In this article, I aim at identifying the main trends in the development of the laws on the special legal regime of entrepreneurship in the Kaliningrad region. I address the problems of the Special Economic Zone (SEZ) in the Kaliningrad region and provide recommendations for improving its legal regulation. I analyse the 12 years experience of the practical application of the federal law on the regional SEZ and examine the gaps and conflicts in the regulatory legal acts. In this study, I consider the legal requirements for the SEZ residents and their investment projects, as well as benefits provided to the residents. Another focus is the goals of the SEZ. I investigate the effectiveness of the benefits to the investors and of the applicable procedures and analyse the factors reducing the region’s investment attractiveness. I outline the 2017 amendments to the federal law on the SEZ in the Kaliningrad region and provide recommendations for the development of regulation and enforcement. I stress the need for tax harmonisation and the introduction of special procedures for the payment of taxes on profits and properties by the SEZ residents.

**Keywords:** special economic zone, special legal regime, legal regime improvement, investment, tax benefits, Kaliningrad region

**Introduction**

The special economic zone in the Kaliningrad region (below, the SEZ) is one of the largest and oldest national zones enjoying economic privileges. The SEZ has grown to become the trademark of the region’s investment attractiveness.
A principal component affecting the investment climate and sought by investors is a stable regulatory environment. However, economic efficiency and investor preferences are equally important factors.

The first step toward greater investment and the preferential treatment of businesses was the legal regime of the Yantar free economic zone.¹ An important contribution to the process was the Federal Law of January 22, 1996, No. 3-FZ ‘On the Special Economic Zone in the Kaliningrad region’.² These steps were necessitated by the special economic position of the region. As the literature stresses, they had to accelerate the socio-economic development of the region in the conditions of its growing isolation from mainland Russia [1, p. 90].

During the past 12 years, the special legal regime for business in the Kaliningrad region has been governed by the Federal Law of January 10, 2006, No. 16-FZ On the Special Economic Zone in the Kaliningrad Region and the Amendments to Selected Legislative Acts of the Russian Federation³ (further, the FZ on SEZ in the Kaliningrad region). An important role in laying down harmonized rules of economic management in the Eurasian Economic Union is played by the Agreement on the Free (Special) Economic Zones on the Customs Territory and the Customs Procedure of the Free Customs Zone of June 18, 2010.⁴

The special legal regime of business in the Kaliningrad region is very different from that in other special economic zones in Russia. The Kaliningrad SEZ cannot be classified into any of the four types of special economic zones listed in the Federal Law of July 22, 2005, No. 16-FZ ‘On the Special Economic Zones in the Russian Federation’.⁵ Note that

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⁴ The Agreement on the Free (Special) Economic Zones on the Customs Territory of the Customs Union and the Customs Procedure of the Free Customs Zone (Saint Petersburg, June 18, 2010). International Agreement Bulletin, 2012, No. 7.
this law is not effective in the Kaliningrad SEZ. In terms of the legal regime of business, the SEZ in the Kaliningrad region occupies a halfway position between a special economic zone and a priority socioeconomic development area [2, p. 29].

The use of the same term to denote different legal regimes is inadequate and incorrect from the perspective of legal science. This holds true for applying a generic term to refer to a legal regime that it does not even cover. In the legal literature, the generic term denoting special legal regimes of business that go beyond the general law on special economic zones in the Russian Federation (the Kaliningrad and Magadan regions, Crimea, and Sevastopol) is the ‘priority socioeconomic development areas’ [3]. However, this approach is not ideal, since the legislation does not specify this notion and the mentioned legal regimes of business differ substantially.

Most authors stress the need for systemic changes in the laws that are effective in the territories with special economic development conditions. However, it has been proposed to unify the legal regimes of these territories and regulate their legal statuses in a single federal law that would contain an exhaustive list of the types of such territories, the definitions of these types, and the description of the cases when each of them can be applied [4, p. 109]. A diversity of territories with special economic conditions does not translate into a diversity of legal measures to encourage business activity. ‘The legislator borrows whole articles, almost verbatim. This, on the one hand, raises the question about the necessity to multiply federal laws when the ones in effect could be amended and applied to the newly created territories. On the other hand, this proves that there is an established range of effective legal means of governmental regulation of the functioning of territories with special business regimes’ [5, p. 63].

Most studies into the development of entrepreneurship in the Kaliningrad SEZ are fragmentary. They focus on isolated aspects of the development of individual industries [6—8], taxation, or customs regulations [9, 10]. There have been attempts to assess the prospects of the development of the Kaliningrad SEZ and the region [11—14]. However, little attention has been paid to the legal aspects of the improvement of the special regime of business in the region. As a rule, current publications only give an overview of the benefits to investors and do not analyze the practical aspects. This might be explained by the local nature of the ongoing problems, which are relevant to only one region of the Russian Federation.
The efficiency of the special legal regime for business

The Federal law on the Kaliningrad SEZ calls for the establishment of a special legal regime for business, production, investment, and other activities. In legal and technical terms, this phrasing is inadequate, since it allows for an open list of activities and uses concepts with overlapping meanings.

An important path to improve the special legal regime of business in the Kaliningrad region is increasing its efficiency. The concept of efficiency is the key to assessing the performance of special economic zones. Indeed, special legal regimes of business are established to ensure greater efficiency than in the usual legal environment. Expert reviews of the efficiency of legal regimes of special economic zones focus on the economic, social, and legal aspects. Thus, we can consider the economic efficiency of a SEZ, the social aspects of this efficiency, and the efficiency of legal regulation.

The economic efficiency of the performance of a SEZ is viewed as a complex property that affects various aspects of the operations of both the SEZ residents and the governing bodies. The efficiency of a SEZ is a complex property that covers various aspects of the operations of the SEZ and its residents, in view of the ratio between the revenues and expenses associated with the SEZ regime [15, p. 520]. As a rule, efficiency assessments consist in comparisons of the performance of a SEZ with associated costs [16, p. 309]. In practice, the economic efficiency of a SEZ is assessed using economic indicators listed in the applicable laws and regulations. A vivid example is the Order of the Government of the Russian Federation of July 7, 2016 No. 63 ‘On the Procedure for Assessing the Efficiency of the Performance of Special Economic Zones’. However, the criteria specified in the law do not extend to all the national special economic zones. In particular, this order is not applied to the Kaliningrad SEZ. Moreover, economic indicators for assessing the economic efficiency of the Kaliningrad SEZ have not been established yet. A composite index used by default is a favourable investment climate capable of attracting additional investment for the economic development of the Kaliningrad region. Since the introduction of the special legal regime in the Kaliningrad region, 216 companies have been included in the list of SEZ residents (as of March 14, 2018, there were 152 functional

residents). The total amount of the committed investment reached USD 106.1 billion as of March 14, 2018. The considerable decrease in the number of newly registered residents in 2013—2015, when only 3—8 investors were included in the list annually, was followed by a slight increase. Twenty-six new residents were registered in 2016, 27 in 2017, and over ten in the first ten weeks of 2018.\(^7\)

The legal aspect of the efficiency of a SEZ is approached from a different angle. Jurisprudence uses the concept of the ‘efficiency of legal regulation’, which describes the correlation between the goals and the impact of legal regulations [17, p. 505]. Therefore, the efficiency of legal regimes can be considered through the prism of attaining the goals that were set when these regimes were established. This applies equally to the (special) legal regimes of business introduced in the special economic zones, including that in the Kaliningrad region.

This SEZ was established to accelerate the socio-economic development of the region. The legal literature has stressed the inadequacy of this phrasing [18, p. 45]. Obviously, acceleration takes a limited time and can be only a short-term measure. The initial 25-year-period of the law (until 2031) contradicted the idea of continuous acceleration of socio-economic development. Amendments to the federal law on the Kaliningrad SEZ\(^8\) extended the period of the law for another 15 years (until 2045), without any changes to the goals of the legal regime. This made the inadequacy of the phrasing even more evident. A better phrasing was used in the earlier federal law of January 22, 1996, No. 13-FZ ‘On the Special Economic Zone in the Kaliningrad Region’, where the sustainable socioeconomic development was stated as the goal and the term ‘acceleration’ was never mentioned. The same goal is set in the National Programme of the Russian Federation ‘The Socioeconomic Development of the Kaliningrad region until 2020’.\(^9\) The phrasing used in this programme seems to be more adequate.

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An analysis of the changes in the key economic indicators (gross regional product, industrial production index, fixed investment, etc.) over the past ten years does not show that the goal of accelerating the region’s socioeconomic development was achieved. However, the positive effect of the legal regime is undeniable.

The stability of the regulatory framework for business is one of the key parameters of an effective legal regime. In describing the legal regimes of business, Prof. Aleksandr A. Mokhov cogently argues that the current regime was not established once and for all. It can change under the influence of various factors — the cycles of the market economy, current macroeconomic problems, the emergence of new forms of relations, etc. [19, p. 9]. In our case, changes to the legal regime seem to be justified. However, this does not hold true for the annual changes undermine the necessary stability of the regulatory framework.

An indicator of the intensive development of the legal regime of the Kaliningrad SEZ is the significant number of changes in the regulatory framework. Over the twelve years that the law on the Kaliningrad SEZ has been in effect, amendments have been made twelve times, which is a considerable number for a principal regulatory act specifying the conditions for investment activities in the region. Many of the regulations of the law have been sharply criticized. This is especially true for repealed chapter 8, which set a transition period until April 2016. The experts have stressed that ‘the competitiveness of the regional economy was a product of customs privileges and, thus, of the rent, which originated from the difference between the cost of the raw materials and components used in the goods manufactured in the SEZ and in those produced elsewhere in the country. Closely connected to the logistics and financial flows, this rent created a system of competitiveness that was unfair to the producers of similar goods located in mainland Russia’ [20, p. 23].

Another important stage of improving the special legal regime of business in the region began with the end of the transition period. It consisted of the preparation of regulations and took place in 2017. In particular, on the instruction of the President of Russia, the regional government in collaboration with the Ministry of Economic Development of Russia drew up the draft federal law ‘On the Socioeconomic Development of the

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Kaliningrad region of March 15, 2016’. Unfortunately, many of the regulations of the draft law were not supported at the federal level and only a few were included in the two federal laws adopted in November — December 2017.12

Another element of improving the efficiency of legal regulation is the increase in the efficiency of legal guarantees for investors. The inefficiency of the current guarantees for international investors has been emphasized in the literature [21, p. 12].

The legal status of the SEZ residents

The legislation links the benefits granted to investors to the obligation to acquire the status of a resident of the Kaliningrad SEZ. The residents are required to enter on the resident register. The eligible companies should be registered in the Kaliningrad region and comply with the industry-specific limitations and the SEZ requirements for investment projects.

The initial goal of the legal regime of the Kaliningrad SEZ was to attract large businesses capable of delivering considerable investment. The required minimum capital investment amount for the investment projects of the Kaliningrad SEZ residents was established at 150 million roubles over three years from the entry on the register. This approach deprived many small and medium businesses planning to launch large investment projects from the opportunity to acquire the status of a SEZ resident. The experts have repeatedly stressed the need to reduce the minimum amount of investment to half or one-third of the initial level and increase the investment project period from three to five years [22, p. 66] in order to attract more investors and expand the range of investment of eligible projects. These proposals were taken into account by the legislator. In 2016, the minimum amount of investment in projects in tourism and recreation, manufacturing, fishing, fish farming, and agriculture was reduced to fifty million roubles. A lower minimum was set in 2018 for investment projects in healthcare (ten million roubles of capital investment), computer technology, software development, information technology, and R&D (one million roubles).

Special tax treatment

The most important benefits granted within the special regime of business in the Kaliningrad SEZ are tax exemptions for the residents. We agree with the authors who have emphasised that the current legal regulation of the taxation of SEZ residents ‘is characterized by inadequate phrasing, a multitude of approaches to providing special tax treatment, and the absence of either a scientific rationale or a single method for creating a system of tax exemptions within special taxation regimes’ [23, p. 29].

Against this background, it seems logical to continue the improvement of the special tax treatment for the residents of the Kaliningrad SEZ. An important novelty was a change to the procedure for establishing the period of corporate tax exemption for the SEZ residents. Earlier, the exemption period was calculated from the date of the entry on the register. Now, it will be calculated from January 1 of the year when a resident starts to receive profits within their investment project. If they do not receive profits during the first three tax years, the exemption period is calculated from January 1 of year 4. Thus, the maximum exemption period was extended from 12 to 15 years.

Although it does not seem logical, the procedure for calculating the property tax exemption period did not change. This problem has led to legal disputes.13 The property tax exemption period is calculated from the date of the entry on the register and it does not coincide with the tax year. The SEZ residents that enter on the register at the beginning of a calendar year are not in the same position as those who enter at the end. No resident can benefit from the whole six-year property tax exemption period.

The land plots used by the Kaliningrad SEZ residents in implementing their investment project are subject to a 0% land tax over a period of five years.

However, the possibilities for expanding the tax exemption periods for the SEZ residents have been largely exhausted. It has been argued in the literature that international investors should be attracted to the Russian SEZs ‘by the general prospects of the Russian economy rather than tax exemptions and cheap labour. The key factors behind the develop-

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ment of the zones and the attraction of investment should be economic stability, capital protection, infrastructure, and administrative support for business’ [24, p. 57]. All this applies equally to the Kaliningrad SEZ.

New ways to enhance the legal regime

Alongside the improvement of the earlier isolated elements of the special legal regime of business, which were discussed above, the legislator developed new regulations aimed to increase the investment attractiveness of the Kaliningrad SEZ.

Firstly, the range of exemptions for the SEZ residents was expanded. New exemptions were introduced in 2018 for the newly registered residents. Particularly, the idea of reduced insurance premium rates was borrowed from the legal regime of the priority socioeconomic development areas.

Legal entities entering on the register of the Kaliningrad SEZ residents from January 1, 2018, to December 31, 2022, will pay insurance premiums at a rate of 7.6%.14 This rate will be applied only if the residents create new jobs. Compiled by the residents, the list of new jobs will be approved by the administration of the Kaliningrad SEZ and the tax service. The reduced rates will be effective until December 31, 2025.

Initially, the exemption was to be granted to a wide range of businesses and it was expected to become a serious incentive. However, in the adopted version of the law, the exemption applies to a very limited group of the SEZ residents (in effect, a few dozen) and, thus, it will not have a considerable effect on the investment climate.

Secondly, the programme for the governmental support for legal entities operating in the Kaliningrad region and the residents of the Kaliningrad SEZ aimed at creating and sustaining new jobs, as well as promoting import substitution and localization of assembly operations, was formalized by law and extended until January 1, 2031. The programme has been effective since April 1, 2016, in accordance with the procedures and conditions established by the Government of the Kaliningrad region.15 The total amount of subsidies granted by the programme reached 25.9 billion roubles in 2016 and 49.6 billion roubles in 2017.16

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Thirdly, the recycling fee for the vehicles produced less than three years ago was abolished. Now they are subject to the free customs zone procedure effective in the Kaliningrad SEZ. This regulation applies to the equipment used in agriculture and construction, with the exception of the vehicles engaged in the international carriage.

Fourthly, the federal law on the Kaliningrad SEZ was supplemented with chapter 5.1 on the regulatory compliance reviews of project documentation and engineering surveys and chapter 5.2 on the environmental impact assessment of projects run in the Kaliningrad region. Moreover, the maximum period of regulatory compliance reviews was reduced from 60 to 45 days and that of environmental impact assessments from three months to 45 days.

Fifthly, a simplified procedure for obtaining a visa for travel to the Kaliningrad region was introduced. A visa application can be submitted online four days before the visit. The document will be valid for eight days. The visas will be issued for business, tourism, or humanitarian purposes. No fee will be changed. This procedure will be effective after the funding is provided, the Customs Service of the Federal Security Service accompanies necessary works, and the Government of the Russian Federation specifies the details of the procedure (but not later than July 1, 2019).

However, the above does not exhaust the possibilities to improve the legal regimes. The literature proposes additional measures of support, in particular, ‘to encourage companies to work for international markets, to create systems for training managers specialising in international trade in view of the experience of the neighbouring countries and the regional characteristics, and to simplify the regime of cargo transit from the Kaliningrad region (including the customs formalities). These measures are expected to benefit the exporters and simplify the administrative and fiscal procedures that will fully comply with the international standards’ [25, p. 61—62].

Conclusions

The analysis of the twenty-year history of the special legal regime of business in the special economic zone in the Kaliningrad region suggests that the current legal measures are not sufficient for attaining the goals set in the federal law on the SEZ in the Kaliningrad region. The region’s socioeconomic development cannot be accelerated by benefits to a limited group of economic entities. Individual entrepreneurs and most small and medium businesses are not eligible for entering on the register of the SEZ residents.
The formalization of the considerable differences in the legal statuses of the residents depending on the date of the entry on the register seems to be unfair. This applies equally to the opportunity to benefit from the reduced insurance premium rates.

Further compliance problems are associated with the legally inconsistent regulations that introduce different procedures for granting corporate and property tax exemptions to the SEZ residents. The formalization of different methods for calculating the exemption periods for corporate tax, on the one hand, and property tax, on the other, does not seem to be justified.

The need to increase the efficiency of the legal regime of the SEZ requires further improvements to the legal regulation.

The major ways to enhance the efficiency of the legal regime of the Kaliningrad SEZ are as follows:

1) to extend the range of businesses eligible for the status of a SEZ resident by reducing the minimum investment amount for the industries that are most important for the region;

2) to apply the regulation on the reduced insurance premium rates to all the residents of the Kaliningrad SEZ;

3) to formalize the calculation of the corporate and property tax exemption periods from the same date.

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