

# **The Influence of a Special Legal Regime for Entrepreneurial Businesses on Economy of the Russian Far East**

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**Abstract.** The rise of the Far East is a national priority for the entire XXI century. To develop enabling environment for doing business and attracting investments, the free economic zones with a special legal regime for entrepreneurial business – the territories of advanced social and economic development and the Free Port of Vladivostok have been established. By using empirical, theoretical and quantitative research methods, the author reflects on the pivot and preliminary results of the ongoing transformations of the legal regime for the entrepreneurship of the free economic zones within the framework of the institutional economics. The article gives an assessment of the quality characteristics of the “addressee” of the institutions analysed and shapes the average resident profile. The author makes a finding of signs of the positive impact of the free economic zones on the economic processes of the Far Eastern macro-region. The author’s point of view bases on the results of a quantitative assessment of such economic indicators as the volume and structure of consolidated budgets, tax revenues, direct investments and gross regional product. The author pays attention to the change in the structure of the consolidated budgets towards increasing the share of tax revenues and “investment breakthrough” of the macro-region entities. This is an evidence of the revitalization of economic agents and increase in the region’s investment attractiveness and, may indicate an increase in the efficiency of protecting property rights and enforcing contracts as the key incentives for private investors.

## **1. Introduction**

In the last decade, the State gives high priority to enhancing the social and economic development of the Far East. For that purpose, the projects designed to reduce entrepreneurs transaction costs and to promote investments and growth of business activities, namely the special legal regimes for entrepreneurial business – the territories of advanced social and economic development (the ADTs) and the Free Port of Vladivostok (VFP) are being elaborated and implemented.

In the few years of its existence, the controversial evaluations were given to the ADTs and VFP: from the statements of high efficiency which stems from the feedback of the government agencies and their affiliated structures [5; 6; 23; 25; etc.], to the denial of their beneficial effects on the economy of the region and the country as a whole. On the margins of the annual Eastern Economic Forum [26], there is a talk of “the increasing interest and commitment of the business community to develop entrepreneurial business in the Far East.” The opposite expert assessment of “practical results” given by specialists is voiced in the periodical press [1; 9; 12; 13; 15; 24; etc.].

It is difficult to provide and evaluate the efficiency of the ADTs and FPV from all the parties concerned, while the inefficiency can be left without attention due to the imperfect accounting procedures. There is also a high probability of political interference in the evaluation procedures. The approaches to the performance evaluation used by the Ministry for Development of Russian Far East and the managing company, which are shown to the public in the form of infographics and annual records / reports, reflect the dynamics of indicators used for analysing selected quantitative characteristics. These indicators are helpful in measuring only the effectiveness of one party concerned, which is acting as “a duty-bearer for adherence to legislation” and responsible for the efficient use of budgetary funds. They do not allow to measure fully the achievements against the objectives of the ADTs and VFP creation as the institutions designed to enable the development of social and economic processes.

The issue of the impact that the special legal regimes for entrepreneurial business have on the economy of the region deserves a systematic and methodical study. The search for an answer to this question attracts more and more researchers. There has been scientific discussions on the approaches to assessing the performance of special (free) economic zones, including the ADT and VFP [4; 11; 17; 20; 21; etc.].

From the publications on this topic, the monograph “Special economic zones as incentives to promote regional development” [10] is noteworthy. The authors base their approach on regression analysis with a dummy variable and assume that by using the following variables, it could possibly build up a more detailed picture of the development of a special economic zone and give it a qualitative and quantitative characteristics: Gross regional product per capita (rub); Fixed capital investment per capita (rub); percentage of an unemployment rate; average per capita monthly money income (rub); Collection of taxes, Fees and other compulsory financial charges to the budget of the Russian Federation (mln rub); consumer price index (percent); industrial production index (percent); retail trade turnover per capita (rub); volume of paid services rendered to the population (mln rub); Number of organizations performing research and development; Number of personnel engaged in research and development; Foreign investment income (mln dollars).

The special attention is focused on the complex approach which is described by a group of scholars in the two-volume publication “Special Economic Zones” [14]. The authors have summarized the approaches for assessing efficiency of special economic zones, grouped the effects in four groups and presented them in the form of quantifiable indicators. “... The economic impact reveals itself through the indicators of economic development of the territories and the financial and economic indicators of the residents’ activities. The social impact reflects the social consequences of the SEZs functioning. The fiscal impact results from the effect of tax and customs privileges granted to residents on generating revenues for the budget. The size of the fiscal impact directly depends not only on the budget expenditures of all levels, but also on the estimated amount of additional revenues to budgets of different levels related to the SEZs functioning. The infrastructure impact reflects the level of the development and reliability of the territory infrastructure” [14, P. 312].

Despite the differences in methods, nevertheless, all researchers share the point of view about the failure to assess SEZs in isolation from the regional social and economic processes.

We are on the same view and call attention to the relatively short period of existence of the special legal regimes – the ADTs and VFP. On one hand, no serious empirical basis has been established to make the judgments about their efficiency or inefficiency. On the other hand, it is long enough to understand the focus and preliminary results of the ongoing transformations. In this regard, the article highlights the attempt to identify and analyse the preliminary results of influence that the ADTs and VFP – the special legal business regimes have on economic processes in the Far Eastern Federal District, as well as to reveal trends in their development. The hypothesis proposes that there is evidence of the beneficial effect of special legal entrepreneurial business regimes on economic processes of the Far Eastern macro-region.

## 2. Methods

Since the special legal regimes for entrepreneurial business – ADTs and VFP are the elements of the system of regulatory impact on the economic processes of the macro-region, the economic and legal approaches to their analysis are promising. The paradigm, in the course of which it is possible and necessary to study these processes, is “institutional economics” [2] – the economic and legal doctrine which focuses on analysing economic processes from the perspective of regulatory systems and their elements which organise the interaction of economic agents, society and the state. The article highlights that all the elements of the logical model required for defining the ADTs and VFP as the institutions can be found, thus making it possible to analyse the patterns of their functioning and the efficiencies of their development within the framework of institutional economics. Special attention is also given to the dependence of the efficiency of institution on the quality of its components.

Theoretical and quantitative research methods allow to evaluate the attributes that characterise the structure of the “addressee” and shape an average resident profile, as well as to analyse the medium-term impact that the special legal regimes for entrepreneurial business have on the macro-region economy. The efficiency of the institutions and their focus on the economic system development and support received from the State are described by the example of such an indicator as “balance of the tax burden of economic agents”, as well as on the results of assessment of economic indicators.

The following databases provide the empirical framework for research: the Unified State Register of Legal Entities and Individual Entrepreneurs, statistics of the Bank of Russia and interdepartmental databases – the Unified Portal of the Budget System of the Russian Federation “Electronic Budget”, the Federal State Statistics Service. The empirical model includes the information on the ADTs and VFP residents and the constituent entities of the Far Eastern Federal District for 2013–2017. The data on volume and structure of consolidated budgets, as well as the data on tax revenues, direct investments and gross regional product are used as economic indicators.

## 3. Results

### 3.1. The elements of the logical institution model of the ADTs and VFP

Before the toolkit of evaluating the performance proposed by the institutional economics is applied, let us turn to the logical institution model. What do we know about the ADTs and VFP as the institutions and their elements?

The ADTs and VFP include all the elements of the logical institution model, in the sense, that is embedded in this category by the institutional economics.

The “situation under the rule” created by the state is evident: “for the progressive and integrated development of the whole region”, the state “launched here a number of mechanisms to stimulate business activities, including preferential tax treatment and administrative regimes”, as well as, within the framework of the ADTs and VFP, “offered investors suitable financial instruments and development of infrastructure, energy, communications and transport” [27]. Residents are the “addressees” whom the benefits, the preferences and the rules are exclusively available for. “Requirements” and “sanctions for non-compliance” for them are formulated primarily in federal laws [18; 19], and in the Performance Agreement. The “the duty-bearers for adherence to legislation” are the management company, the Ministry of the Development of Far East and the state supervisory authorities in tax, customs and other areas. Consequently, the ADTs and VFP, as special legal regimes for entrepreneurial business, have all the characteristics of institutions, which make it possible to analyze the patterns of their functioning and development within the framework of institutional economic theory.

The efficiency of institutions is closely related to the qualification status of its constituent elements. The study of information from the Unified State Register of Legal Entities and Individual Entrepreneurs makes it possible to evaluate the qualification status of “an addressee” of the ADT and VFP, as well as to form an average resident profile. It turned out that a resident of these special legal business regimes is a legal entity established by legal entities and / or individuals of the Far Eastern

Federal District, registered in the Primorsky Krai under the legal form of a limited liability company (under the laws of Russian Federation) and has an authorized capital of about 10,000 rubles. The largest amount of direct investments to residents is affiliated with the state (Russian) capital and / or domestic holding structures. The ADT residents have received the major flows of foreign direct investments, and Japanese companies are the primary foreign investor. The largest number of residents, who have foreign founders, have been created by investors from the People's Republic of China.

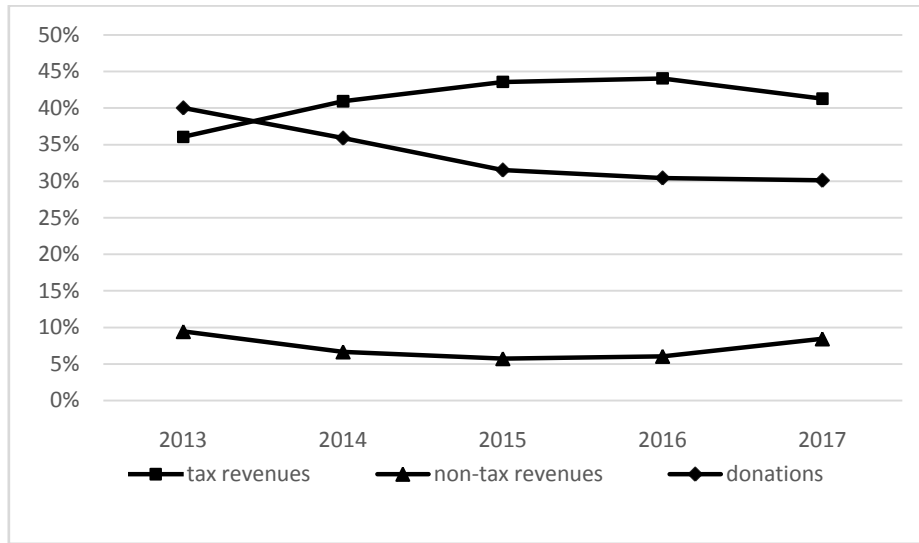
Such a qualification status of the profile may indicate the desire of residents to minimize the risks of losses associated with the possibility of foreclosure on the property owned by participants of resident companies, as well as domestic investors' greater interest in the development of special legal regimes for entrepreneurial business in the Far East of Russia. A limited liability company (company under the RF laws) is a "product of collective imagination", perceived as "... a legal entity...", "... [the company] is separated from the people who has founded it, and from those who has invested money in it or managed it. ... Over the past centuries, such companies have become leaders in the economy ... " [8, C. 40]. As for investments, a number of researchers note that no one powerful state has come to its power at the expense of foreign investors. For example, according to the Chinese economists Guan Xuelin and Zhang Meng "... as the global practice shows that there are no examples of developing countries which by involving foreign capital ..., have gained the status of a high income country", without falling into the "middle income trap"[7, p. 129]. The French economist Thomas Piketty's monumental study also shows that in human history "... there is nothing to indicate that catching up is provided primarily by the investments that rich countries make to the poor. Rather, the opposite: ... investments ... at home look more promising. ..." [22, P. 87].

### *3.2. The ADTs and VFP tax burden and the structure of consolidated budget of the Far Eastern Federal District constituent entities*

Is it possible to speak about the ADTs and VFP as inclusive institutions, or have they transformed into extractive ones and do not enable economic development? The main focus of the ADTs and VFP institutions is on the creation of a favorable system of taxation of business transactions and property of residents. From the institutional economics perspective, if the functioning of institutions shows the positive impact according to the taxation indicator, this will serve the evidence of their effectiveness. Let us look more closely at the results of applying tax benefits to the ADTs and VFP residents, which provide tax reduction by 3.5 and 2.8 times of total Russian taxation, respectively.

One of the objectives of implementing the ADTs and VFP projects is focus on making up regional and local budgets of the constituent entities of the Russian Federation and the municipalities of the Far Eastern Federal District from tax revenues. The analysis of information on the tax authority of a resident received from the Unified State Register of Legal Entities and Individual Entrepreneurs makes it possible to figure out the recipients of its future tax payments as a taxpayer – which regions will receive tax deductions from investment projects implemented by the ADTs and VFP residents. The study has shown that this task has been carried out until recently. There are 100% of residents registered in the constituent entities of the Russian Federation where the corresponding territories with special regimes for entrepreneurial business have been created. Since 2017, legal entities with the taxpayer code of other Russian regions have started to acquire resident status.

The figure 1 shows average tax and non-tax revenues, as well as gratuitous receipts to a consolidated budget of a subject of the Far Eastern Federal District for 2013-2017. These indicators make it possible to compare how the revenue part of the regional budgets had been formed before the ADTs and VFP were created; what has become and, probably, it can predict what will happen.



**Figure 1.** Dynamics of an average consolidated budget of a constituent entity of the Far Eastern Federal District, RF, percentage.

According to the Unified Portal of the Budget System of the Russian Federation “Electronic Budget”, the structure of an average consolidated budget of the Russian Far East subject has been improving for the period under study. The share of tax revenues has increased by 5%, while non-tax revenues have decreased by 10%. The dynamics like this contributes to increase in accountability of regional authorities to local population and reduction of dependence on government subsidies, grants and subventions. However, the study has revealed that this economic growth has been under way before the ADTs and VFP were implemented.

The initial increase in tax revenues is mainly due to corporate income tax. However, with the development of new institutions, the indicators have slowed down by 2016 and further decreased. On the contrary, the share of personal income tax has showed a slow, but stable, positive trend. This source of tax revenues in the structure of consolidated budget ranks first in the Amur Region, the Kamchatka Territory, the Primorye Territory, the Khabarovsk Territory and the Jewish Autonomous Region.

Since 2015-2016, in the context of certain constituent entities of the Russian Federation, there has been a tendency of growth in the share of non-tax revenues, in which government subsidies, grants and subventions from other budgets play the main role. It is interesting that the authors of the work [16] interpret this source as “compensation for the deficit of endogenous investments due to the redistribution of public resources ...”. The revenues are growing from fines, sanctions and payments for damage. The dynamics of this indicator can be affected by both revitalization of the “duty-bearer for adherence to legislation” and increase in opportunism among residents and other legal entities – misconduct of economic agents.

Thus, on the whole, the creation of new institutions has influenced the structure of the consolidated budgets of the constituent entities of the Far Eastern Federal District in terms of tax revenues, particularly adversely affecting the amount of income from corporate taxation and positively affecting tax revenues from personal income taxation. The increase in share of tax revenues is mainly provided by the northern constituent entities of the Far East and it turned out to be sufficient to compensate for reduction in share of gratuitous receipts from other budgets of the Russian Federation budget system. Whether the reduction of federal subsidies is an all-Russian tendency or the specific to the Far Eastern Federal District is the subject of additional research. But already now, there are the authors of other studies [28, p. 31] who confirm the greater effectiveness of the development of the Sakhalin Region and the Republic of Sakha (Yakutia), attributing the sustainable management to the “specialization of the northern constituent entities in commodity” and the “substantial reduction in the population”.

3.3. The macro-region investment attractiveness

For the growth of the institutional environment, institutional economics notes the importance primarily the level of protection of property rights and securing contracts. Let us keep the focus on the study of variables that assess the investment attractiveness of a country and a region, since it is known that if property rights and contracts are not secured, then economic agents will lose their incentives to invest, introduce technologies, etc. On the contrary, redistribution becomes more attractive than productive actions. In compliance with the methodology of the Bank of Russia, the data for 2013-2017 on liabilities of direct investment enterprises – residents to their direct investors, direct investors – residents to direct investment enterprises and liabilities of resident enterprises to non-residents enterprises, which are in the relationships of direct investment, are set out in Figure 2 [3, p. 270].

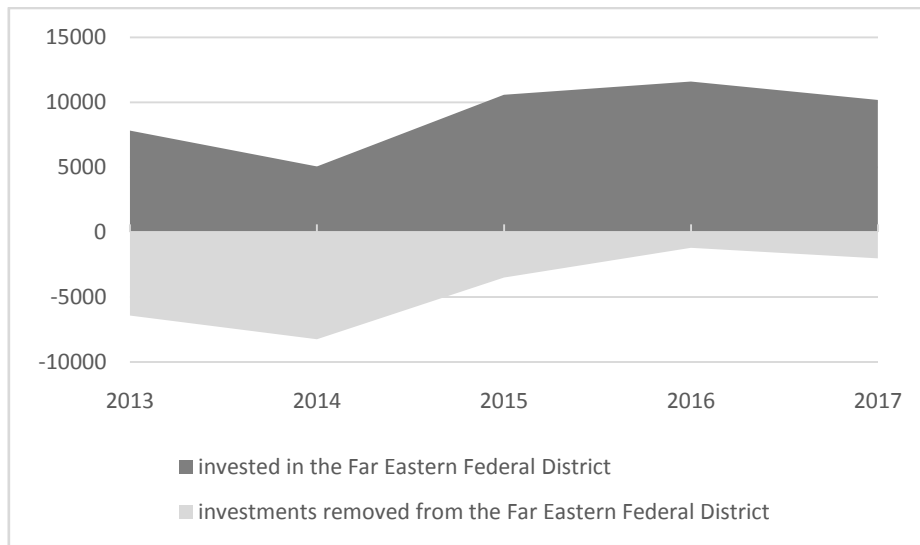


Figure 2. Dynamics of direct investment, the Far Eastern Federal District, mln USD.

What has changed with the direct investments of the constituent entities of the Far Eastern Federal District with the ADTs and VFP creation? The data allows us to talk about the intensification of economic agents and the growth of the investment attractiveness of the macro-region. The Far Eastern Federal District surplus has increased by 5.86 times (in 2017 compared to 2013) and reached 28.4% in direct investments in the country (in 2013 – 2.1%). Such dynamics has been called “the investment breakthrough of the regions of the Far Eastern Federal District” [26].

The breakthrough is mainly due to a significant increase in direct investment in the Sakhalin Region, the Sakha Republic (Yakutia) and the Primorsky Territory. The great share of investment came from Bermuda and the Commonwealth of the Bahamas investing in mining of Sakhalin. The significant amount came from Western Europe investing in mining of Yakutia, and the transportation and storage of Primorsky Territory was invested by the Republic of Cyprus. These are mostly fixed investment in the legal entities.

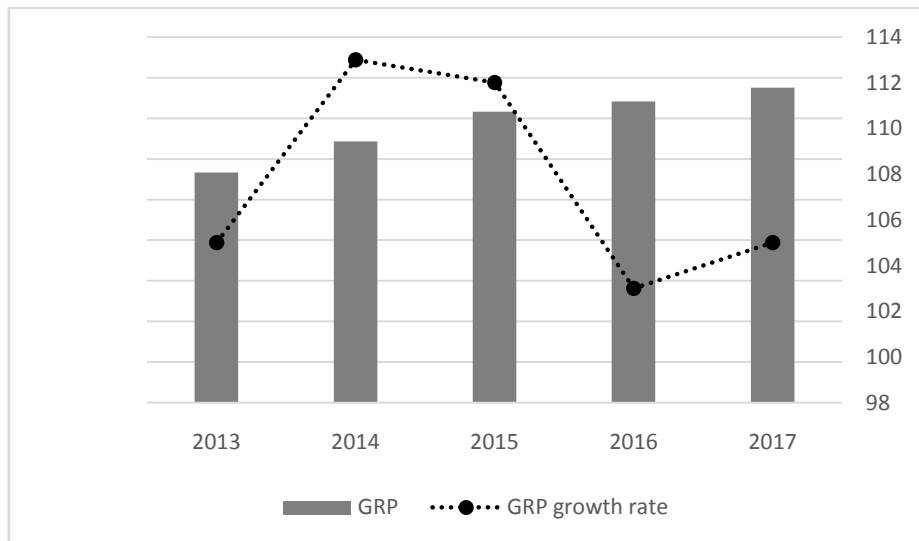
The volume of direct investment abroad is on a declining trend. Nevertheless, it should be taken into account that, for example, with respect to the consolidated budget of the region, the volume of direct investment from the Primorsky Territory in the Republic of Cyprus (1006.0 million dollars as of 01/01/2018) is commensurate with half of the regional consolidated budget (123, 8 billion rubles in 2017) or several budgets of the city of Vladivostok – the capital of the Far Eastern Federal District. At the same time, the investment leader of the macro-region in foreign countries is the Sakhalin Region (5426.4 million dollars). Along with the Republic of Cyprus, the Commonwealth of the Bahamas and Southern Europe are the most polar areas of direct investment abroad.

Thus, there are two main trends that, at first sight, indicate an increase in the effectiveness of protecting property rights and securing contracts as the key incentives for private investors. The direct

investment in the regions coming from offshore zones, which operates today as the “foreign capital” of Russia, continues to increase. The declining capital outflows indicate a revitalization of economic agents and an increase in the region’s investment attractiveness. However, a radical transformation of the sources of direct investment has not happen. The countries – the main foreign trade partners of the macro-region have low investment activity in the regions of the Far East of Russia. The most attractive constituent entity for investment is not the Primorsky Territory, but the Sakhalin Region, the entity where since 2015, a share of tax revenues on an organization’s profit has greatly declined.

3.4. Well-being of the Region

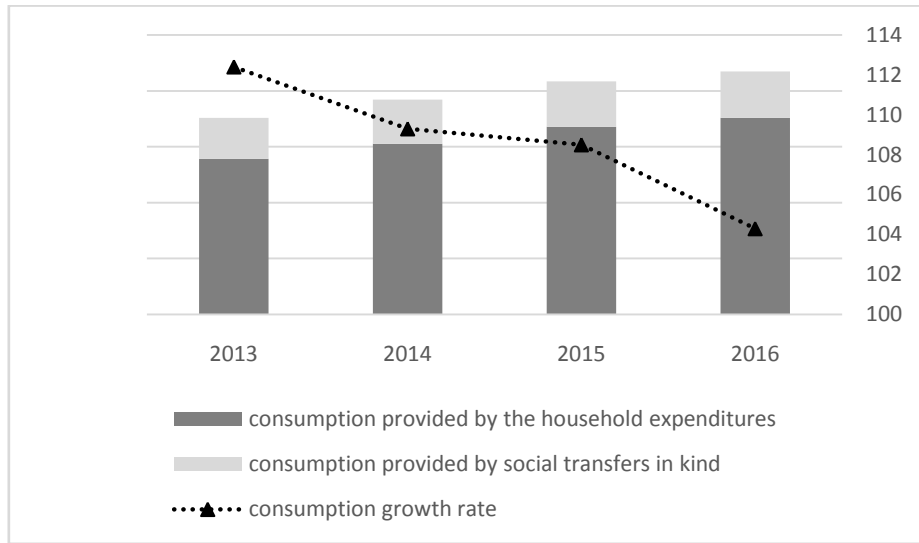
Such a general indicator of the development of a region as gross regional product may also reflect the influence of special legal regimes for entrepreneurial business on the economy of the Russian Far East. First of all, we study the growth rate of this variable (see Fig. 3). Gross regional product per capita is not considered because of its inaccuracy due to the demographic characteristics of the macro-region. Since the population of the region is constantly decreasing, the domestic regional product per capita is growing regardless of its volume.



**Figure 3.** Dynamics of GRP volume and growth rate in the Far Eastern Federal District, mln rub and percentage

Let us turn our attention to the fact that, according to calculations based on official data from the Federal State Statistics Service, the gross regional product in absolute values is on a stable positive trend and shows an increase by 36.9% in 2017 to 2013, in contrast to its growth rates. The chain growth rate of gross regional product of the Far Eastern macro-region is positive, but not evenly distributed, and is decreasing, balancing the last two years by about 4-5%. Although the gross regional product is the gross value added created by residents of the region, it might be assumed that it turned out not to be sensitive to the influence of the ADTs and VFP institutions. This may be the result of peculiarities of the method for its calculation, which does not take into account the activity that is actually implemented in the region and therefore reflects in other regional indicators (employment, household income, consumer spending, land use, etc.)

In order to understand the real situation, it is necessary to compare the gross regional product with the indicator of “actual final consumption”, the dynamics of which is shown in Figure 4. Its analysis is also useful for studying the level of well-being of the population.



**Figure 4.** Dynamics of actual final consumption of households in the Far Eastern Federal District, mln rub.

The official data from the Federal State Statistics Service indicate an increase in the absolute volume and a decrease in the growth rate of final consumption of goods and services in the macro-region. Households consume products and services from their own income. Consumption of individual non-market health care services, education, culture, etc., which the state and non-profit organizations provide to households as social transfers in kind, remains stable.

**4. Conclusion**

To sum up, the results of the analysis of economic indicators with a view to identifying the impact of special legal regimes for entrepreneurial business on the economy of the Far East has revealed a number of trends: (1) the structure of the consolidated budget of the subject of the Far Eastern macro-region has improved independently of new institutions performance; (2) the flow of investments has mainly provided by the Sakhalin Oblast and is directed towards mining; (3) the Gross regional product should be estimated together with the indicator of “actual final consumption”.

Anyway, the encouraging initiatives of the tax and budget systems, as well as the “investment breakthrough” of the macro-region’s constituent entities may indicate the economic agents’ revitalisation and the enhancement of the region investment attractiveness, as well as the beneficial effects of the ADTs and VFP institutions on the economic processes of the Far Eastern macro-region. We know that from the institutional economics perspective, the change in the structure of the consolidated budgets of the Far Eastern Federal District towards increasing the share of tax revenues as compared to other types of revenues that form the budget revenues has resulted in positive social and political consequences. On the other hand, the “foreign capital” repatriation of Russian business and the reduction in direct investment abroad may indicate an increase in the efficiency of protecting property rights and enforcing contracts as the key incentives for private investors. These areas should be further improved.

To enhance the influence of the ADTs and VFP institutions, it is necessary to carry out a thorough legal study of proposals for their improvement, and also to grant not just tax and customs privileges to residents, but to make the following amendments to the federal laws:

- regulations establishing a special regime of implementing and protecting the title to the facilities of the ADTs and VFP production infrastructure, owned by residents;
- rules on the enforcement (guarantees of compulsory enforcement) of obligations under contracts to which an ADT resident or a VFP resident is a party.



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