 66, at 54-57.

¹⁵³ See id. at 53-54, 59-60.

¹⁵⁴ See WU, supra note 49, at 56.

Local Russian leaders often saw the SEZs as opportunities to expand their authority, rather than opportunities for economic development, and engaged in counterproductive struggles for control. The economic dislocations of *perestroika* also hit hard in the areas in which SEZs were created or proposed, making investments in them unattractive and leaving few resources for infrastructure improvement.

Any new legislation on SEZs in Russia would necessarily have to remedy these problems in order to increase the likelihood of success. The experience of the Chinese SEZs suggests that Russian policy-makers must, to the extent feasible, first provide a predictable legal, political, and economic environment, as well as insure investment in physical infrastructure, in order for the SEZs to flourish in the RFE. In addition, future Russian SEZs, like the SEZs in China, would benefit from greater openness and autonomy.

The Chinese SEZ model is not directly transferable to Russia. The SEZ in Shenzhen, for example, benefited from the region's historically hard-working, entrepreneurial spirit and its close proximity to trade routes. But even if Russian SEZs cannot replicate the Chinese SEZs, they would be more successful if managed by responsible local authorities rather than by centralized control.

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156 *See supra* Parts III.A.1, 2.
157 *See supra* Parts III.A.1, 3.
158 *See supra* Parts II.A, II.D.
159 E-mail from Veronica Taylor, Professor of Law and Director of Asian Law Center, University of Washington School of Law, to Valentin Povarchuk (Jan. 16, 2004) (on file with author). Although certain significant cultural and geographic differences exist between south-eastern China and the RFE, there are also commonalities. For example, Nakhodka is located at the intersection of major trade routes between Europe and Asia. *See supra* Part III.B.1. The RFE territories also have many well-educated local entrepreneurs, and many hardworking, honest citizens. *See DAVIS, supra* note 10, at 4.
159 This argument assumes control by local officials who are primarily interested in promoting local economic development rather than pursuing short-term personal gains. Unfortunately, this may be the most vulnerable assumption. Corruption is a malady widely shared by all regions of the RFE as well as all of Russia. *See id. at* 55. Accordingly, policy openness as well as stable laws and predictable law enforcement are vital for the success of the SEZs in the Far East. Fortunately, President Putin and his administration have made the establishment of the rule of law one of their primary domestic objectives. *See Judith Thornton & Charles E. Ziegler, The Russian Far East in Perspective, in* THE RUSSIA'S FAR EAST: A REGION AT RISK, *supra* note 3, at 14.
160 *See supra* Part II.A.
IV. THE DRAFT LAW IS A PROMISING APPROACH AND AVOIDS CONFLICT WITH RUSSIA’S FUTURE WTO OBLIGATIONS

The Draft Law is not the first attempt to pass a national SEZ law in Russia. It does, however, appear to address numerous problems associated with previous SEZ-related laws and the ad hoc SEZ formation approach practiced in Russia to date. Its drafters, intent on avoiding repetition of past Russian SEZ failures, have correctly identified the necessary conditions for success and set the right priorities in designing SEZ attributes. For example, the Draft Law provides for uniform SEZ formation procedures, strict SEZ benefit limits, precise territorial limits, and a guarantee against adverse legal changes. Finally, the Draft Law avoids conflict with Russia’s future WTO obligations because it does not provide for export-contingent or actionable subsidies.

A. The New Approach of the Drafters Is Based on Research

The new Draft Law was developed by the Ministry of Economic Development and Trade of the Russian Federation (“MEDT”). It is accompanied by draft amendments to the Russian Tax Code and the drafters’ explanatory Note on Principles of Creation of SEZs. MEDT finished the development of the law in January 2003 and secured the approval of all concerned agencies, except for the Ministry of Finance. In

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163 See Note on Principles of Creation of SEZs, supra note 7, at *3-4.

164 See Appendix A, Draft Law, supra note 6.

165 See Appendix A, Draft Law, supra note 6, arts. 5-10, 22.

166 See generally id.

167 See id.


169 See Note on Principles of Creation of SEZs, supra note 7.

late July, the Finance Ministry still opposed the Draft Law, citing a negative impact on Russia’s investment climate, adverse effects on the revenue part of the national budget, and potential violations of WTO norms. Nevertheless, it is likely that the Draft Law or an amended form of it will be adopted sometime in 2004.

The Draft Law’s Note on Principles of Creation of SEZs reveals that, at the very least, the drafters have methodically researched the successes and failures of SEZs in Russia and other countries. It briefly surveys the experience of SEZs worldwide, identifies the problems associated with Russian SEZs of the 1990s, and concludes that effective realization of SEZ advantages requires:

- Formation of an official SEZ policy that considers the economic interests of the local (regional) and federal authorities;
- Development and adoption of an appropriate legal and regulatory framework, which would regulate the creation, operation, and termination of SEZ status;
- Creation of SEZs in limited, defined territories with prescribed limits on their residents, to prevent violation of the uniformity of the national customs territory and competition for business activity with other economic units of the state;
- The ability (and willingness) of federal and regional authorities to direct funds to create an appropriate infrastructure with the understanding that real benefits may accrue only in the future;

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172 The head of MEDT, Minister German Gref, is actively lobbying for adoption of the Draft Law as one of the means of achieving higher economic growth. Deputy Prime Minister of Russia Boris Alyoshin expected a compromise in August or September of 2003; after this the bill could be introduced to the Duma and eventually passed in 2004. See Russia Working on Law on Special Economic Zones, INTERFAX NEWS AGENCY, June 30, 2003, LEXIS, Nexis Library, INTFAX File. In the early August conference between Alyoshin, Gref, and Finance Minister Kudrin, the chief opponent of the bill, Kudrin found himself “caught . . . in a pair of pincers,” as Alyoshin proposed provisional creation of five to seven SEZs and using them to work out the regulatory framework. See Aleksei Kudrin, German Gref and Boris Alyoshin Organize an Interzonal Tournament, KOMMERSANT, July 1, 2003, LEXIS, Nexis Library, CDSP File.

President Putin, in principle, favors the creation of SEZs as a means of assisting the region’s development. In fact, he tasked Minister Gref with developing SEZ legislation in 2000. See Putin Wants Gref to Make Production Sharing Agreements Work, ITAR-TASS, Aug. 1, 2000, LEXIS, Nexis Library, TASS File. Finally, Russia’s Duma had passed SEZ legislation in the past, see supra note 162, and being especially pliant to President Putin’s wishes today, is likely to do so again.

173 See generally Note on Principles of Creation of SEZs, supra note 7.
and

- Equal treatment of domestic and foreign investors and provision of more advantageous business conditions than investors possess abroad and in other parts of the country.\textsuperscript{174}

In addition, the Note on Principles of Creation of SEZs appropriately recognizes that tax benefits should be neither the sole, nor the primary factor in attracting investment.\textsuperscript{175} In the opinion of the drafters, the principal advantage of the zones lies in the maximum predictability of long-term expenses of conducting business.\textsuperscript{176} In this regard, the drafters prioritize the following benefits:

- Administrative stimulus, including simpler registration, certification, inspection, and immigration procedures, as well as elimination of certain licensing requirements and provision of the right to buy land upon which improvements are made;

- Additional guarantees of static SEZ rules, including the government’s guarantee not to change the rules;

- Investments in the infrastructure of the SEZ from the federal and local budgets;

- Customs benefits, including simplified and expedited import and export procedures, and the possible creation of a free customs zone regime for goods imported into the SEZ for production of export goods; and

- Possible provision of tax benefits, including a waiver of local property taxes and taxes on profits for a limited time period.\textsuperscript{177}

By providing these benefits, the authors of the Draft Law believe they can create favorable investment environments within the SEZs.\textsuperscript{178} In turn, they expect the SEZs to achieve the following goals:

\textsuperscript{174} Id. at *1 (translated by author).
\textsuperscript{175} Id. at *2.
\textsuperscript{176} Id.
\textsuperscript{177} Id. at *2-3.
\textsuperscript{178} Id. at *4.
A shift in the economic structure of the region towards high-technology processing industries;

Creation of workplaces, especially in the regions with high risk of unemployment;

Accelerated development of the economically depressed territories through diversification of their production bases, expansion of the tax base, and provision of their infrastructure needs.\(^{179}\)

Thus, the Note on Principles of Creation of SEZs demonstrates that the drafters carefully considered the history of Russian SEZ failures and the experiences of other nations in creating the Draft Law.

**B. The Draft Law Provides for Tight Controls and Limited Benefits of SEZs**

Although the Draft Law does not completely follow the vision of the Note on the Principles of Creation of SEZs,\(^{180}\) it represents a significant step forward in Russian SEZ legislation. First, it envisions two types of SEZs: industrial-production zones and technology-implementation zones.\(^{181}\) Each type of zone is intended to target the specific strengths of its individual locale.

The SEZ’s underlying purpose is described as “stimulation of production of high technology and highly processed goods, including industrial goods, through the use of intellectual property and implementation of competitive innovations at the domestic market of the Russian Federation and in the world markets.”\(^{182}\) Thus, in defining the scope of activities and the purposes of the zones, the draft authors deliberately focused on the regions’ growth potentials, rather than on their development needs. While this is not entirely consistent with the expectation that the zones would provide for increased employment and accelerated development of economically depressed territories,\(^{183}\) it is a welcome deviation from prior approaches that regarded the creation of SEZs as an immediate panacea to

\(^{179}\) *id.*

\(^{180}\) See *infra* Part V.

\(^{181}\) Appendix A, Draft Law, *supra* note 6, art. 3.

\(^{182}\) *id.* art. 4.

\(^{183}\) See Note on Principles of Creation of SEZs, *supra* note 7, at *4.*
the problems of regional development.\textsuperscript{184}

The Draft Law also provides for a uniform procedure for creation of SEZs. In accordance with article 5.2, the "[d]ecision on the creation of an SEZ on the territory of a subject of the Russian Federation is made by the Government of the Russian Federation, based on the results of the review of the applications of the subject of the Russian Federation for creation of SEZ."\textsuperscript{185} Applications are to be selected on a competitive basis and evaluated on criteria furnished by the government.\textsuperscript{186} The primary criteria to be used in considering applications for industrial production SEZs include the zone's need for public financing, infrastructure capability, proximity to export markets, and availability of qualified labor.\textsuperscript{187} The approved subject\textsuperscript{188} of the Russian Federation on the territory subject to SEZ formation must conclude an agreement with the Government of the Russian Federation specifying 1) the sources of financing of the infrastructure projects, including federal, regional, and local budget shares; 2) a program designed to ensure appropriate outfitting and technological equipment of the SEZ; 3) participation in the administration of the SEZ; 4) responsibilities of the federal, regional, and municipal organs in providing regulation of business and investment activity; and 5) rights and responsibilities of the parties in connection with the operation of the SEZ.\textsuperscript{189}

Further, the Draft Law provides for a strictly controlled regime of SEZ operation. In accordance with article 9, the SEZ is managed by a "special organ of the state, created in accordance with the present federal law, that performs the functions of administering the SEZ," referred to as the "Administration of SEZ."\textsuperscript{190} The use of the phrase "organ of the state" implies the federal status of this body.\textsuperscript{191} This tight level of control places the Administration of SEZ and its head firmly under the control of the federal government.

\textsuperscript{184} See, e.g., the purpose clauses of FEZ Nakhodka Regulations, supra note 109; FEZ Sakhalin Regulations, supra note 44.
\textsuperscript{185} Appendix A, Draft Law, supra note 6, art. 5.2.
\textsuperscript{186} See id. art. 5.4.
\textsuperscript{187} See id. art. 6.2.
\textsuperscript{188} The Russian Federation consists of eighty-nine territorial units with differing levels of autonomy. Russian law refers to all units within this system of "asymmetric federalism" as subjects of the Federation.
\textsuperscript{189} See Appendix A, Draft Law, supra note 6, art. 5.5.
\textsuperscript{190} Id. art. 9.2.
\textsuperscript{191} Other provisions of the Draft Law further confirm that the Administration of SEZ is accountable to the federal government. The head of the Administration of SEZ is appointed by the Government of the Russian Federation upon agreement with the subject of the Russian Federation hosting the SEZ, see id. art. 9.3, and bears responsibility under the laws of the Russian Federation for failure to fulfill his or her functions. See id. art. 9.7. The Administration of SEZ reports to the Government of the Russian Federation, by submitting an annual report on the SEZ's progress. See id. arts. 9.5, 10.1.
The Draft Law provides for SEZs that would be quite limited in geographic and temporal scope and confer benefits only upon a limited set of enterprises. For example, industrial production zones may occupy no more than ten square kilometers and exist for no more than twenty years from the date of creation. Technology implementation zones may occupy no more than one square kilometer and exist for just fifteen years. No extension of the term is allowed. A business registered in accordance with Russian law as a legal entity that seeks SEZ resident status must timely submit documents to the Administration of SEZ detailing its investment proposals and the manner of their implementation. In order to be considered for SEZ resident status, a business must be an entirely new legal entity, not simply the product of a reorganization, and must invest a sum in rubles in excess of €10 million, excluding its non-material assets. If the Administration of SEZ decides to approve the investment proposal, it must conclude an investment agreement with the legal entity that submitted the proposal, recognizing the business as an SEZ resident. Thus, the Draft Law provides SEZ preferences only to a limited set of businesses with serious ideas for new projects and significant investment capabilities.

In exchange for allowing such limited access to benefits, the Draft Law provides significant protections for SEZ residents ranging from untimely termination of the SEZ status or its accompanying benefits to other unpredictable events. For example, article 22.1 provides that "[f]ederal laws and other regulations of the Russian Federation adversely affecting the legal and (or) economic situation of the residents of SEZ...shall not be applied during the duration of SEZ status." Inspections other than those performed by tax and customs authorities may be conducted only in the form of "comprehensive" inspections, and their

\[192\] Id. art. 6.1.
\[193\] Id. art. 8.1.
\[194\] Id. art. 7.1.
\[195\] Id. art. 8.1.
\[196\] Id. art. 8.2.
\[197\] See id. art. 13.2. Industrial-production zone participants must do this within ten days of their registration as a legal entity. Id.
\[198\] See id. art. 13.4.
\[199\] See id. art. 13.5.
\[200\] Termination of the SEZ status before the expiration of its term, except as provided by law for national defense purposes, is prohibited. Id. art. 8.3.
\[201\] See id. art. 22.
\[202\] See id. arts. 20-21.
\[203\] Id. art. 22.1. Part 2 of this article, however, provides exceptions for federal laws and other normative acts in defense of the constitutional system, morality, health, and legal rights of other persons, as well as national defense. Id. art. 22.2.
results may be appealed to administrative or judicial authorities. In addition to the standard guarantee of just and adequate compensation in the event of a nationalization of property, the Draft Law also provides investors with a right to be compensated for illegal actions (or failures to act) of the state, local, or SEZ authorities. On the other hand, the taxation and customs privileges that the Draft Law provides are relatively limited. Nevertheless, the Russian Finance Ministry has opposed the adoption of the Draft Law on the ground that its tax and customs privileges may conflict with Russia's future WTO obligations.

C. Russia's Impending WTO Accession Does Not Prohibit Adoption of the Draft Law

Russia is currently negotiating for early WTO accession—a top government priority. Critics who have objected to the Draft Law on the ground that it is incompatible with Russia's future WTO obligations have argued that the establishment of SEZs could violate the principle of fair market competition. In light of the Russian government's high prioritization of early WTO accession, this issue requires attention. As previously noted, China's WTO accession process resulted in commitments to revoke certain SEZ tax and customs preferences that are the hallmark of SEZs' "special" status. Further, the subject of SEZs has already been raised in Russia's WTO accession talks.

A review of the relevant provisions of the WTO Agreement on Subsidies and Countervailing Duties ("Subsidies Agreement") reveals that

204 See id. art. 15.
205 See id. art. 21.
206 See id. art. 20.3.
207 See id. arts. 18-19; Appendix B, Tax Code Amendments, supra note 168.
208 See Cabinet to Discuss Mid-term Results of WTO Membership Talks, INTERFAX NEWS AGENCY, July 9, 2002, LEXIS, Nexis Library, INTFAX File. The principal critic of the Draft Law on SEZ has been the Russian Finance Ministry. See Finance Ministry Opposes Inclusion of Special Tax and Customs Regime Into Law on Special Economic Zones, supra note 171, at *1.
210 See Maxim Medvedkov, Russia's Accession to the WTO: The View From Russia, in RUSSIA AND THE WTO 37 (Katinka Barysch ed., 2002). Currently, the Russian government plans to conclude accession talks in 2004. See Russia About to Wrap Up Coordination of WTO Accession, INTERFAX NEWS AGENCY, June 18, 2003, LEXIS, Nexis Library, INTFAX File.
211 See Cabinet to Discuss Mid-term Results of WTO Membership Talks, supra note 208.
212 Indeed, MEDT has recognized the issue as "weighty." See Russian Gov't Plans to Discuss Results So Far of WTO Accession, INTERFAX NEWS AGENCY, July 3, 2002, LEXIS, Nexis Library, INTFAX File.
213 See supra Part III.A.3.
the Draft Law does not contravene them per se.\footnote{Agreement on Subsidies and Countervailing Measures, Apr. 15, 1994, WTO Charter, Annex 1A, LEGAL TEXTS [hereinafter Subsidies Agreement].} Article 1 of the Subsidies Agreement provides that:

a subsidy shall be deemed to exist if:

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:

(i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);

(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)\footnote{Id. art. 1.1.}.

Under this definition, the Draft Law’s treatment of SEZs may certainly be deemed a subsidy. The tax benefits and waivers of custom duties granted to SEZ residents can likely qualify as “revenue foregone” under article 1.1(a)(1)(ii).

The Subsidies Agreement considers subsidies problematic only if they are either prohibited under Part II, or actionable under Part III. Prohibited subsidies include:

(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;

(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.\footnote{Id. art. 3.1 (footnotes omitted).}

The Draft Law does not make any export-contingent subsidies or subsidies contingent upon the use of domestic, rather than imported, goods.\footnote{See generally Appendix A, Draft Law, supra note 6.} Nothing in the Draft Law makes the conferral of any of its
benefits directly or indirectly dependent on reaching certain export targets or the use of any domestic goods. The ability to receive tax and custom preferences in a Russian SEZ, as contemplated by the Draft Law, depends only on the enterprise’s status as an SEZ resident. This, in turn, depends on the presentation of an acceptable investment project and the ability to invest a sum in rubles exceeding € 10 million in this project. Consequently, the Draft Law does not provide any prohibited subsidies.

In order to be actionable under Part III of the Subsidies Agreement, a subsidy must be specific within the meaning of article 2. Article 2 provides that a subsidy may be deemed specific where the “granting authority . . . explicitly limits access to a subsidy to certain enterprises.” In addition, “[a] subsidy which is limited to certain enterprises located within a designated geographical region . . . shall be specific.” Under both of these standards the benefits provided by the Draft Law can qualify as specific subsidies. They are both limited to certain enterprises—those that satisfy the criteria for SEZ resident status—and provided within a designated geographical region, the territory of the SEZ. Hence, the Draft Law provides specific subsidies to SEZ residents and they may fall under the category of actionable subsidies.

Even though the subsidies envisioned by the Draft Law are specific, they are not actionable. Article 5 of the Subsidies Agreement prohibits only specific subsidies that may cause adverse effects to the interests of other WTO members in the form of “an injury to the domestic industry, nullification or impairment of certain benefits accruing to other members, or serious prejudice to the interests of another member.” Although the terms “injury to the domestic industry” and “serious prejudice” are subject to further definitions and may generate disagreement among nations, they are not likely to be caused by the types of subsidies that the Draft Law provides. The Draft Law generally confers its tax and customs preferences upon

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219 See id.
220 See id. art. 4.
221 See id. arts. 18, 19.
222 Id. art. 13.
223 See Subsidies Agreement, supra note 215, art. 1.2.
224 Id. art. 2.1(a).
225 Id.
226 See Appendix A, Draft Law, supra note 6, arts. 6, 7, 13, 18 & 19.
227 See Subsidies Agreement, supra note 215, art. 5.
investors willing to make a significant investment into a new business project.\textsuperscript{228} These preferences are designed to promote the creation of the high technology and advanced processing industries, and provide them with limited relief during their nascent years.\textsuperscript{229} Such industries are not likely to pose such an immediate threat of competition to the industries of other WTO members that it would cause an injury or serious prejudice to them.

In addition, potential Russian SEZs in the RFE should be distinguished from Chinese SEZs. The major Chinese SEZs, such as the Shenzhen SEZ, existed for twenty years or more at the time of China's entry to WTO.\textsuperscript{230} Chinese SEZs have become major exporters of goods, reaching US$ 25 billion in exports from Shenzen SEZ alone.\textsuperscript{231} As such, they may well present threats of injury or serious prejudice to the domestic industries of other WTO members. Thus, it is not surprising that WTO members that negotiated China's admission to WTO compelled it to commit to revoking preferential tax and custom treatment in its highly competitive SEZs.\textsuperscript{232} Potential Russian SEZs, on the other hand, are not likely to present equally competitive threats to WTO members in the foreseeable future. For this reason, Russia should not be deterred from adopting the Draft Law by fear of potential non-compliance with WTO standards.

V. THE DRAFT LAW SHOULD BE REvised TO MORE EFFECTIVELY HELP THE RUSSIAN FAR EAST

The Draft Law has many advantages over previous SEZ legislation, but it is far from perfect. Deficiencies include a lack of total certainty regarding future rulemaking for SEZs, unreasonable limits on access to SEZ resident status, excessive restrictions on local rulemaking, and low inability to promote much-needed development of RFE regions. Russian policy makers should remedy these defects before adopting the Draft Law.

First, the Draft Law does not fully implement the intent of the drafters to provide what they identified as the top benefit of an SEZ—an

\textsuperscript{228} See Note on Principles of Creation of SEZs, \textit{supra} note 7, at *4. Legal entities that existed before their application for SEZ resident status simply cannot obtain this status. \textit{See} Appendix A, Draft Law, \textit{supra} note 6, art. 13.4.

\textsuperscript{229} The exemptions from the profit taxes are limited to the maximum of seven years, and remaining exemptions from property taxes and duties on imported goods are limited by the term of duration of SEZ status—fifteen or twenty years. \textit{See} Appendix B, Tax Code Amendments, \textit{supra} note 168; Appendix A, Draft Law, \textit{supra} note 6, arts. 8, 18.

\textsuperscript{230} \textit{See} supra Part III.A.1, 2.

\textsuperscript{231} \textit{See} SEZs After China's Entering WTO, \textit{supra} note 63, at *2.

\textsuperscript{232} \textit{See} Protocol, \textit{supra} note 91.
administrative framework of maximum simplicity and predictability.\(^{233}\) For example, one of the administrative stimuli that the Note on the Principles of Creation of SEZs expressly mentions is simplified procedures for exit and entry of foreign citizens.\(^{234}\) The Draft Law has no provision to simplify the immigration regime, except that one of the functions of the Administration of SEZ is to "issue invitations for visas of foreign citizens for work in the territory of SEZ."\(^{235}\) In fact, the creation of a special simplified immigration procedure is possible, but not specifically provided for in the Draft Law. Further elaboration of legal norms and standards governing the operation of SEZs may be achieved through "other laws," as well as federal and local regulations.\(^{236}\) The Draft Law does not precisely allocate responsibility for provision of regulations, choosing instead to have the matter decided by agreement between the central Government, the subject of Russian Federation, and municipal authorities.\(^{237}\) This not only creates a potentially divisive issue for the SEZ agreement, but also fails to provide potential investors with sufficient guidance on what regulation to expect from various regulatory bodies.

Second, the Draft Law does not provide municipal authorities with sufficient policy and rulemaking autonomy. Success of the SEZs in China depended in part on the delegation to local SEZ administrations and municipal authorities of the right to develop their own sophisticated local regulatory regimes and to administer the tax proceeds of SEZs according to their local needs.\(^{238}\) Although the Draft Law envisions some local participation in the rulemaking process,\(^{239}\) it is not clear precisely what role local authorities may play. Almost all of the profit tax revenue resulting from operation of the SEZ under the Draft Law must be remitted to the central government.\(^{240}\) The main administrative organ of SEZs—the Administration of SEZs—answers directly to the Federal Government of the Russian Federation.\(^{241}\) This arrangement may help to limit corruption and

\(^{233}\) See supra Part IV.A.

\(^{234}\) See Note on Principles of Creation of SEZs, supra note 7, at *3.

\(^{235}\) Appendix A, Draft Law, supra note 6, art. 10.1.

\(^{236}\) The Draft Law provides that the regulation of operation of SEZs can be provided in accordance with the Constitution of Russian Federation by the Draft Law itself, normative acts of the subjects of the Russian Federation, and other laws. See id. art. 1. Further, the Government of Russian Federation may adopt normative acts regarding operation of SEZs. Id.

\(^{237}\) The SEZ agreement between the subject of the Russian Federation, the municipal authorities, and the Government would specify responsibilities of the federal, regional, and municipal organs in providing regulation of business and investment activity. Id. art. 5.5.

\(^{238}\) See supra Part III.B.2.

\(^{239}\) See Appendix A, Draft Law, supra note 6, art. 5.5.

\(^{240}\) See Appendix B, Tax Code Amendments, supra note 168.

\(^{241}\) See supra Part IV.B.
political infighting and prevent problems such as those that deterred the development of the Nakhodka SEZ. On the other hand, because the leadership appointed by the central government is answerable only to the central government, appointees may not fully understand or consider local concerns. The centrally-controlled administration may also be tempted to achieve the highest return possible in terms of increased exports, at the expense of local physical and business infrastructure improvements. A better version of the law on SEZs would provide for a greater and more certain degree of autonomy for local authorities in arranging their economic affairs, while allowing for some central oversight, perhaps through periodic reporting and fiscal incentives.

Third, while specification of criteria for establishment of an SEZ and conferral of SEZ resident status is a step in the right direction, few places in Russia may be able to meet such stringent requirements. Much depends on how strictly the Russian government will apply these criteria. For example, if availability of infrastructure is one of the main criteria for SEZ site selection, and a particular location currently has poor infrastructure but good potential for growth given an appropriate investment in infrastructure, it is questionable whether it could obtain the SEZ status. The Draft Law may thus set a prohibitively high bar to achieve the ends that it seeks to achieve.

Finally, while the Draft Law is generally well-intentioned, it may prove too little too late for some potentially viable zones in the RFE. This is due to its provision that invalidates the status of all existing SEZs, with special exceptions provided by federal laws. Further, the date when the first SEZs are expected to begin operation is 2006, assuming that the Draft Law will be adopted in 2004. Yet there are at least two SEZs that already formally exist in the RFE. The business expectations of investors in these

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242 Such analysis is especially pertinent for the future of the Kuril Islands. They present a case where the provision of guarantees and incentives to establish advanced sea product processing and ship repair facilities may spur development due to the wealth of the marine resources, as well as great physical and perhaps even cultural proximity to the Japanese market. See Stanley R. Boots, Comment, The Personal Contacts Alternative – A Comparison of Japanese and Russian Legal Cultures in the Russian Far East Timber Trade, 9 INT’L LEGAL PERSP. 257 (1997) (arguing that there are substantial similarities between Russian and Japanese ways of conducting business and negotiation styles). Unfortunately, the infrastructure of the islands is in a dreadful condition, but it is conceivable that through the assistance of the Federal Program of Development and the revenues of Sakhalin oil projects it could be greatly improved. Yet with strict application of the Draft Law conditions such as the availability of infrastructure and the minimum investment of $10 million to establish new high-technology enterprises, the Kurils may never be able to get the SEZ status or attract sufficient investment.

243 See Appendix A, Draft Law, supra note 6, art. 23.

244 See Economics Ministry to Submit Bill on Special Economic Zones, INTERFAX NEWS AGENCY, Jan. 28, 2003, LEXIS, Nexis Library, INTFAX File.

245 See supra Part III.B.1 for FEZ Nakhodka; see also supra, note 100 for FEZ Magadan.
existing SEZs may be greatly disappointed by the lack of continuity in the Draft Law. Russian policymakers would therefore do well to specifically provide for continuance of the status of the existing SEZs in the Draft Law and for a gradual period of transition to the new SEZ regime.

VI. CONCLUSION

After many years of mismanagement and neglect, the RFE today is in great need of development. The experience of many countries has shown that SEZs can help to promote local economic development when the right conditions are provided. In China, in particular, openness and autonomy allowed in the SEZs has helped to turn small rural communities into recipients of billions of dollars of FDI and exporters of billions of dollars worth of products. Yet Russian experimentation with SEZs in the Far East up to now has failed to produce favorable results due to inadequate legal and physical infrastructures as well as lack of political, economic, and legal stability. The new Draft Law is a promising approach that builds upon the lessons of the past to provide a more certain and reliable investment environment. However, to help ensure the Draft Law’s success in promoting development of the Russian Far East, Russian policymakers should include several changes, including provisions specifying division of central and local authority, allowing for greater local involvement in SEZ administration, softening criteria for conferral of SEZ benefits, and providing for continuation of the existing zones. The sooner such SEZ legislation is adopted, the sooner the RFE may realize its great potential for development.
APPENDIX A – Draft Law∗

RUSSIAN FEDERATION
FEDERAL LAW

ON SPECIAL ECONOMIC ZONES IN THE RUSSIAN FEDERATION

CHAPTER 1. GENERAL

This Federal law regulates the creation, functioning and termination of the status of special economic zones on the territory of the Russian Federation, as well as entrepreneurial and investment activities in the special economic zones.

Article 1. Russian Federation legislation on special economic zones

Legal regulation of relations associated with the creation, functioning, and termination of the status of special economic zones on the territory of the Russian Federation takes place in accordance with the Constitution of the Russian Federation, the present Federal law, regulatory acts of the subjects of the Russian Federation adopted in accordance with it, as well as other legislative acts of the Russian Federation.

In the circumstances prescribed in the present Federal law, the Government of the Russian Federation adopts regulatory acts on the functioning of special economic zones and activity on the territories of special economic zones.

Article 2. Definition of special economic zone

A special economic zone (SEZ) is that part of the territory of the Russian Federation, where, in accordance with the present Federal law and other legislative acts of the Russian Federation, a special regime of entrepreneurial and investment activity is established, and a regime of free custom zone is created.

Article 3. Types of special economic zones

∗ Translations in Appendices A and B contain minor formatting changes introduced by the author to enhance readability. Otherwise, translated versions of the Draft Law and Tax Code Amendments are true to the original Russian versions.
SEZs created on the territory of the Russian Federation may be:
- industrial-production zones,
- technology-implementation zones.

Article 4. Goals of creating special economic zones

SEZs are created with the goals of activization of production of goods of high level of processing and technology, including industrial goods, through the use of intellectual property and implementation of innovations competitive at the domestic market of the Russian Federation and world markets.

CHAPTER 2. CREATION AND TERMINATION OF THE STATUS OF SPECIAL ECONOMIC ZONES

Article 5. General procedure for creation of special economic zones

1. Creation of an SEZ takes place by decision of the Government of the Russian Federation in accordance with the requirements of the present article.

2. Decision on the creation of an SEZ on the territory of a subject of the Russian Federation is made by the Government of the Russian Federation based on the results of the review of the applications of the subject of the Russian Federation for creation of SEZ.

3. An application for creation of an SEZ is submitted by the subject of the Russian Federation in cooperation with the organs of local self-governance of the municipal entities on the territory of which it is proposed to create an SEZ.

   An application of the subject of the Russian Federation for creation of an SEZ is supplemented by documents confirming the consent of the organs of local self-governance of the municipal entities on the territory of which an SEZ is planned to delegate the control over the territory of SEZ to Administration of SEZ.

   The form of application, guidelines for its completion, as well as the procedure and timelines for submitting applications, and the list of the required documents submitted with the application for creation of an SEZ is determined by the Government of the Russian Federation in accordance with the requirements of the present Federal law.

4. Selection among applications for creation of SEZs of the same types is done by the Government of the Russian Federation on competitive
basis. The procedure and criteria for the competitive selection are determined by the Government of the Russian Federation.

5. Based on the review of the applications for creation of SEZ and the decision to create an SEZ by the Government of the Russian Federation the executive organs of the subject of the Russian Federation and the organs of local self-governance of the municipal entities, on the territory of which it is proposed to create an SEZ, conclude an agreement.

The agreement between the Government of the Russian Federation, executive organs of the subject of the Russian Federation and the organs of local self-governance of the municipal entities on the territory of which the SEZ is to be created, establishes:

- sources of funding of the creation of infrastructure of the SEZ, including the respective shares from the federal, regional, and local budgets;
- a complex of measures designed to ensure the equipment and material-technological provisioning of the SEZ;
- participation in the activity of the organ of governance of the SEZ;
- duties of the federal, regional and municipal organs in creation of the regime of monitoring of entrepreneurial and investment activity on the territory of the SEZ;
- rights and obligations of the parties in connection with the functioning of the SEZ.

Article 6. Creation of industrial-production zones

1. Industrial production zones are created on territory not exceeding 10 square kilometers.

2. The major criteria in review of the desirability of creation of industrial production zones are:

- the need for financial resources from the budgets of all levels of the budgeting system of the Russian Federation for creation of the industrial-production zone;
- potential availability of objects of infrastructure of all kinds;
- proximity to potential markets for realization of goods;
- potential availability of well-qualified labor resources.

3. At the time of the decision of the Government of the Russian Federation on creation of industrial-production zones in the subject of the Russian Federation, the territory provided for the SEZ may not contain (except for the property owned by the state and (or) the municipality)
property owned in any way by legal or natural persons, as well as property that belongs to the residential fund in accordance with laws of the Russian Federation.

**Article 7. Creation of technological-implementation zones**

1. Technological-implementation zones are created on limited parcels of land that overall do not exceed 1 square kilometer.
2. Technological-implementation zones are created on separate parcels of land, or on the territories of the industrial-production zones, or on the territories connected to the institutions of higher education, preparing specialists in the technical, exact, or natural sciences, and (or) scientific-research institutions of the similar orientation.
3. Residents of technological-implementation zones are not eligible for any grants, subsidies, or subventions from the federal budget.

**Article 8. Termination of the status of special economic zone.**

1. The status of an SEZ is terminated upon the expiration of the term provided for by the present article.
   - The status of an industrial-production zone is valid for 20 years from the time of its creation.
   - The status of a technological-implementation zone is valid for 15 years from the time of its creation.
2. Extension of the term of the status of an SEZ is not allowed.
3. Termination of the status of SEZ before the expiration of its term determined in accordance with the present article is not allowed, except in the circumstances provided for by the laws of the Russian Federation and international agreements of the Russian Federation related to national defense and security of the Russian Federation.
4. The procedure for termination of the status of SEZ, resolution of property and other issues related to the termination of the status of SEZ, as well as regulation of financial relations between the Administration of SEZ and residents of SEZ are determined by the Government of the Russian Federation in accordance with the laws of the Russian Federation, including the present Federal law.
CHAPTER 3. ADMINISTRATION OF SPECIAL ECONOMIC ZONES

Article 9. Organ of administration of special economic zone

1. Administration of the SEZ is effected by the Administration of Special Economic Zone ("Administration of SEZ").
2. Administration of SEZ – a special organ of the state, created in accordance with the present Federal law, that performs the functions of administering the SEZ.
3. Administration of SEZ is headed by the head of the SEZ, who is appointed by the Government of the Russian Federation upon consultations with the administration of the subject of the Russian Federation on the territory of which the SEZ is located.
4. The SEZ Bylaws are adopted by the Government of the Russian Federation in cooperation with the subject of the Russian Federation simultaneously with the decision to create the SEZ and conclusion of the agreement on creation of the SEZ between the Government of the Russian Federation, executive organs of the subject of the Russian Federation, and organs of local self-governance of the municipal entity.
5. The Administration of SEZ reports to the Government of the Russian Federation.
6. The procedure for financing of the activity of Administration of SEZ is determined by the SEZ Bylaws.
7. The head of SEZ is responsible in accordance with the laws of the Russian Federation for failure of the Administration of SEZ to perform the functions provided for by the present Federal law.

Article 10. Functions of the Administration of special economic zone

1. Administration of SEZ performs the following functions in its exercise of its authority in accordance with the laws of the Russian Federation:
   - exercises authority over the land on which the SEZ is located;
   - acts as the procurement agent in the planning and construction of the objects of infrastructure of the SEZ (planning and construction of the customs infrastructure is performed by the Administration of SEZ in cooperation with federal customs authority);
   - reviews investment projects proposed for realization on the
territory of the SEZ and issues written conclusions to support or decline support for a particular investment project;
- performs registration of legal entities as residents of the SEZ;
- in the circumstances provided for by the present law, annuls the registration of legal entities as residents of the SEZ;
- reports data on registration and annulment of registration of legal entities as residents of the SEZ to tax authorities;
- maintains a register of the residents of the SEZ, provides excerpts from the register upon request of a resident, and issues certificate of residency in the SEZ;
- sets up the procedures for the required expert review and approval of project and investment documentation;
- concludes agreements with residents of the SEZ within the confines of its authority;
- develops proposals on realization (changes) of the strategy and program of development of the SEZ and submits them to the Government of the Russian Federation, executive organs of the subject of the Russian Federation, and organs of local self-governance;
- represents the SEZ in interactions with the organs of state authority and local self-governance, Russian and foreign investors and international organizations;
- issues invitations to foreign citizens for obtaining visas for work on the territory of the SEZ; and
- monitors compliance of the residents of the SEZ with the terms of investment agreements.

Each year not later than April 1 of the year following the reporting year, the Administration of SEZ reports to the Government of the Russian Federation on the results of the operation of the SEZ during the reporting year.

2. Administration of SEZ may not:
- act as a founder (participant) of the entities—residents of the SEZ;
- be a part of the governing organs of the entities—residents of the SEZ;
- interfere in entrepreneurial activity performed by the residents of the SEZ.
Article 11. Procedure for dispute resolution

Disputes arising out of creation of the SEZ, violation of the conditions of entrepreneurial or investment activity on the territory of the SEZ, termination of the status of the SEZ, as well as arising out of agreements concluded with the participation of Administration of SEZ and residents of the SEZ, are resolved through judicial procedure in accordance with subject matter jurisdiction established by the laws of the Russian Federation.

CHAPTER 4. FEATURES OF THE REGIME OF ENTREPRENEURIAL ACTIVITY IN SPECIAL ECONOMIC ZONES

Article 12. Regime of entrepreneurial and (or) investment activity in special economic zone

Except for the circumstances in section 1, Article 14 of the present Federal law, residents of SEZ may perform entrepreneurial and (or) investment activity on the territory of the SEZ in accordance with the requirements of the present Federal law.

Article 13. Registration in the special economic zone

1. State registration of legal entities on the territory of a special economic zone takes place in accordance with the laws on state registration of legal entities.

2. A legal entity registered on the territory of a technological-implementation zone and aspiring to acquire the status of resident of this zone, shall supply the Administration of SEZ with a certificate of state registration, a copy of its bylaws, as well as documents containing the necessary information about the goals and purposes of investment projects planned for realization on the territory of the special economic zone, as well as information on the procedure for their implementation, and other necessary data.

A legal entity registered on the territory of an industrial-production zone and aspiring to acquire the status of resident of this zone, shall supply the Administration of SEZ with the named documents within ten days from the time of state registration.

Upon review of the documentation submitted by the legal entity established on the territory of the SEZ, the Administration of SEZ shall make one of the following decisions:
to approve the investment project and conclude an investment agreement; or

to decline approval of the investment project.

The list of documents that must be submitted to the Administration of SEZ for its review, as well as the procedure for their submission and the timeline for the review of investment projects, shall be determined by the Government of the Russian Federation.

3. Within one month of the decision to approve the investment project the Administration of SEZ shall sign an investment agreement with the legal entity registered on the territory of the SEZ.

4. The amount of assets proposed by the investment project to be invested on the territory of industrial-production zone (exclusive of non-material assets) must exceed the sum in rubles equivalent to 10 (ten) million euro, as calculated based on the exchange rate of the Central Bank of the Russian Federation on the day of concluding the investment agreement with the Administration of SEZ.

A legal entity aspiring to acquire the status of resident of industrial-production zone may not be established through re-organization of an existing legal entity or several existing legal entities.

5. The Head of Administration of SEZ makes a decision to recognize a legal entity registered on the territory of SEZ as a resident of special economic zone based on the presence of an investment agreement between the Administration of SEZ and the legal entity.

The decision to recognize a legal entity as a resident of special economic zone shall be made by the Head of Administration of SEZ within ten days from the time of the signing and entry into force of the investment agreement.

The Administration of SEZ shall record the recognition of a legal entity as a resident of the SEZ in the special register within three days from the decision to recognize the legal entity as a resident of special economic zone by the Head of Administration of SES [sic]. Legal entity recognized as a resident of SEZ shall receive a certificate of residency from the Administration of SEZ. The form of the certificate shall be determined by the Administration of SEZ.

A legal entity recognized as a resident of SEZ acquires the status of resident of special economic zone at the time of issuance of certificate of residency in the SEZ.

6. Administration of SEZ shall report the information on recognition or annulment of recognition as a resident of SEZ to the tax authority within three days.
7. The resident of the SEZ acquires the rights and duties necessary only for the entrepreneurial and (or) investment activities on the territory of SEZ in accordance with the goals and purposes of the SEZ and requirements of the present Federal law.
8. The resident of the SEZ may not:
   - act as a founder (participant) of entities, including residents of the SEZ;
   - be a part of the governing organs of entities, including residents of the SEZ;
   - have separate subdivisions outside the territory of the SEZ.

**Article 14. Limitations on certain types of entrepreneurial activity**

1. The territory of the SEZ may not contain objects or enterprises of the national defense character, extractive, energy, iron ore and mineral mining industries, or serve for production of dual use goods subject to excise tax (except for passenger cars and motorcycles), arms or military equipment.
2. Residents of industrial production zones may not engage in activity other than that included in the investment project.
3. The activity of residents of technological-implementation zones must be consistent with the specialization of the higher education institutions and (or) scientific-research institutes referred to in section 2 of Article 7 of the present Federal law.

**Article 15. Activity of state inspection organs on the territory of special economic zone**

1. State inspection organs may conduct inspections of the residents of the SEZ in accordance with the Federal law “On protection of the rights of legal entities and individual entrepreneurs during state inspections,” and in accordance with the provisions of this article.
2. Inspections, other than customs and tax inspections conducted by the officials of customs and tax authorities of the Russian Federation, may be conducted only as comprehensive inspections.

Comprehensive inspections provided for by this article are conducted upon decision of Administration of SEZ with participation of inspection organs authorized to inspect the activity of residents on the territory of the SEZ.

Comprehensive inspections shall be conducted at least once every three years, and may last no longer than two weeks, except for the
circumstances provided for in section 3 of this article and in the Customs Code of the Russian Federation.

3. In the event of a finding in the course of a comprehensive inspection conducted by state inspection officials of violations of the laws of the Russian Federation and requirements established on the territory of the SEZ for residents of the SEZ, the violator shall be subjected to an additional inspection, the subject matter of which will be ensuring compliance with instructions to correct the violations.

4. Upon the finding, based on the additional inspection, that a resident of the SEZ failed to comply with instructions to correct the violations within two months, the Administration of SEZ shall annul the recognition of the status of resident of the SEZ.

5. During a comprehensive inspection, the resident of the SEZ has a right to:

- be present during the inspection and provide explanations regarding the subject matter of inspection;
- receive information, disclosure of which is provided for by the regulatory acts of the Russian Federation;
- review the results of the inspection and note in the inspection report the fact of its review, agreement or disagreement with the report, as well as agreement or disagreement with the particular actions of state inspection officials;
- appeal the actions (or inactions) of the state inspections officials through administrative and (or) judicial channels in accordance with the laws of the Russian Federation.

6. The rights and responsibilities of tax and customs organs of the Russian Federation conducting tax and (or) customs inspections on the territory of the SEZ are prescribed by the laws of the Russian Federation.

The rights and liabilities of the residents of the SEZ during tax and (or) customs inspections are prescribed by the tax and customs laws of the Russian Federation.

Article 16. The procedure for expert review of project documentation

1. Documents required for expert review of investment project documentation shall be submitted to the Administration of SEZ.

2. Administration of SEZ shall set up the procedure for expert review of project documentation in accordance with the laws of the Russian Federation and special requirements of this article.
3. The scope of the expert review shall be limited to evaluation of project decisions touching upon the safety of life and health of people, safety of erected buildings, other structures and constructions, and the consistency of project decisions with the established construction standards.

4. The expert review of project documentation for investments projects proposed for implementation on the territory of SEZ shall be conducted in no more than 60 days for full expert review of project documentation, and no more than 30 days for partial expert review of project documentation.

5. Expert review of project documentation provided for in section 3 of this article shall be conducted by state expert organs and shall be concluded by a resolution in the form of an expert opinion.

Article 17. The regime of land use in special economic zone

1. Administration of SEZ exercises authority over land allotted to the SEZ in accordance with the laws of the Russian Federation and the provisions of the present Federal law.

2. Residents of an SEZ that erect real estate objects on leased land in accordance with the terms of the investment projects within the SEZ, may, upon registration of their rights by recording them in the Unified state register and receiving a certificate of registration, buy out the leased land plots at the market rate in the order established by the Land Code of the Russian Federation.

3. The order and procedure for control of land use and real estate objects by the Administration of SEZ is determined by the Government of the Russian Federation in accordance with the laws of the Russian Federation.

Article 18. Customs regulation in special economic zones

1. Residents of the SEZ may employ any of the customs regimes provided for by the customs laws of the Russian Federation if otherwise not provided for by this article.

2. Customs regime on the territory of the SEZ is free customs zone established in accordance with the proclaimed goals and purposes of the SEZ at the time of the decision of the Government of the Russian Federation to create the SEZ.

3. For the purposes of the present article, a free customs zone is a customs regime established within the territorial limits of the special
economic zone, in which imported foreign goods may be brought in and used within the appropriate territorial limits or structures (places) without the payment of customs duties, taxes, and without any limitations or restrictions of economic character established by the laws of the Russian Federation on state control of international commerce while Russian goods are brought in and used on conditions of the customs export regime, defined by the customs laws of the Russian Federation.

4. Any goods, other than goods prohibited from import and export from the customs territory of the Russian Federation due to the considerations of national defense, internal security, morality, life and health of the people, protection of animal and plant species, protection of the environment, and protection of intellectual property, may be placed under the customs regime of free customs zone.

Customs authorities of the Russian Federation may not require payment of customs duties or taxes at the time of placement of goods on the territory of the special economic zone.

Goods required for ensuring the achievement of the purposes of a special economic zone, such as technological equipment, goods intended for construction and equipment of buildings, structures, and constructions included in the list established by the Government of the Russian Federation at the time of decision to create the SEZ, may be brought in the special economic zone under the free customs zone regime.

Goods with the potential to harm other goods or requiring special storage conditions, must be stored in specially modified premises.

Goods previously placed under different customs regimes may be placed under the free customs zone regime.

5. Goods placed under the free customs zone regime may be subjected to the following operations:
   1) safety and security procedures;
   2) preparation of goods for sale or transportation, such as separation into groups, shipping preparation, sorting, packaging, repackaging, marking, as well as basic assembly that does not alter the characteristics (quality) of goods;
   3) processing;
   4) tuning and testing of technological equipment and products; and
   5) elimination of industrial waste, if it is economically unfeasible to place it under another customs regime.

Goods placed under the customs regime of free customs zone may be sold, or title to them may be transferred otherwise, except for retail sales.
The Government of the Russian Federation may determine the procedure for limits and restrictions on specific operations with goods placed under the customs regime of free customs zone.

In the event of violation of the present Federal law, customs authorities of the Russian Federation may prohibit residents of the special economic zone from engaging in operations with goods.

6. Upon request of an interested party, customs authority of the Russian Federation shall confirm the origin of goods with a certificate of origin on the territory of the appropriate special economic zones according to the procedure determined by the Government of the Russian Federation.

In the absence of the certificate of origin, the goods shall be regarded as Russian-made for the purposes of collection of customs duties and application of economic policy at export, and otherwise as foreign-made.

Limits and restrictions of economic character imposed in accordance with the laws of the Russian Federation on state regulation of international commerce shall be applied based on the origin of goods as well as the applicable customs regime.

The criteria for establishing the special economic zone as the place of origin shall be determined by the Government of the Russian Federation at the time of decision to create the special economic zone.

7. Goods placed under the customs regime of free customs zone may remain on the territory of the special economic zone without a time limit throughout the duration of the special economic zone.

8. Residents of a special economic zone shall maintain records of goods placed under the customs regime of free customs zone, including records on export and import, storage, production, processing, acquisition and sale of goods and shall report to the customs authority of the Russian Federation on the status of goods according to the procedure determined by the State Customs Committee of the Russian Federation. Any changes to the goods within the special economic zone must be reflected in the records.

9. Goods remaining on the territory of the special economic zone at the time of termination of the status of special economic zone shall be transferred to another special economic zone, or placed under a different customs regime within three months. As used here, goods for customs purposes are considered to be goods remaining in a temporary storage warehouse.

Objects of infrastructure found on the territory of the special economic zone at the time of termination of its status the construction of which required materials for which the customs authority assessed but did
not require the payment of customs duties, shall remain in possession of their respective owners without payment of the duties.

10. Special requirements for construction, provision and material-technological equipment of the special economic zone, including requirements necessitated by the needs of appropriate customs control, shall be determined by the Government of the Russian Federation at the time of creation of the special economic zone.

11. Import of goods into the territory of the special economic zone and their export from the territory of the special economic zone may take place only upon authorization of the customs authority of the Russian Federation on the condition of compliance with the requirements of the appropriate customs regime and requirements provided for by this Federal law and other legislative acts of the Russian Federation. Customs authority of the Russian Federation may at any time conduct customs inspection of goods placed in the special economic zone, in accordance with the appropriate customs regime.

Conditions for customs inspection of goods brought in, stored, or taken out of the SEZ shall be determined by the State Customs Committee of the Russian Federation.

Access of persons onto the territory of the special economic zone shall take place in accordance with the procedure established with the participation of the customs authority of the Russian Federation.

The customs authority of the Russian Federation may deny access onto the territory of the special economic zone to persons who violate the provisions of the present Federal law.

**Article 19. Taxation of residents of special economic zone**

1. A special procedure for assessment and payment of income and property taxes shall be applied to residents of the SEZ in accordance with the laws of Russian Federation on taxes and collections. The procedure for assessment of taxes and the time frames for their payment shall be determined by the laws of the Russian Federation on taxes and collections.

The above-mentioned procedure for taxation is applied to residents of SEZ in accordance with limitations established by the present Federal law and the Tax Code of the Russian Federation.

2. Entities that operate on the territory of the SEZ but do not have the status of resident of SEZ shall pay taxes and collections in accordance with the general procedure established by the laws of the Russian Federation on taxes and collections.
Article 20. Guarantee of legal protection of investors in special economic zone

1. Investors may conduct investment activities on the territory of SEZ in any form not prohibited by the laws of the Russian Federation.

   Investors are entitled to full and unconditional protection of their rights and interests provided for by this Federal law, other federal laws or regulatory acts of the Russian Federation, as well as international agreements of the Russian Federation.

2. Goods, materials, parts or other products, including industrial goods, brought onto the territory of the SEZ for entrepreneurial activity as part of an investment project shall not be alienated.

3. The investor is entitled to compensation of losses suffered as a result of illegal actions (failures to act) of the state organs, organs of local self-governance, governing organs of the SEZ or officials of these organs, as well as a result of inadequate performance of their duties in accordance with the laws of the Russian Federation by these organs or officials.

Article 21. The guarantee of compensation in the event of nationalization and requisition of the property of investor.

1. Property of an investor shall not be alienated, including by nationalization or requisition, except in the circumstances and upon the basis determined by federal law or international agreements of the Russian Federation.

2. In the event of requisition the investor shall receive market value of the requisitioned property. In the event that the circumstances which triggered the requisition cease to exist, the investor may request the return of remaining property through judicial channels, but shall remit the compensation received for this property, minus the losses caused by devaluation of property.

   In the event of nationalization the investor receives the value of nationalized property as well as other losses.

3. Disputes regarding compensation of losses shall be resolved in accordance with the procedure established by the laws of the Russian Federation.

Article 22. Guaranty of adverse change in laws of the Russian Federation for investor in a special economic zone
1. Federal laws and other regulations of the Russian Federation adversely affecting the legal and (or) economic situation of the residents of the SEZ in comparison to their situation before the adoption of such laws or regulations, shall not be applied during the duration of the status of SEZ.

2. The provisions of section 1 of this article shall not apply to changes and amendments introduced to the legislative acts of the Russian Federation, or new federal laws or other regulatory acts of the Russian Federation in the interests of protection of the constitutional system, morality, health, and the rights of other persons, as well as national defense and security.

CHAPTER 5. FINAL PROVISIONS

Article 23. Status of existing special economic zones

From the time of entry into force of this law, the term of special economic zones created prior to the adoption of the present Federal law shall expire, except for the circumstances provided for by other Federal laws.

Article 24. Scope of application of the present Federal law

This federal law does not apply to creation and functioning of recreation zones on the territory of the Russian Federation.

Article 25. Entry into force of the present Federal law

This federal law shall enter into force after one month after its official publication.

The President of the Russian Federation.
APPENDIX B – Tax Code Amendments

RUSSIAN FEDERATION
FEDERAL LAW


“Article 288.1. Special taxation of residents of special economic zones.

1. This article establishes special taxation of organizations possessing the status of resident of special economic zone (hereinafter—“Resident of SEZ”) and engaging in investment and entrepreneurial activity in accordance with the requirements of the Federal law “On special economic zones in the Russian Federation.”

2. Residents of SEZ shall maintain separate records of revenues and expenses attributable to the income discussed in section 3 of this article and to the income subject to profit taxation according to the rates of article 284 of the Code.

3. The tax rates indicated in section 4 of this article shall apply to the income defined as the monetary expression of revenue received from the sale of goods produced on the territory of the SEZ, decreased by the expenses associated with the production and (or) the sale of these goods.

Taxable income for taxation of profits obtained from the sale of goods produced on the territory of the SEZ shall be determined separately for each investment project in accordance with the procedure established by this chapter of the Tax Code.

4. Income defined by section 3 of this article shall be taxed as follows:

1) during the breakeven period of the investment project, but not longer than three tax years from the beginning of investment project – 0 percent;

2) during the fourth to seventh tax years from the beginning of the investment project, with investment of 80 or more percent of profits received by the resident of SEZ in accordance with accounting rules into expansion of its own
production facilities—3.75 percent. In this case the sum assessed at the tax rate of 3.75 percent is directed toward the federal budget;

3) during the fourth to seventh tax years from the beginning of the investment project, with investment of up to 80 percent of profits received by the resident of SEZ in accordance with accounting rules into expansion of its own production facilities—12 percent.

   In this case:

3.75 percent of the assessed tax is directed into federal budget;
7.25 percent of the tax is directed into the budgets of subjects of the Russian Federation;
1 percent of the tax is directed into the local budgets;

4) beginning with eighth tax year from the beginning of the investment project the applicable tax rate is determined by section 1 of article 284 of this Code.

   For the purposes of this article, the beginning of investment project is the time of receipt by the resident of the SEZ of a certificate of residency in accordance with the Federal law “On special economic zones in the Russian Federation.”

   Expansion of its own production facilities implies investment in general facilities.

5. Profits obtained by residents of SEZ not included in the income defined in section 3 are subject to taxation at the rate provided for by article 284 of the Code.


“y) organizations possessing the status of residents of special economic zones in accordance with Federal law “On special economic zones in the Russian Federation,” with respect to the real property located on the territory of SEZ, as well as certain other property.”
Article 3. This Federal law shall enter into force on January 1, 2004.

President of the Russian Federation.