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Special Economic Zones of Russia

Alternatives for development of Transport Hub SEZs

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<p>This dissertation pursues to find alternative solutions for improvement of efficiency of Special Economic Zones (SEZs) Project in Russia. Since special economic zones in general can be seen as a way to enhance economic growth of any country (based on research by M. Porter), we see SEZ as a very important mechanism, which however needs deeper evaluation with subsequent development of competitive and viable scenario. The dissertation provides the reader with detailed outlook of SEZ concept in general, as well as specific recommendations and conclusions for development of alternative scenario for Transport Hub SEZ in Russia (a functional category of SEZs) based on the critical reasoning, contemporary economic theory, analysis of SEZ mechanism in context of liberalization and globalization. The dissertation also takes into consideration positive experience with similar projects implemented by other countries (China).</p>	
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Appendix 1. Revised Kyoto Convention of the World Customs Organization

1 Introduction

1.1 Topic selection and definition of research area

The topic of this Bachelor's thesis is Special Economic Zones in Russia (further referred to as SEZ). The main problematic research question: How to improve the success of Special Enterprise Zones in Attracting Foreign Direct Investment to Russia? The changes are in fact needed, since despite the generally recognized attractiveness of the Russian investment climate ("59% [of investors] see investment attractiveness improving over the next three years, up from 57% last year [2012]") the number of potential investors not yet established in Russia is declining (Ernst & Young, 2012, 34; Ernst & Young, 2013, 28):

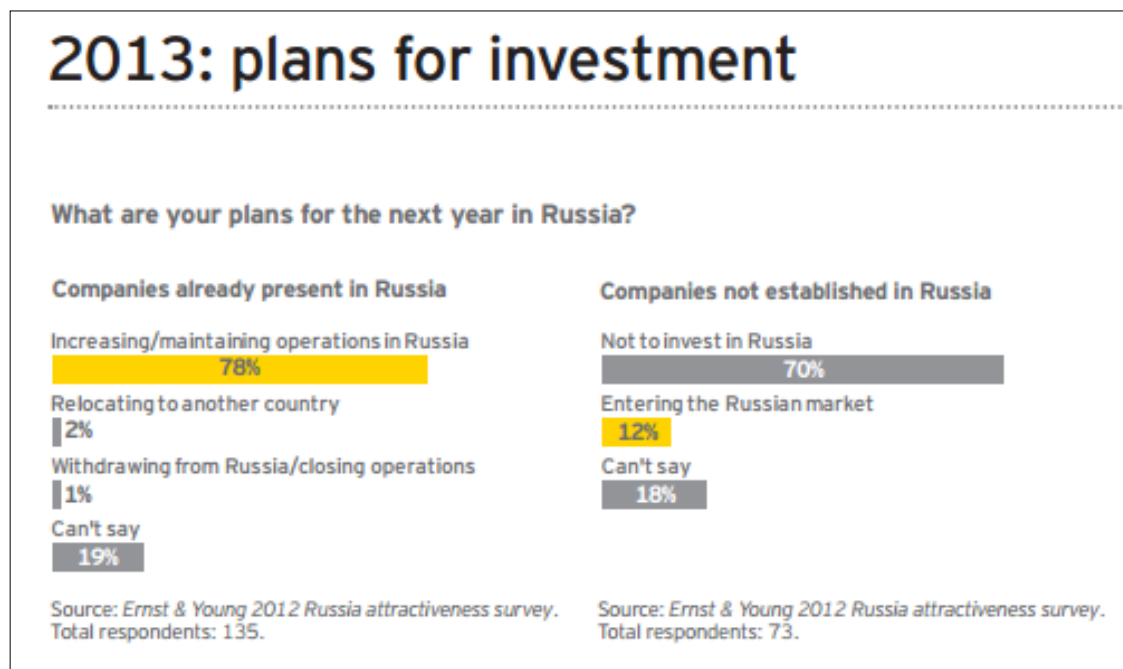


Figure 1. Investors' plans for 2013 according to Ernst & Young's 2012 Russian attractiveness survey.

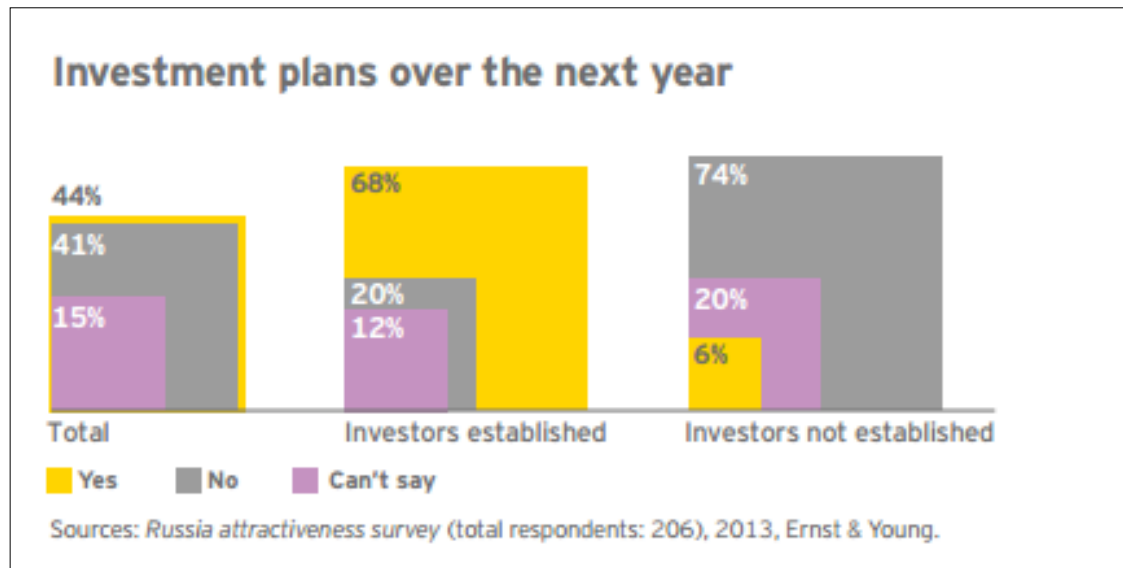


Figure 2. Investors' plans for 2014 according to Ernst & Young's 2013 Russian attractiveness survey.

Before offering detailed recommendations with respect to the function and performance of SEZs, there is first a need to define a concept of SEZ, viewed in this work in terms of Porter's cluster theory (Porter, 2000); thereafter, to verify the viability of SEZ projects in a context of trade liberalization and market economy; to determine the role and scope of involvement of the government in SEZ implementation with co-relation thereof with the scope of financial, legal and ethical responsibility of SEZ Managing Body; and to study and analyse the examples of successful SEZ projects around the world, especially in China.

There is no doubt that a study of the Russian investment climate in general is a highly important topic due to the base law of supply and demand – according to the Ministry of Economic Development of Russian Federation “Russia has abundance of educated labor, land and recourses to supply any venture and at the same time it has a sufficient demand (over 139 million of people) to absorb any products entering the market” (Ministry of Economic Development of Russian Federation, 2004-2012). However, my understanding of investment potential is not limited to Russia serving as a large output market for whatever products produced in excess by any other nation or attracting third parties with the goal of cutting costs for labour- and capital-intensive activities.

There is a need for a qualitative rethinking of investment policy: investments need not only generate revenue, but can also distribute economic well being more evenly over

the country, stimulating interaction between state research institutions and private companies based on business-driven goals rather than on command bureaucratic collaboration (Liuhto, 2009: 11), which in the long run should switch Russia's status of a commodity and resource exporter¹ to innovations and value-added products exporter.

The conclusions above naturally narrowed the scope of studies to investment boosting initiatives which serve or at least are aimed to serve the abovementioned goals. Special Economic Zones from my perspective must correspond to all mentioned criteria.

¹ The key driver to Russia's GDP growth is [still] its vast stock of natural resources. In fact, two-thirds of Russia's stock market is dominated by the extractive industries" (KPMG Advisory N.V., 2013: 9)

1.2 Literature review

On the initial stages of the research publications on investment climate in Russia were reviewed – the goal was to have a broad outlook from the perspective of the Russian economy as well as to consider international sources (World Bank, OECD, Ernst & Young reviews, USA Department of State reports, etc.). Research has established that

...Russia recognizes foreign investment's critical role in the country's economic development and has encouraged foreign investment by removing administrative barriers and establishing special economic zones, high-technology parks, and investment promotion funds (U.S. Department of State. Bureau of Economic and Business Affairs, 2012).

Elaboration of the research topic resulted in a more focused and targeted research material selection – from establishing the theoretical basis for special zones' creation worldwide, to scanning general information available on all 4 types of SEZs in Russia and China, and finally to a more problem-solving search for facts and details related to one particular SEZ type- Port Zones or Transport Hub SEZs, which are characterized by the weakest performance indicators – the number of residents and total amount of investments attracted (see further chapters).

Literature analysis disclosed firstly constant discrepancies on SEZs' current status,² which can possibly indicate poor informational flow, and secondly particularly insufficient information on the Managing Company - SEZ JSC, which is rarely mentioned in media or reports (domestic and foreign). Key word search was done for Forbes, Interfax, Kommersant and other databases, and the managing company seems to have mainly a representative function; not much information (apart from what is provided in SEZ JSC's official web site) can be found on its legal, financial and ethical responsibilities. Thus the management process of any SEZ should be studied more closely to understand what Russian SEZs are lacking. The literature review provided sufficient information on more successfully functioning zones – particularly in China.

² For example, according to the Investment Map of Russian Federation Transport Hub SEZ "Ulyanovsk-East" has no registered residents (Ministry of Economic Development, 2013), but Government of Ulyanovsk Region according to the web-page information latest updated in January 2014 is proud to host 6 residents (Government of Ulyanovsk Region, 2014)

1.3 Methodology

Due to the nature of the research work primarily secondary sources will be used – there is plenty of material to analyze and compare. As to the methodology, a qualitative approach will be used. Qualitative descriptions can play the important role of suggesting possible relationships, causes, effects and dynamic processes associated with functioning of SEZ. Since the purpose of this research is to suggest improvements to the current situation, it is more beneficial to determine the cause of the problem, relate the concept to the existing economic theories, and analyse the specifics of SEZ operation in the framework of a case study. Case study is applicable when researchers want to answer “how” and “why” questions (Baxter & Jack, 2008). Qualitative case study methodology provides tools for researchers to study complex phenomena (production and research clusters) within their contexts (the context of the SEZ country’s political, legal, social framework). Case study is very applicable here due to its feature of naturalistic generalization, meaning comparison of actual problem (not enough investment intensity in SEZ Russia) with known cases (SEZ in China).

However, while the prime goal of the research is not to gather statistics, secondary statistical data are used for supporting conclusions.

2 Special Economic Zone - Concept and Reality

2.1 Definition and historical outlook

A case study of one of the most successful SEZ examples – Guangzhou special zone, points out that the origin of development zones can be traced back to the early 17th century, when free ports emerged in some European cities such as Venice, Marseilles, and Hamburg. Thus the reason behind the development of the very first “Special Zones” was to facilitate trade between the countries.

However, systematic studies on SEZ development did not develop until the 1970s when the concept of EPZs (export processing zones - a special type of SEZ) was adopted by various countries as a policy to achieve greater economic openness (Wong, 2005). According to the World Bank (World Bank, 1992) an EPZ is "an export processing zone is an industrial estate, usually a fenced-area of 10 to 300 hectares that specializes in manufacturing for export. It offers firms conditions and a liberal regulatory environment."

The United Nations Industrial Development Organization defines EPZs as administratively or geographically delimited areas enjoying special status and allowing free import of production equipment and material (United Nations Industrial Development Organizations, 1980). Researchers from Lund University, Sweden, view SEZs in general as geographically or juridically bounded areas in which free trade, including duty-free import of intermediate goods, is permitted providing that all goods produced within the zone are exported (Johansson & Nilsson, 1997), thus pointing out the evolution of the zone concept from trade to production.

The core definition of a free zone, as well as proposed guidelines and standards for them, are contained in the Revised Kyoto Convention of the World Customs Organization (World Customs Organization, Revised in 1999). Specifically, Annex D and the accompanying guidelines provide standards and recommendations on the treatment of imports to and exports from free zones including territorial limits (free zones are defined as “outside the customs territory” for purposes of the assessment of import duties and taxes); minimal documentation requirements; and issues to be covered by national legislation (see Appendix 1).

The World Bank has made a comprehensive study of over 30 years of worldwide experience in SEZs, and according to this report published in 2008, there are both private and governmental sector operated zones³.

By some estimates, there are approximately 3,000 zones in 135 countries today, accounting for over 68 million direct jobs and over \$500 billion of direct trade-related value added within zones. (World Bank, 2008: 7)

According to the type of activities, the zones can fall into different categories, described below:

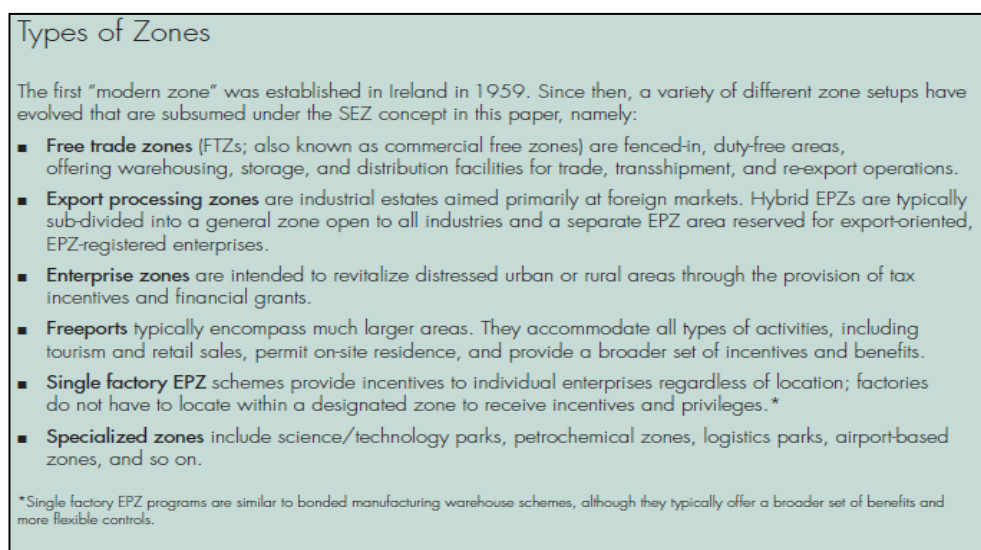


Figure 3. Different types of special zones according to the World Bank report.

However, no matter how they are titled, the basic concept for a Special Zone incorporates the following key principles:

- Geographically delimited area, physically secured (fenced-in);
- Single management / administration;
- Eligibility for benefits, based upon physical location within the zone;
- Separate customs area (duty-free benefits) and streamlined procedures. (World Bank, 2008: 9).

³ According to the stocktaking exercise conducted for this study, 62 percent of the 2,301 zones in developing and transition countries are private sector developed and operated (World Bank, 2008).

According to widely cited research by D. Madani, among the basic characteristics of the SEZ concept should be also included less governmental red-tape and more flexibility with labour laws for the firms in the zone, as well as above average (compared to the rest of the host country) communications services and infrastructure (Madani, 1999).

The concept of a Special Zone has not been static. The World Bank report gives us an overview of how the zones were built and looked like in the beginning:

Free zones were traditionally developed as isolated enclaves, both in terms of the underlying policy framework and geographic location (Table 5). Access to a generous set of incentives and privileges was tightly controlled. Qualifying firms typically had to be 80–100 percent export-oriented (for EPZs), engaged in recognized manufacturing activities, and at times only foreign-owned. Zone location was restricted to relatively remote areas or near transport hubs, and zones were viewed primarily as growth poles for regional development. Zones were exclusively developed and operated by government bodies (World Bank, 2008).

There has been many changes in terms of structure, ownership and scope of incentives offered in the course of time, including but not limited to: “the preferential policy package has been enhanced across depth and breadth; spatial dimensions have been broadened (traditionally, zones were located in the proximity of ports but modern SEZs have increasingly been located on country-wide basis in an effort to integrate them with host economies); number of privately owned, developed, and operated zones has grown worldwide” (Aggarwal, 2010).

Over the course of years the need for changes of other kinds became evident, since zones were not uniformly successful worldwide. For the zones to remain sustainable in the volatile economical climate there was a need for deeper, strategically-oriented re-thinking of the zone’s role, potential and integration with the main economic development pattern.

2.2 Economic mechanism behind the concept of a SEZ.

2.2.1 Regional economic development and opening of restricted economies.

General literature review has given us two main reasons which were originally behind all types of special zones development:

- 1) Tackling serious localized problems of distressed areas by attraction of inward investment (Regional Development);
- 2) Moving away from trade-restricted or closed economy and generate FDI and exports (Opening-up for international market).

When talking about the rationale behind the zone development, many authors claim that the economic justification for the development of special economic zones differs between developing and developed countries (World Bank, 2008).

Taking the developing countries first, there have been both a policy and an infrastructure rationale which was beyond SEZs' (and in particular EPZs, concentrated on production for export) rapid expansion. The infrastructure rationale consisted of realizing agglomeration benefits from concentrating industries in one geographical area for infrastructure – poor countries (World Bank, 2008: 12). Cling and Letilly based their research on a premise, that the political rationale was a convergence of two phenomena:

The conversion of all developing countries to export-led growth policies, considered the optimal strategy to stimulate employment and favour insertion in the global economy; simultaneously, with the accentuation of international competition, there has been a growing trend to transfer the production of labour-intensive goods towards developing countries. Enterprises in such sectors direct investment to countries with surplus, low-cost labour, and which adopt concessionary regimes such as those applied to EPZs (Cling & Letilly, 2001).

The latter was conceptualised in economic theory as the “global value chain approach” (Aggarwal, 2010).

Neoclassical theory explains a zone's creation as a “second best choice” for an originally closed economy aimed at export-led growth. The best policy according to the theorists is one of overall liberalization of the economy (Madani, 1999). Thus, the

“second best option” consists in “compensating for one distortion (import duties) by introducing another (a subsidy)” (Cling & Letilly, 2001). It is worth noting that the role of SEZs in this case is rather negative, as of a distortional trade instrument, unless they become a transitory element, “facilitating the transition of an economy from import substituting regime to free trade regime with minimal government intervention” (Aggarwal, 2010). What would happen to a SEZ in an ideal case of liberalization of economy, will however be discussed later on in the thesis.

For such developing countries, as India, China, and Mexico, creation of zones was relatively efficient in opening up for international market. India was one of the first countries in Asia to recognize the effectiveness of the EPZ model in promoting exports. It established Asia’s first EPZ at Kandla, in the state of Gujarat in 1965. Presently, India has 19 functioning SEZs contributing 5-6% to the national exports and more than 400 SEZs have been principally approved by the Government of India at various locations (Dhingra & Singh, 2009). EPZ programs also spearheaded export diversification efforts in most countries, from an almost total reliance on primary commodities to manufactured exports. For example, most of the countries of the Caribbean and Central America exported mainly fruits and vegetables before the establishment of EPZs (World Bank, 2008: 35).

The rationale for free zone development in industrialized countries is more varied. World Bank research calls SEZ created in most developed countries “growth poles” for revitalization of the economically distressed parts of the country (World Bank, 2008: 50).

Johnathan Moore in his article examines UK policy of reviving distressed urban areas, where the contraction and relocation of existing industry had resulted in a weakened economic base, physical dereliction and high concentration of economic and social problems in the beginning of 1980s (Potter & Moore, 2000). By offering tax concessions (for 10 years), reduced bureaucracy and public sector renewal, the UK Government managed to secure a certain economic regeneration within problematic areas where zones – small up to 450 ha enclosed areas on the vacant, unoccupied or deteriorating industrial land – had been built. According to a report by PA Cambridge Economic Consultants, cited in the report by Moore, in the end of the 10 year existence of the EZ in UK total employment on the surveyed zones amounted to nearly 126 000 people in an estimated 5 000 firms at the time of de-designation.

However, all jobs created in the framework of SEZ programmes, come at a high cost. If we view USA example, the State of California reports an estimate of \$290 million in tax credits⁴ in 2008 for similar activities in economically depressed areas (Ham, et al., 2011); nevertheless the study provided a statistical proof of significant labor market improvement and general economic boost in the designated areas.

There are certain concerns related to the opportunity cost of zone creation, which need to be mentioned in connection with the regional development. A set of concerns provided in the study by Moore includes:

- Structure of incentives in favour of capital intensive, rather than labour intensive investments;
- Possibility of stimulating low-skill and poorly remunerated job creation;
- Weak links to local suppliers and possible displacement of local firms; According to the estimation of researchers, out of 63,300 jobs created in UK within the framework of SEZ policy, only 13,000 were estimated to be new jobs – in other words, 80% of jobs created by Enterprise Zones were displaced from other areas. Many of these jobs were displaced from within the same town – estimates range from 25% of jobs displaced from within the same town, to 86% of firms are relocations within the same county (Sissons & Brown, 2011).
- Low percentage of local people winning the jobs with the investors;
- Absorption of EZ land by local relocations of already existing operations⁵ (simple transfer of jobs from adjacent areas to get a benefit from tax exemptions) (Potter & Moore, 2000). This can be well illustrated by example of Scotland, and namely Clydebank Enterprise Zone: “...in the Clydebank Enterprise Zone, of the first 1,764 jobs, 1,165 were in pre-existing firms making short-distance moves into the area; in the Lower Swansea Valley EZ the proportion was even higher” (Lever 1987: 47).

In other words, how justified is focus on zone development in general, when opportunity costs are so high? When resources are diverted from addressing other

⁴ Both ENTCS and EMPZs [In USA] provide employers a work opportunity tax credit of up to \$2400 for hiring 18–24 year olds who live in the areas (Ham, et al., 2011).

⁵ It was reported, that as a result of UK SEZ programme 23% of establishments on the territory of SEZs were new branches of subsidiaries of firms headquartered elsewhere and 38% were transfers of entire firms into the zones (Potter & Moore, 2000).

pressing needs, such as education, health care and etc., SEZs need to provide “dynamic” benefits, rather than “static”. Under static benefits researchers from the World Bank Group understand such measurable (and also highly amplified in developing countries) gains as direct employment creation, growth and diversification of export, foreign exchange earnings and amount of attracted FDI (World Bank, 2008: 32). The dynamic benefits are much harder to measure, but are far more important to the long-term contributions from zone development. Indirect employment creation, upgrading of skills, technology transfer and, what is mostly important, “demonstration effect” arising from application of “best practices” (World Bank, 2008: 32) with subsequent integration into main economic policy will prevent zones from becoming “pressure valves for countries with growing unemployment, and allow them to avoid implementing painful structural reforms” (Madani, 1999).

2.2.2 Spill-over or catalyst effects of SEZs over the rest of the economy

To understand the importance of long-term “dynamic” benefits of SEZ creation, we need to address one of the longest-standing debates in the theory of economic development, which concerns the relative efficacy of balanced as opposed to leading sector investment strategies for achieving rapid growth (Litwack & Qian, 1998). SEZs might become a viable solution especially for a developing economy if they will solve a “developing country dilemma”, which does not have enough resources to invest in a balanced way to all sectors, as presented by researchers Litwack and Qian and summarized as follows:

- 1) Constant need for significant tax revenue during transition;
- 2) Possibility of curbing economical development as a result of increased taxes by government.

This dilemma might result in a “bad equilibrium” trap: “if only a few units / sectors restructure and the rest do not, revenue will be so low that the government will succumb to pressure and increase tax rates with high probability” (Litwack & Qian, 1998). “Unbalanced” investment into SEZs according to the authors has high chances to help avoiding the above mentioned trap due to possible “spill-over” effect or pulling up other interdependent sectors⁶.

Broader interpretation of the SEZ phenomenon and better explanation of SEZ catalyst effects is provided by Michael Porter in his theory of clusters. By “cluster” is meant “geographic concentrations of interconnected companies, specialized suppliers, service providers, firms in related industries, and associated institutions (e.g., universities, standards agencies, trade associations) in a particular field that compete but also cooperate” (Porter, 2000: 16). One of the main ideas derived from the work of Porter is that clusters cannot be understood independently of a broader theory of competition and competitive strategy in a global economy. Porter also stresses the importance of location, claiming that “that a good deal of competitive advantage lies outside companies and even outside their industries, residing instead in the locations at which their business units are based” (Porter, 2000: 16). Cluster thinking suggests that healthy “surroundings” alongside a sound microeconomic business environment will

⁶ “Special economic zones can be optimal particularly if there is a high degree of complementarity between resources that are sensitive to state investment policies and local restructuring” (Litwack & Qian, 1998).

foster progressive competition, which will bring about the update (diversification instead of cutting labour costs) for each of the participants.

SEZs can be designed in accordance with the principles of cluster theory. Namely, the cluster is based on the existence of geographically proximate - close - competitors in the same industry together with companies operating in related and supporting industries. The SEZ model has a strictly pre-defined territory as a pre-requisite with the aim to attract domestic and foreign companies, whose activities will match the profile of each specific SEZ (port activities, export production, etc.). Cluster theory stresses the need for timely and steady opening of the local market to imports that boost local efficiency, thus SEZs which help to attract FDI and establish itself as a globally significant and competitive economic region are also in line with cluster thinking.

If viewed as a cluster and given that a proper microeconomic context is created, SEZs according to Porter shall “broader than traditional industry categorizations, capture important linkages, complementarities, and spill - overs in terms of technology, skills, information, marketing, and customer needs that cut across firms and industries” (Porter, 2000: 18). This makes us presume, that SEZs under ideal conditions shall “increase the current (static) productivity of constituent firms or industries, increase the capacity of cluster participants for innovation and productivity growth, and stimulate new business formation that supports innovation and expands the cluster” (Porter, 2000: 21), which can be fully regarded as a “dynamic” benefit, discussed earlier.

Finally, Porter’s cluster theory precisely explains highly debatable role and involvement of Government when clusters / SEZs are in question:

[First role is to] achieve macroeconomic and political stability. A second role of government is to improve general microeconomic capacity through improving the quality and efficiency of general-purpose inputs to business and the institutions that provide them identified in diamond theory such as an educated workforce, an appropriate physical infrastructure, and accurate and timely economic information. The third role of government is to establish the overall microeconomic rules and incentives governing competition that will encourage productivity growth. A fourth role of government is to develop and implement a positive, distinctive, long-term economic action program, or change process that mobilizes government, business, institutions, and citizens (Porter, 2000: 26).

However, we would view a role of government in a broader sense, because “failure or success of a zone is linked its policy and incentive framework” (World Bank, 2008: 48).

30 year experience, studied by World Bank researchers, suggests that possible causes for SEZ failure, which can be directly linked to the role of government, are as follows:

- 1) If zone development entails massive government capital outlays (for onsite or offsite infrastructure development);
- 2) If the zones are not operated on a cost-recovery basis;
- 3) And/or, if they receive subsidized inputs such as electricity or other services (World Bank, 2008: 4).

The Dakar Free Zone in Senegal (described in World Bank report (World Bank, 2008: 53) was beset by an assortment of constraints, which ultimately resulted in “severe obstruction”. In our work it can serve as an example of SEZ failure due to unwise policy of the government. According to the report the principal obstacles to success for this program included:

- Excessive bureaucracy involving different institutions in the country, especially customs;
- Unnecessarily long delays in obtaining necessary permits (often more than one year);
- Unrealistic goals imposed on potential investors, both with regard to jobs to be created (each company was required to employ at least 150 people) and to initial investment;
- Poor reputation of the local workforce, which was labeled unproductive and overly expensive;
- Elevated cost of other factors of production (energy, water, communications);
- Rigid and constraining labor regulations - employment contracts were permanent and employers did not have complete freedom to recruit the people they wanted (World Bank, 2008).

Thus every government should be really careful in offering generous incentive packages such that they do not obstruct competition and improvement.

2.3 SEZs in the context of liberalization and globalization

We felt obliged to touch upon the topic of SEZ's viability in the context of liberalization and globalization, because it is a very sensitive topic for our target country, Russia. On December 16th, 2011 an 18 year old long negotiation process regarding Russia's WTO membership was finally brought to the end. The WTO adopted Russia's terms and conditions of entry, and now Russia has committed to "immediate reduction of one third of national tariff lines" and [subsequent reduction during three years], "elimination of quantitative restrictions on imports that are not justified under WTO provisions" and "elimination of industrial subsidy programmes" (Tochitskaya, 2012). When talking about developing and / or transition economies in general, some analysts argue that the rationale for zones is diminishing not only due to average tariff rates falling around the world, but also because of dismantling of Multi-Fibre Arrangement, given the dependence of many zones on the apparel and textiles industry (World Bank, 2008).

Zones in industrialized countries are under pressure as well, due to elimination of tariff restrictions in general and since "as from 2003, the measures contained in the WTO agreement on subsidies (ASCM) will outlaw EPZs in countries with a GDP per capita in excess of \$1,000" (Cling & Letilly, 2001).

Thus all SEZs face a dilemma under current circumstances: "...either provide the host country with an impetus to continue with trade liberalization reforms, thereby promoting additional export expansion, or have an adverse effect on total exports by conserving existing anti-export biases" (Johansson & Nilsson, 1997). The first option, according to Johansson and Nilsson is possible only in case of a successful EPZ performance.

As we have previously discussed, we understand the success of an SEZ as occurring when there is not competition on the basis of fiscal or tariff incentives only (which becomes highly challenging in the context of trade liberalization), but rather on the basis of providing a "constructive and efficient forum for dialogue and [and co-existence] among related companies, their suppliers, government, and other institutions" (Porter, 2000). SEZs in our view can become an alternative mechanism for enhancing competitiveness (which is strictly in accordance with cluster theory) by providing a healthy, competition-friendly business environment; companies will choose to invest in SEZs, since they will still see the benefits of:

...operating in a flexible, duty-free environment. Operating costs are lower as a result of reduced insurance, security, and overhead costs. Cash flow is enhanced by the ability to postpone duty payments until and only upon entry into the domestic customs territory (World Bank, 2008: 65)

When subsidies conditional on exports are prohibited in the WTO framework, zones have to focus on providing the best logistics solutions to domestic and international residents, since “international manufacturers have realized that there is much greater scope to reduce logistics costs than production costs. This can be accelerated within a zone setting by reducing transaction processing times and paperwork requirements” (World Bank, 2008: 67). This will serve for export trade promotion and further FDI attraction, which is especially valid for Russia, and will contribute to “the process of liberalizing trade and integrating national economies into the global economy” (Wong, 2005).

The Chinese example should be discussed here, regardless of the fact that China will be brought into focus in another chapter. China’s accession to the WTO in 2001 marked a new phase of China’s opening-up to the world, but simultaneously it caused a profound re-thinking of the governmental approach to SEZs, since “the existing preferential policies implemented within development zones [had to be] gradually forfeited as non-compatible with the requirements of the WTO (Wong, 2005):

To conform with the principle of national treatment, the Chinese government has to gradually remove preferential tax breaks and other privileges for foreign investment, to equalize the treatments for foreign investors and nationals. Such an adjustment is considered necessary, not only to dovetail with the WTO rules but also sustain the development of Chinese enterprises, by providing a fairer competitive environment in which the Chinese enterprises can be in a better position to compete with foreign companies. Moreover, to conform with the principles of free trade and fair competition, the Chinese government has committed to opening more provinces and cities for foreign investors. Under such circumstances, development zones which relied very much on granting preferential policies to attract foreign investors will gradually lose their competitive advantages because they will be on an equal footing with other areas (Wong, 2005).

China did not of course cancel the whole SEZ program, because of the changes and constraints necessitated by WTO access. The best solution possible in those circumstances as described in the report cited above was to stop approving any new SEZ projects, and challenge the local governments to analyze the efficiency of each specific type of special zone and clean up all inefficient ones with the re-conversion of arable land back to agriculture.

But what was more important, China started to view the remaining zones in a context of general urban developmental strategy. SEZs due to their “comparative advantage over other areas with their high-standard infrastructural facilities and rich experience in managing FDI” were finally ascribed “a role in leading regional development rather than simply attracting FDI and serving as a pioneer in open door policy” (Wong, 2005).

Thus we can presume that under right approach SEZs can remain completely legitimate, viable and efficient economic entities in the context of globalization and liberalization.

3 30 years of China's SEZ experience. Lessons to learn?

China alone accounts for about 19 percent of zones in Asia and the Pacific (World Bank, 2008, 31):

Zones in Developing and Transition Countries	
Number of countries with zones	119
Number of zones	2,301
Asia and the Pacific	991
China	187
Vietnam	185
Americas	540
Central and East Europe and Central Asia	443
Middle East and North Africa	213
Sub-Saharan Africa	114

Notes: Excludes single factory zone programs and sponsoring countries. Zones in the entities of Macau, Hong Kong (China), and Taiwan (China) are included in the Asia and the Pacific region.
Sources: BearingPoint; ILO database; WEPZA (2007); FIAS research.

Figure 4. Zones in developing and transition countries according to the World Bank report.

These 119 zones are not homogeneous and were created at different stages and on different levels (national, provincial and city level). They offer different types of incentives on the basis of which they can be classified into different types (for example, free trade zones, export processing zones, high technology developing zones, etc.). However all of them can be viewed as “industrial policy tools” (Barbieri, et al., 2013) aimed at guiding the economic reform processes.

These processes were in a line with Open Door Policy of overcoming thirty years of semi-imposed isolation. And the benchmarking decision within this policy was that Guangdong and Fujian provinces should take the lead in conducting economic exchanges with other countries and implementing “special policies and flexible measures.” By August 1980, Shenzhen, Zhuhai, and Shantou within Guangdong Province were designated as special economic zones (SEZs), followed by Xiamen in

Fujian Province in October 1980 (Yeung, et al., 2009). The term “special economic zone” was selected after considerable semantic discussion and intellectual debate, with SEZs being conceptualized as a complex of related economic activities and services rather than unifunctional entities (Wong, 1987). SEZs in China thus differed from export processing zones and similar special areas in Asia by being more functionally diverse and covering much larger land areas:

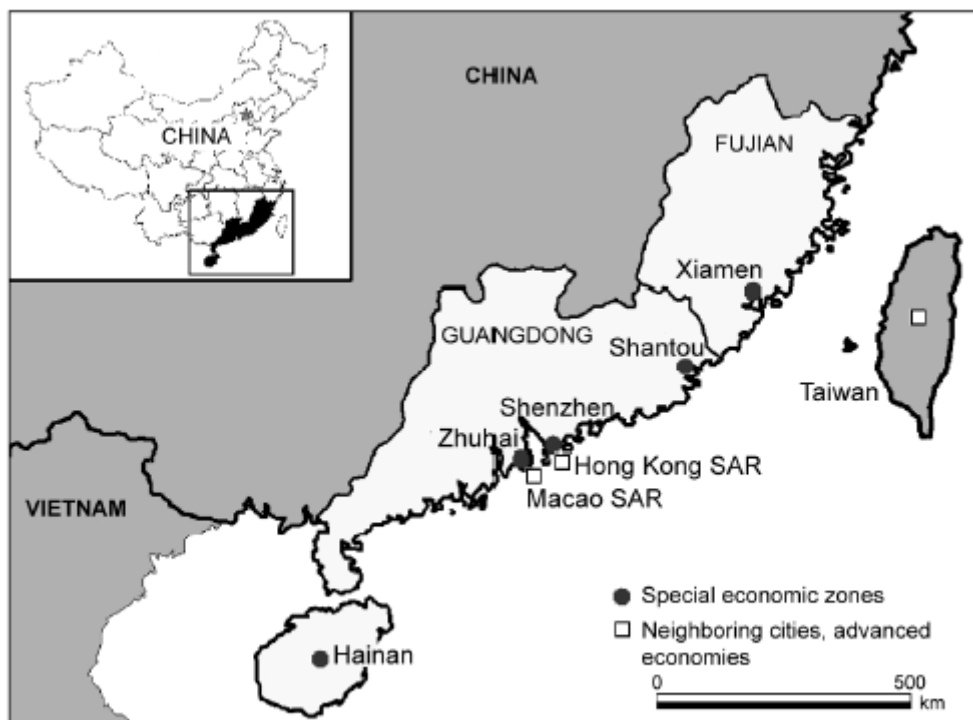


Fig. 1. Regional setting of the five SEZs

Figure 5. Regional setting of the 5 SEZs (Yeung, et al., 2009).

Special economic zones were established by China to serve as “demonstration areas” for policy reforms and to encourage foreign investment (World Bank, 2008). By demonstration areas it is meant that it would be possible “to test the impact of new policies and approaches designed to improve the business environment” (World Bank, 2008). The Chinese SEZs, for example, experimented with market-oriented FDI, land, and tax policies before extending them to all enterprises. This from our point of view constitutes the first strong point of Chinese SEZs – integrity and consistency with central economic policy.

SEZs were encouraged to pursue pragmatic and open economic policies that, if proven effective, would be implemented more widely across the country. The emphasis on

forward linkages with the world, especially through liberalization of foreign investment and trade relations with capitalist countries, and backward linkages with different parts of China, was very much the rationale for their establishment (Yeung, et al., 2009). Here would be logical to refer to the concept of spill-over effect, described in the work of Litwack. In his work he describes Chinese development as “unbalanced”, concentrated first in the East and coastal regions and later extended to the West and inland (Litwack & Qian, 1998). He also speaks about flexibility of Chinese SEZ policy, which in our opinion constitutes a second important strong point, which can be taken into consideration while thinking about possible improvements to Russian SEZs. Flexibility helped to magnify the spill-over effect on the rest of the economy. In the beginning stages both Guangdong and Fujian provinces kept most of the tax revenues they produced. Guangdong delivered a fixed but very low quota of revenue to the central government and Fujian received a fixed subsidy. This is referred to in the work by Litwack as “SEZ type 1” – high investment with low taxation for SEZ provinces to maximize the incentive effect, while relying on the less-reformed region of Shanghai for revenue to meet political obligations and maintain social expenditures. But gradually China moved to “SEZ type 2” – by balancing and unifying tax policies for SEZ with the rest of the economy. According to Litwack higher tax revenue from heavily invested regions generated a positive spillover effect and pulled up the rest of the economy, from Guangdong initially to other coastal areas, and then to the whole country (Litwack & Qian, 1998). Thus tax preference policy should never be viewed as a cornerstone of SEZ existence for its future success, SEZ should in our opinion always turn from subsidy-receivers into donors.

We could illustrate the situation when tax incentives are used as a main attraction to investors by referring to the case of Siemens, which is wanting to invest in new engineering plant in the US, but is hindered by a lack of sufficiently skilled labour: “...first, the US is underskilled. It has high unemployment at a time when there are 3.5m job vacancies, according to the Bureau of Labor Statistics. And second, the US is overqualified. Almost half of Americans with a degree are in jobs that do not require one, according to a study by the Center for College Affordability and Productivity (Luce, 2013) . Instead of investing in better education, local authorities are attempting to lure investment by offering tax incentives, which Siemens and other companies do not want: “US states tend to outbid each other with tax breaks, [but] getting a tax holiday does not make up for having a bad business plan, it just delays the pain” (Luce, 2013).

It is extremely important to mention the wise location of Chinese SEZs, which could also be viewed as a contribution to their success. While choosing the location, many factors were taken into consideration:

- 1) Political - The SEZs were deliberately located far from the center of political power in Beijing, minimizing potential risks should any problems or political effects be generated during their functioning.
- 2) Historical - the original four zones were sited in coastal areas of Guangdong and Fujian that had a long history of contact with the outside world through outmigration.
- 3) The most strategically important zone out of five – Shenzhen – constituted a *tabula rasa* (small fishing village), upon which a new landscape of urban and economic development could be writ instead of changing giant metropolices.
- 4) Proximity to Hong-Kong, Macao and Taiwan could foster trade-based learning (Yeung, et al., 2009).

The economic impact of all Chinese zones has been far-reaching, transforming entire regions and economies (World Bank, 2008). A recent review of cost-benefit analyses of selected Asian EPZ programs applying the “enclave model approach” showed that EPZs in the Republic of Korea, Malaysia, Sri Lanka, China, and Indonesia are “economically efficient and generate returns well above the estimated opportunity costs of the respective countries” (Jayanthakumaran, 2003), which can be specifically proven for China by rapidly going GDP, as well as FDI inflows and export numbers in each of 5 zones:

Year	Shenzhen	Zhuhai	Shantou	Xiamen	Hainan
GDP, bill. current RMB ^a					
1978	0.196 ^b	0.209 ^b	1.079 ^c	0.48	2.886 ^d
1990	17.167	4.143	7.245	5.709	10.242
2000	218.745	33.143	45.016	50.187	52.672
2006	581.356	74.770	73.738	116.802	105.285
2007	680.157	89.590	85.010	137.526 ^e	122.96 ^e
2008 ^e	561.176	70.041	72.083	111.442	106.275
Per capita GDP, current RMB ^f					
1978	606 ^b	579 ^b	366 ^c	528/n.a.	510 ^d
1990	8,724	6,678	2,029	5,103/n.a.	1,562
2000	32,800	27,693	9,741	38,233/24,481	6,798
2006	69,450	52,185	14,872	72,827/50,130	12,654
2007	79,645	61,693	17,048	n.a./56,595 ^e	14,631 ^e

Figure 6. Economic Performance of Special Economic Zones, 1978 – 2008 (Yeung, et al., 2009).

Year	Shenzhen	Zhuhai	Shantou	Xiamen	Hainan
Exports, billion current US\$					
1978	0.009 ^a	0.009 ^a	0.251 ^b	0.082	n.a.
1990	8.152	0.489	0.84	0.781	0.471
2000	34.564	3.646	2.595	5.880	0.803
2006	135.959	14.843	3.484	20.508	1.376
2007	168.542	18.477	3.912	25.555 ^c	1.838 ^c
2008 ^d	163.780	19.730	3.278 ^e	26.970	n.a.
Utilized FDI, million current US\$					
1978	5.48 ^a	n.a.	1.61 ^b	n.a.	0.10 ^b
1990	389.94	69.1	98.09	72.37	100.55
2000	1961.45	815.18	165.61	1031.50	430.8
2006	3268.47	824.22	139.60	954.61	748.78
2007	3662.17	1028.83	171.62	1272 ^c	1120 ^c
2008 ^d	3929.58	1138.49	n.a.	1955.63	n.a.

Figure 7. Exports and FDI Inflows in SEZ, 1978 - 2008 (Yeung, et al., 2009).

However, what is more important is that China not only enlarged, but also diversified its export base. The learning-by-doing principle encompassed synergetic learning of domestic enterprises from foreign ones within SEZs, with subsequent innovation diffusion outward from SEZs to the whole of China (Yeung, et al., 2009). Thanks to the deliberate emphasis on R&D and learning, China economy has succeeded in moving from low value-added manufacturing to attracting investment and encouraging exports in a wide range of industries (World Bank, 2008: 27). By 1998, high-tech industries accounted for almost 40 percent of the industrial output within Shenzhen SEZ, reflecting the goal since the late 1980s of moving toward a more technology-intensive, higher-value-added stage of development (Yeung, et al., 2009), which was followed by a rapid decline of importance of agriculture (from 37.0% in 1978 to 0.1% in 2007) (Yeung, et al., 2009).

All in all, Chinese policy of “walking on two legs” establishing five special economic zones as windows and laboratories to test new and innovative policies and measures proved a tentative but ultimately sure way forward, given the uncertainties that prevailed both in China and the world at the time. By 2008, three decades after launching the reforms, China’s decision to focus on economic rather than political development can be judged a success (Yeung, et al., 2009). Despite all the triumphs, however, there are some concerns and unsolved challenges:

One concern no doubt felt in the SEZs is that the migrant labor that has been driving their growth machine over the past 30 years is now facing the prospect of unemployment, after thousands of factories have closed for a variety of reasons since early 2008.⁷ (Yeung, et al., 2009)

One possible solution might lie in joint urban projects with neighbouring areas, conversion (but not simple closure) of enterprises, more emphasis on agriculture (R&D investment in agriculture to move away from traditional low-yield practices into mechanised, computerised and scientifically justified methods.

⁷ In the first nine months of 2008, some 50,000 out of 1 million industrial enterprises in Guangdong Province had collapsed, and its 30 million migrant workers are inevitably affected (*Straits Times* (Singapore), November 15, 2008).

4 Special Economic Zones in Russia

4.1 Achievements and challenges of SEZs in Russia

The first steps in developing special economic zones in the Soviet Union were made at the end of 1980s. At that time SEZs were considered as an element of state foreign policy and their main assigned function was to foster international economic relations. Still the SEZ operations at that time did not bring any tangible result to the Soviet economy as the system that created them stopped its existence a few years later – a time period too short to make conclusions about the effectiveness of the SEZ (Zashev, 2008)

In the beginning of the 1990s a new element in the state concept of SEZ came into being: the regional initiatives when nearly 20 special economic zones were created in Russia. The creation of zones happened in the atmosphere of political and economic instability: “Five years into economic transition in Russia, by contrast, sharp yearly declines in investment activity continue in a highly unstable fiscal environment that is characterized by continual changes in tax rules and emergency tax collection drives to meet expenditure requirements” (Litwack & Qian, 1998).

In Russia, the government has been locked into ambitious stabilization programs, involving international organizations and investors, designed to reduce yearly budget deficits and inflation.

After 5 years of economic transition in Russia, some progress has been made in macroeconomic stabilization. However, the economic environment still exhibits high, unstable taxation, corresponding to continual adjustments of tax rules and enforcement and subject to chronic tax revenue crises. Firms operating in Russia face an average of about 50 different but important taxes.

In addition to high, unstable taxation and high interest rates due to budgetary problems, investment in Russia is also limited by a weak infrastructure.

Thus, [as the challenges to creation of SEZs] can be seen limited resources of the state, political pressures on the budget that grow with decreases in state expenditures, the absence of fiscal commitment, and important complementarities between infrastructural and local investments, all exist in Russia. (Litwack & Qian, 1998).

Instability was consequently reflected in SEZ policy too: “Legal status and privileges granted to zones were constantly changed and questioned – ex. the Russian Federation /RF/ tax authorities have interpreted tax privileges for SEZs as invalid and that actually abolished a significant part of the privileges given to zones before” (Law of the RSFSR №1545-1 “About foreign investment in the RSFSR” of 4.7.1991) (Zashev,

2008). Due to the fact that government “resisted implementing the legal underpinnings which might actually provide for investor confidence and an increase of FDI into the Russian Federation” (Curtis & Shannon Hill, 2006) “the initial expectations were not matched by the results and soon the amount of zones was sharply reduced. Some experts believe [that additional] reasons for failure could be in the absence of a purposeful state policy on development of special economic zones, imperfection of their legislative base, and weaknesses in the organizational system of state control over the zone’s foreign trade activities” (Zashev, 2008)

Some researchers suggested that when comparing the rationale behind creation of SEZs in Russia and China, differences in terms of the political leadership and motivation behind the introduction of SEZs should not be overlooked while determining reasons for limited success of SEZ in Russia:

While China’s central government strategically allowed for the establishment of carefully monitored SEZs in certain geographic locations in order to boost regional development, the Russian leadership in the early 1990’s exercised a very different style of management in terms of the SEZs. Yeltsin designated people in favour of economic liberalization and marketization as governors of regions with the expectation that they would establish more open market economies, including SEZs

In reality, however, “the procedures and institutions established for special zones seem to have been designed to meet other goals of regional leaders: to retain and expand control over regional economies, to enhance opportunities for corrupt gains, and to provide additional assets that can be mobilized for political purposes – i.e., to hold on to power (Curtis & Shannon Hill, 2006).

Apart from political and economic hindrances, there were also purely organizational and planning drawbacks: “although SEZs were established in Russia in order to take advantage of their geographical location, they did not benefit from location in the same way as Chinese SEZs. Regions [chosen for SEZ location] “lacked the resources needed to develop the zones so that they would be attractive to outside investors. Infrastructure for effective development of the territory was woefully inadequate, and regional resources were not mobilized for this purpose” (Curtis & Shannon Hill, 2006).

The report cited above also mentioned the lack of labour force in comparison to China as a hindrance to SEZ development in Russia: “when the Soviet Union was dissolved in 1991 it was an industrialized state, in which more people were employed in state-owned industry than in the agricultural sector. These employees were accustomed to social benefits. The state continued to subsidize its enterprises and provide these

benefits. Employees, therefore, had no incentive to move into other jobs, like in China,” (Curtis & Shannon Hill, 2006).

However, in 1997 a new draft law on free economic zones was passed by the parliament. At the same time, a few selected regions, e.g., Kaliningrad, Nakhodka, and Ingushetiia, have received at least temporary, although as yet uncertain, status as special zones, with preferential tax rates and advantages for foreign Investments (Litwack & Qian, 1998).

The special economic zones re-entered the focus of Russian policy makers in the beginning of the 2000s. It took several years to formulate the new aims and objectives the government vested into the creation of SEZ and by 2005 a new selection of geographic locations was made for the new zones to be established.

The SEZs in Russia are a result of disputes between the author of the SEZ project, the ex-Minister of Economic Development German Greff and Minister of Finance Alexey Kudrin. Greff had in mind the development of high-tech and gigantic production, and Kudrin on the other hand was against disrupting the competition and providing tax holidays. Greff was hoping that the experience gained from co-operation with foreign residents can be transferred to the rest of the country, and Kudrin was suggesting a balanced improvement of investment climate overall in Russia. The dispute was ended by President Putin, who passed the law in favour of the zones ⁸ (Sitnina, 2013)

The beginning of the 2000s not much happened in regard to the SEZs until a significant breakthrough came in 2005 with the introduction of the new Federal Law №116-FL of 22.7.2005. It clearly defined that special economic zones are a part of the territory of the Russian Federation in which a special mode of enterprise activity is valid (Article 2, Federal Law №116 of 22.7.2005) (Zashev, 2008).

⁸ Особые экономические зоны в современном понимании этого слова появились в России в 2005 году, чему предшествовали два года ожесточенных споров между автором идеи, бывшим тогда министром экономического развития Германом Грефом и тогдашним министром финансов Алексеем Кудриным. Греф мечтал о новейших технологиях и гигантах индустрии, а Кудрин был против нарушения правил конкуренции и предоставления налоговых льгот. Греф рассчитывал, что приобретенный опыт по обслуживанию резидентов потом удастся распространить на всю страну, а Кудрин предлагал сразу начать повсеместно улучшать инвестиционный климат. Точку в споре поставил президент Владимир Путин, постановивший "зонам быть" (Sitnina, 2013).

The law has been amended a few times with respect to residency requirements, permitted activities and customs regulations⁹ (Kudelin, 2011) and now in its current form we have 28 special economic zones of 4 different types (Ministry of Economic Development of the Russian Federation, 2013) which are claimed to be tools for attracting FDI to Russia:

- 6 Industrial and production zones (in Republic of Tatarstan, Lipetsk, Samara, Sverdlovsk, Pskov and Kaluga regions);
- 5 Technology and innovation zones (in Moscow, Saint-Petersburg, Tomsk, Dubna (Moscow region) and Republic of Tatarstan);
- 14 Tourist and recreational zones (in Republic of Altai, Republic of Buryatia, Altai Territory, Stavropol Territory, Primorsky Territory, Irkutsk region, also there is cluster in the Krasnodar Territory, Republic of Ingushetia, Republic of Dagestan, Republic of North Ossetia-Alania, Republic of Adygeya, Kabardino-Balkar Republic, Karachi-Cherkess Republic and Chechen Republic);
- 3 Port zones (in Ulyanovsk, Murmansk regions and Khabarovsk Territory).

According to the information presented by the management company Stock Company Special Economic Zones (SEZ JSC), which was established in 2006 as a fully state-owned company (with over 3.4 billion USD in assets under management and in charge of design, construction and operation of SEZs; attraction of private investors as well as providing various services to private investors (Special Economic Zones JSC, 2013) is proudly demonstrating the benefits of entering the SEZ, which mainly consist of tax benefits (property and transport tax exemptions for 10 years and land tax exemptions for 5 years) and free customs zone benefits (no customs duty, refundable VAT), streamlined administrative procedures (possible due to close cooperation with Ministry of Economic Development) and ready-to-use infrastructure:

⁹ Most amendments became effective as of early January 2012. The purpose of the amendments was to make special economic zones (each such zone being a "SEZ") more investor-friendly as well as to facilitate SEZ operation and management. The Amendments have extended the list of permitted activities for residents of industrial and port SEZs, but limited free customs regime for Tourist and Recreation zones. The Amendments prohibit retail sale of goods placed under the FCZ regime and products containing goods (materials) placed under the FCZ Regime, which makes it easier to import goods into zones now. The Amendments abolish tender process for SEZ establishment and provide that the Russian government must set criteria for a SEZ establishment (Kudelin, 2011).

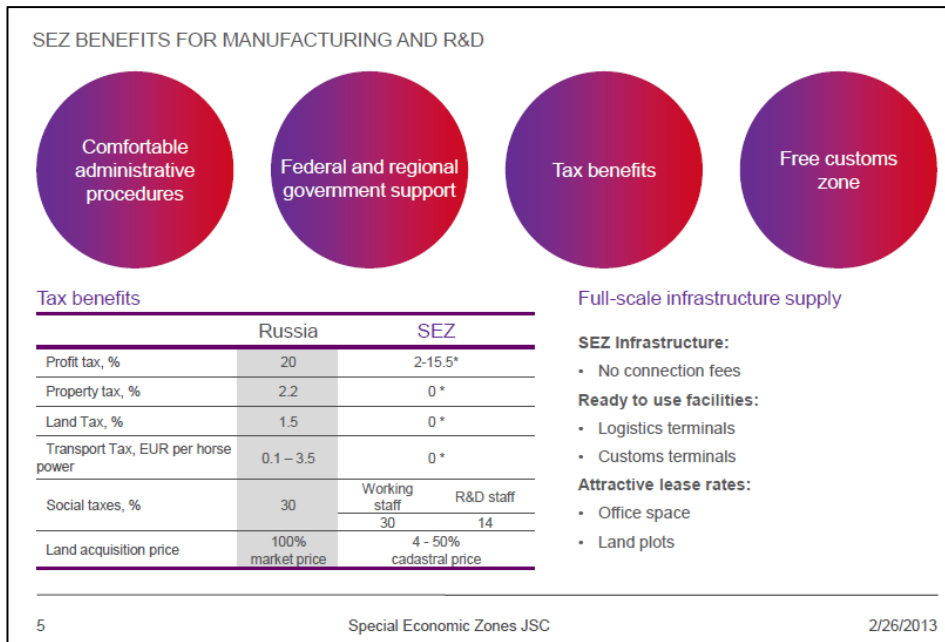


Figure 8. Key Benefits of SEZs in Russia (Special Economic Zones JSC, 2013)

The management company proves the efficiency of SEZs by showing the number of investors that displays a steady growth, and total influx of investment capital:

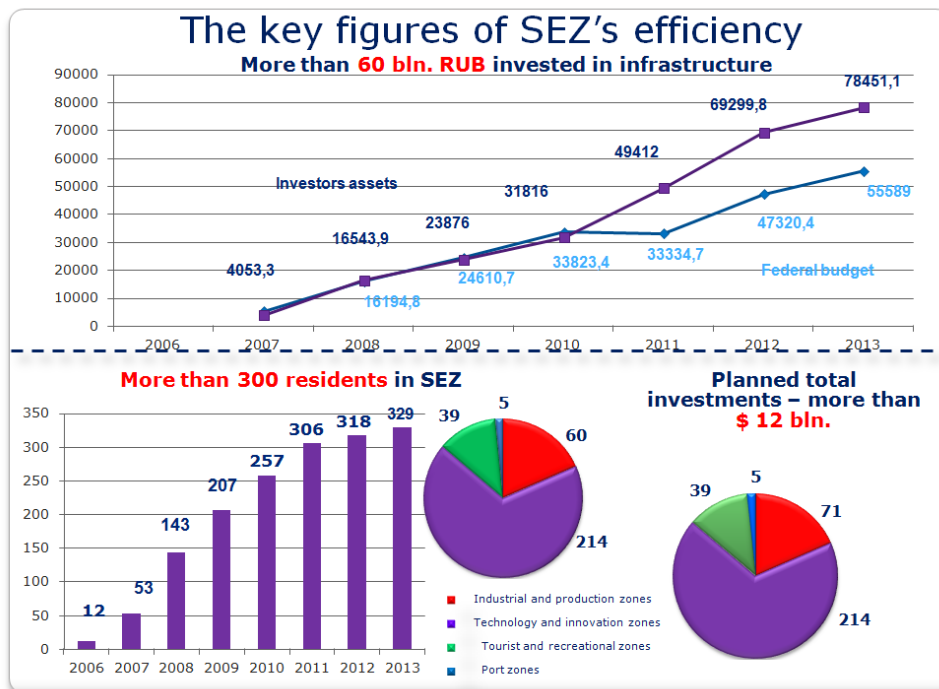


Figure 9. Key Figures of SEZ efficiency according to Ministry of Economic Development

According to official sources, the SEZ project has had a positive impact on regional development dynamics: “Zones have had a positive influence on social situation. In Alabuga [Industrial SEZ] there are currently 3 000 employees, and 70% of them are from Naberezhnye Chelny [neighboring city]...Many restaurants, cafes, comfortable hotels and housing have been built thank to the SEZ project¹⁰” (Sitnina, 2013).

However, success of the SEZs in Russia is not uniform, and most results can be ascribed to industrial zones, and success thereof is mainly explained by Managing Company by “right positioning, HR potential and raw material sources. The imminent criterion for success is also in the pro-activity of local government¹¹” (Kommersant, 2014).

Even most successful Industrial SEZs are often criticized for hosting very few technologically-intensive operations. The officials are trying to justify this by the mere fact of existence of Technology and Innovation Zones (which are supposed to host advanced technology-oriented enterprises). Industrial SEZs, by providing a platform for Ford or Yokohama (who enter zones with the goal of producing traditional spare parts or assembling complete existing vehicles), are supposed to attract FDIs and substitute imports (Kommersant, 2014). In a long run, according to official opinion, Ford, Yokohama and other leading enterprises should form a core for automotive cluster in Russia, and foster the development of local automotive industry (which is highly unlikely from our point of view).

At the same time, while assessing the overall performance of the SEZ project, one should not forget the failure of Tourist and Recreation SEZs in attracting investors. There were a few “objective” reasons named by official representatives, namely the “short touristic season, high flight prices and lack of English-speaking personnel” (Kommersant, 2014). However in our opinion the failure to foresee the obvious difficulties, such as inability to negotiate more affordable prices with airline monopolists

¹⁰ Зоны также позитивно влияют на социальную обстановку в регионе. В "Алабуге" уже работает почти 3 тыс. человек, из них 70% из Набережных Челнов... Благодаря приезжим появляются кафе и рестораны, строятся гостиницы и новые комфортные дома (Sitnina, 2013).

¹¹ ... это правильное позиционирование, доступность кадровых ресурсов и источников сырья. Обязательным условием успеха является активная позиция региональных и местных властей (Kommersant, 2014).

(even for a beginning period), and inability to target the programme to the right group of tourists, could be viewed as a more realistic explanation of the weak performance.

According to the recent evaluation from the current Minister of Economic Development, the performance of Institute of SEZ is unsatisfactory, also because: "...relatively big governmental funds allocated for SEZ project have not been duly used. At the moment Managing Company Stock Company Special Economic Zones (SEZ JSC) has over 40 billion RUR of unused funds on its accounts¹²" (RosBusinessConsult, 2013).

The State Audit Chamber has come up with even sharper criticism of SEZ activity: "The amount of governmental spending on SEZ has reached by 2012 115, 4 billion RUR, and as an outcome only 6, 7 thousand of work places have been created. There is no data, indicating how many employees have simply migrated from other areas. Throughout the whole period of implementation of SEZ policy the amount of tax revenue from SEZ residents has reached 6,3 billion RUR, and the amount of various subsidies and tax breaks – 5, 3 billion RUR. The average salary in SEZ is not higher than an average salary in the respective region; the technological links with other already operating enterprises in the region have not been established, thus the residents of SEZ are operating in isolated environment... The main conclusion of the auditors – everything is happening too slowly. The deadlines for construction of various infrastructural objects ... have been postponed as a result of prolonged land ownership recognition procedures. 223 objects were planned, and only 144 have been commissioned so far, the cost of work performed amounts to 73 billion RUR which constitutes only 40% of the planned cost of all objects¹³" (Sitnina, 2013).

¹² "Я, к сожалению, не могу оценить работу института особых экономических зон как удовлетворительную. К сожалению, те довольно большие средства, которые выделялись, не использовались целевым образом в должном объеме. Сейчас у компании ОАО "Особые экономические зоны" на счетах большие объемы неиспользованных средств - порядка 40 млрд руб.", - сказал он (RosBusinessConsult, 2013).

¹³ При затратах на российские ОЭЗ, достигших к 1 июля 2012 года 115,4 млрд руб., в них создано всего 6,7 тыс. рабочих мест. Какое число из них мигрировало из других районов и регионов — неизвестно. За весь период налоговые отчисления резидентов составили 6,3 млрд рублей, а полученные ими льготы — 5,3 млрд. Зарплаты работников в ОЭЗ не превышают средних зарплат в регионе, технологические цепочки с участием других предприятий региона не формируются, резиденты зон работают как бы в резервации.

Главный вывод аудитором: все идет слишком медленно. Были перенесены сроки строительства ряда объектов инфраструктуры ОЭЗ ... из-за длительного решения множества вопросов земельно-имущественного характера на местах". При плане в 223 объекта в эксплуатацию введены 144, работы выполнены на 73 млрд рублей государственных средств, что составляет 40% плановой стоимости объектов (Sitnina, 2013).

One of the key proofs of the low efficiency of the Managing Company could be the fact that over 49 billion RUR were allocated for non-profile financial activities, such as creation of non-profile subsidiaries, purchase of bonds and creation of quick deposits in commercial banks (Reznikova, 2012).

The main conclusion could be that since the economical effect of the SEZ platform (total investment vs. total gain, in monetary terms as well as in terms of new work places creation), according to the estimate of state auditors, has not reached more than 1% and the finalizing of all planned infrastructure by 2015 is quite doubtful, the SEZ project is in the need of deep re-thinking.

4.2 Port Zones or Transport Hub SEZs – overview

The port zones have been established to develop logistical hubs in Russia. The ultimate goal of the Russian Government is to attract private capital, including foreign capital with tax privileges, to aid the Russian Government to build modern logistics hubs in the country (Liuhto, 2009). According to the governmental policy, Port SEZ are supposed to be created for the period of 49 years, and can be located on the territory of sea and river ports, as well as international airports. The permitted activities include loading / unloading, warehousing and packing / re-packing, assembly and wholesale trade. Residents of Port SEZ will be exempt from paying VAT and import duties when importing equipment and construction materials for own needs, fuel excises as well as land and property tax benefits in exchange for private investments for new port construction in the amount of 100 million EUR, sea port or airport – 50 million EUR and reconstruction of existing object – 3 million EUR¹⁴ (Kommersant, 2008).

In 2008 three regions won the tender for creation of Port SEZs:

- Murmansk (SEZ Murmansk) – to specialize on re-shipment of iron-ore production, petroleum products and general cargoes, ship repair and seafood processing.
- Ulyanovsk (SEZ Ulyanovsk – East) – oriented at making use of aircraft-construction potential of the region being the first aviation zone in Russia; according to the plan will be specialized at construction and modernization of airplanes and aircraft spare parts as well as provision of airport logistics services (Development Corporation Ulyanovsk Region, 2014).
- Khabarovsk (SEZ Sovetskaya Harbour) – aimed at creating multi-profile port and ship repair center, construction of container terminals and processing of seafood (Interfax, 2013).

¹⁴ ПОЭЗ создается сроком на 49 лет и может располагаться на территории морских и речных портов, а также международных аэропортов. В них допускается ведение погрузо-разгрузочных работ, оказание услуг по складированию и хранению грузов, комплектование и переупаковка товаров, сборка, оптовая торговля. Резиденты зон в течение пяти лет освобождаются от НДС и импортных пошлин при ввозе оборудования и стройматериалов для собственных нужд, топливных акцизов, а также получают льготы по земельному и имущественному налогу. Взамен частные инвесторы обязаны вложить в строительство нового морского порта от €100 млн, речного или аэропорта — €50 млн, а в реконструкцию существующего объекта — €3 млн (Kommersant, 2008).

The recent investor data on SEZs available from Ministry of Economic Development Portal looks as follows:

SEZ "MURMANSK"	
Type of the special economic zone	Transport Hub Zone
General description	
Region	Murmansk Oblast
Resident companies	
Name	No registered residents
Characteristics of the zone	
Area, thousand ha, total	3 050
Municipal infrastructure	
Gas	
Availability of gas (tot. (meters cubed annually))	Approximate capacity of SEZ will become available only after a draft of the design will be prepared.
Electricity	
Total (kilowatt an hour)	Approximate capacity of SEZ will become available only after a draft of the design will be prepared.
Heat supply	
Total (giga Calories an hour)	Approximate capacity of SEZ will become available only after a draft of the design will be prepared.
Term of completion for the project	

Figure 10. Key Figures of SEZ Murmansk according to the Ministry of Economic Development

SEZ "ULYANOVSK-EAST"	
Type of the special economic zone	Transport Hub Zone
General description	
Region	Ulyanovsk Oblast
Resident companies	
Name	No registered residents
Characteristics of the zone	
Area, thousand ha, total	640
Area, ths ha, free	640
Logistical infrastructure	
The nearest highway, the distance	The nearest federal highway – 7 km. The nearest road of regional significance – 0,5 km.
Railroad station, the distance	Railway from the railroad station "Upper Terrace" comes directly to the territory of SEZ (the airport Ulyanovsk-East). The nearest freight and passenger railway station "Upper Terrace" – 16 km. The railway station "Ulyanovsk" – 34 km.
Railroad station, the name	"Upper Terrace", "Ulyanovsk"
The nearest international airport, the name	International airport Ulyanovsk-East, Airport Ulyanovsk-Central
The nearest international airport, distance	Spaces SEZ immediately adjacent to the International airport Ulyanovsk-East. Airport Ulyanovsk-Central – 45 km.

Figure 11. Key Figures of SEZ Ulyanovsk according to the Ministry of Economic Development

SEZ "SOVETSKAYA HARBOUR"	
Type of the special economic zone	Transport Hub Zone
General description	
Region	Khabarovsk Krai
Resident companies	
Name	No registered residents
Characteristics of the zone	
Area, thousand ha, total	290
Logistical infrastructure	
The nearest highway, the name	M60 "Ussuri", M58 "Amur"
Railroad station, the name	Station "Khabarovsk-2"
Municipal infrastructure	
Gas	
Availability of gas (tot. (meters cubed annually))	Approximate capacity of SEZ will become available only after a draft of the design will be prepared.
Electricity	
Total (kilowatt an hour)	Approximate capacity of SEZ will become available only after a draft of the design will be prepared.

Figure 12. Key Figures of SEZ Sovetskaya Harbour according to the Ministry of Economic Development

As we can see, from the graph, the SEZ Port zones are in fact lagging behind, since due to numerous problems there are no official residents due to the English version of Ministry of Economic Development web site page (however, the Russian version of the same informational portal gives us information about 6 official residents registered in Ulyanovsk – East SEZ¹⁵, including AAR Corporation, leading provider of diverse products and services to the worldwide commercial aviation and government/defense industries) (Ministry of Economic Development of Russian Federation, 2013). Moreover, all of them were facing the threat of closure at some point (the question of closure is always raised if the SEZ fails to attract any investors after 3 years of its official registration) (Sitnina, 2013). This is a very bad sign from our point of view, since closure of each approved SEZ also means an investment failure for the whole region, what can negatively influence the whole investment climate and reliability of the area.

The original selection of the zone location has reasons behind it – if we view the example of Khabarovsk region, it is specializing at the transport services, and the idea to further develop any port activities seems pretty much logical. Last year [2011] the freight turnover for the given region amounted to 88 billion ton / km¹⁶ and overall port activities constitute 17% of Regional GDP (Maritime News of Russia, 2012). If we view

¹⁵ Количество резидентов - 6 резидентов (по состоянию на 01.11.2013).

¹⁶ Край специализируется на транспортном обслуживании грузовых перевозок, тесно завязанных на работу морских портов. В прошлом году грузооборот транспортной отрасли превысил 88 млрд тонно-километров (Maritime News of Russia, 2012).

the whole Far East area, in the area from Posjet till Tiksi there are 32 sea ports and 300 smaller ports, harbours and havens of local importance. According to the results of 2011 the cumulative freight turnover for the whole area equaled 23, 4% of the total freight turnover of all other Russian ports¹⁷ (Maritime News of Russia, 2012).

However, the mere presence of port activity in the area does not automatically make any area a successful Port SEZ. The concept of Free Port zone is long known in the world, however the Port SEZ projects are only successful when there are objective favourable pre-requisites (apart from tax benefits) which could make the area competitive, and Sovetskaya Harbour SEZ [as well as other 2 SEZs] did not possess those competitive advantages¹⁸ (Ogonek Magazine, 2013). Due to numerous reasons to be presented in the next chapter, all 3 zones did not use their potential to the full. Our goal was to try to present the analysis of what went wrong in a form of comprehensive cumulative SWOT analysis for all 3 Port SEZs, and come up with the ideas of possible improvements.

¹⁷ В Дальневосточном бассейне от Посьета до Тикси расположено 32 морских порта, а также около 300 небольших портов, портовых пунктов и гаваней, имеющих локальное значение. По итогам 2011 года их грузопереработка составила 125,4 млн тонн (23,4% от общего грузооборота российских портов) (Maritime News of Russia, 2012).

¹⁸ Такой тип особой экономической зоны, как свободный порт, в мире давно известен, однако проекты свободных портов реализуются только тогда, когда есть объективные условия в виде наличия высокой сравнительной конкурентоспособности места для развития конкретного вида деятельности. В случае Совгавани в 2008 году такой конкурентоспособности не было. (Ogonek Magazine, 2013).

4.3 Transport Hub SEZs – SWOT

STRENGTHS

1. Favourable geographical location of most existing Transport Hub Zones (not related to the quality of infrastructure.

See previous chapter.

2. The legislative base of SEZ is sufficiently clear (especially after the new amendments mentioned before were introduced).

Moreover, the legislation is on a federal level, which protects the SEZ residents (companies registered within the SEZs) from sudden and unexpected legislative changes on a regional level (Liuhto, 2009).

3. The SEZs offer customs advantages, tax benefits and other privileges.

We have previously discussed that those advantages alone cannot guarantee the success of any SEZ, however in a complex with other measures they constitute a solid advantage for an investor.

4. All SEZs (including Port SEZs) act on the basis of the "single window" principle, which reduces the bureaucratic burden for investing firms.

Single window means that investor give all documents to one special agency and this agency assist in agreement procedures that reduce the time on initial stage of the investment project. The application procedure for becoming a resident comprises 4 major steps (Ministry of Economic development of Russian Federation, 2004-2012). It is important to mention, that so far no corruption cases related to new SEZs have hit the headlines (Liuhto, 2009).

5. Abundant in educated workforce, which is cost-competitive compared to the researchers in western countries.

This statement is true to Russia in general, but to validate this concept, we would like to present information on Khabarovsk Region:

The Khabarovsk Region has rather a high education and research potential. The region is rich in fundamental, sectoral and university research institutions.

Over 1000 institutions of the Region engage in education and bringing up of over 320 thousand people.

The system of professional education of the Region is represented by 27 higher professional education institutions (16 state and 11 private ones), 28 secondary professional education institutions (25 state and 2 private ones) and 16 primary professional education facilities.

9 specialized education institutions of professional training are working under primary and secondary professional education institutions training personnel for larger companies in the priority economy sectors: vessel and aircraft manufacturing, heavy engineering, construction, agriculture, and forestry

(Investment Portal of Khabarovsk Region, 2013).

6. Transport SEZ have been located in the regions which are at the moment well-developed from economical prospective.

If to take the example of Khabarovsk Region again, the economy started to grow after the crisis year of 2009. According to the forecast, the Regional Domestic Product in real numbers is supposed to grow by 4, 3%, industrial production – by 11%, tax and non-tax revenues to the Regional budget – more than 15%...The average monthly salary in the year 2012 will amount to 29 700 RUR (10% increase minus inflation)¹⁹ (Maritime News of Russia, 2012)

¹⁹ После известного кризисного спада 2009 года экономика края стабильно растет. Уходящий год также не исключение. По прогнозу, ВРП в реальном исчислении увеличится на 4,3%, промышленность – на 11%, налоговые и неналоговые доходы в бюджет края – более чем на 15%...Хорошие итоги складываются в сфере личных доходов населения: среднемесячная заработная плата в 2012 году составит 29 700 рублей на одного работника – рост на 10% за вычетом инфляционной составляющей (Maritime News of Russia, 2012).

WEAKNESSES

1. Russia has not made and does not have a procedure for a sanation of inefficient or underperforming zones.

As described in the previous chapter, China was forced to do it at one point. The newest headlines are devoted to the fact that one more SEZ is possibly going to be created on the territory of newly annexed Crimea. However, the creation of any additional SEZs without proper analysis and elimination of inefficient ones is unreasonable according our point of view.

2. The legal basis of SEZ however well-defined, is quite rigid and does not allow for some vital changes in order for some SEZ to stay viable.

The first vice-speaker for Duma of Khabarovsk Region Sergey Lugovskoi has pointed out, that the enlargement of Sovetskaya Harbour SEZ by combining it with Vanino Sea Port [the measure to be defined in Opportunities] has faced a number of legislative hurdles: “Namely, a Port SEZ has to be located within the borders of one port...Thus it is necessary to introduce some amendments to the original Federal Law²⁰ (Article 2, Federal Law №116 of 22.7.2005) (Kommersant, 2013).

3. To get federal financing for infrastructural development, SEZs need to obtain financing from the regional budgets first.

Sometimes it creates challenges, while however growing from economical perspective, certain areas are facing current budgetary deficits. If we look at Ulyanovsk SEZ, the 30% financing from the regional budget will amount to 3 billion RUR (needed for creation of roads, communications, social infrastructure and education of personnel). Taking into consideration, that the budget for the region was approved with 3, 4 billion RUR, and inner Regional debt to the Federal budget as of January 1, 2014 is planned

²⁰ Первый вице-спикер законодательной думы Хабаровского края Сергей Луговской в среду сообщил, что расширение Советско-Гаванской портовой особой экономической зоны (ПОЭЗ) за счет территории Ванинского порта натолкнулось на ряд законодательных сложностей...Поэтому необходимо внесение изменений в закон от 22 июля 2005 года №116-ФЗ «Об особых экономических зонах в РФ».

to be 9, 4 billion RUR, thus it will be extremely hard to comply with SEZ co-financing obligations ²¹ (Kommersant , 2013).

4. While setting up the “benefit package” for potential SEZ residents, the interests of specifically logistics operators were not taken into consideration.

If to view Murmansk Port SEZ as an example, the benefits offered are attractive for those interested in construction of new objects (for example, for fish processing plants). But to serve as a point for transshipment, for example, and be attractive for the international freight, the law needs to be amended in a way to cancel the duties for the entry of foreign ship. According to the Ministry of Finance, all ship built or modernized outside of Russia are subject to VAT (20%) and customs duties (5%), and we can only imagine how expensive it will be for 12 billion EUR ship to unload in port of Murmansk. This makes it impossible for such kind of ship to enter Russian ports, and they have to choose Norway ²² (Sitnina, 2013).

5. What was previously thought as a strength – a well defined functional division of SEZ (as described in detail in the previous chapter), can sometimes work as a limiting factor.

Some SEZ previously ascribed for one type of activity can perfectly have potential for other activity. The vivid example here is Alabuga industrial SEZ, which has a potential for becoming a tourist and recreation zone, due to attractions of historical part of Elabuga city (Kommersant, 2014). We also see the potential for attracting tourists from Murmansk Port SEZ, which lies in the northernmost region of Northwestern Russia, on the Kola Peninsula, which borders Finland's Lapland to the west, Norway's Finnmark

²¹ Стоит отметить, что 30 процентов финансирования Ulyanovsk ПОЭЗ должно идти из регионального бюджета — это около 3 млрд рублей (в основном на подъездные дороги, сети, объекты социальной инфраструктуры и систему обучения персонала). Учитывая, что бюджет региона был утвержден с дефицитом в 3,4 млрд рублей, а государственный внутренний долг региона на 1 января 2014 года запланирован на уровне в 9,4 млрд рублей, исполнить эти обязательства региону будет непросто (Kommersant , 2013)

²² Им нужна отмена пошлин при заходе в порт иностранных судов. По мнению Минфина, суда, построенные или модернизированные за пределами России, должны облагаться НДС и таможенными пошлинами. Из-за этого многие российские суда, построенные или отремонтированные на иностранных верфях, не могут теперь зайти в российские порты. Основная проблема для них: суда, построенные за рубежом, должны при заходе в порт заплатить НДС 20% и пошлину 5%. Если судно построено за €12 млн, то можно представить себе, сколько будет стоить каждый заход в Мурманск. Поэтому многие суда разгружаются в Норвегии (Sitnina, 2013).

Region to the northwest, the Barents Sea to the north, the White Sea to the southeast, and Karelia to the south. Kirovsk, a large town on the Murmansk peninsula can be really interesting due to its unique nature, similar to that of Finland and the world's northernmost botanical gardens as well as a ski resort (Wikitravel, 2014).

6. Russia's national image as a low-tech country does not support the development of the SEZs aimed at innovations.

Despite all attempts to promote Russia as innovation-friendly country, one will find it difficult to name three famous non-military-related innovations designed in Russia and used widely in the developed West on the consumer market (Liuhto, 2009).

7. The land on which the port SEZ are located has legally few owners and the process of land integration and land ownership transfer is not fully concluded yet.

There are really few land plots which are privately owned, and there are a lot of land plots which are subject to land lease agreements. Moreover, there are a lot of land plots which belong to special category according to the law – agricultural land, land of Ministry of Defense – and all of this needs to be transferred to the category of land for industrial and transport purposes. The second round of construction for the Murmansk Port SEZ needs to be done on the left bank of the Murmansk bay, there are around 120 land owners on the territory of fishing port and around 170 owners on the territory of the trading port. In fishing port there are 11 land owners who we have failed to locate²³ (Sitnina, 2013).

8. The third parties which are to be chosen and monitored by the Managing Company are not doing their job properly and on time, which often delays the implementation of SEZ projects and attraction of residents.

²³ В частных руках земли очень мало, но очень много участков, переданных в аренду. К тому же много категорий: земли Минобороны, сельхозназначения, лесные участки; и все нужно переводить в категорию земель промышленности и транспорта. Вторая очередь должна строиться на левом берегу залива, и здесь ситуация еще сложнее. Там порядка 120 собственников на территории рыбного порта и порядка 170 на территории торгового. В рыбном порту 11 собственников вообще не смогли найти (Sitnina, 2013).

The problem faced by Murmansk SEZ is as follows: up till current moment there was no agreement with Ministry of Economic Development regarding the territory planning, however the first stage of the process has already started. A Moscow company “Financial and Organizational Consulting” has won the tender for preparing the planning, and they were supposed to finish their job 1,5 years ago [in 2011], but it has not been done, which is hindering the Regional authorities from proceeding with property assets inventory ²⁴ (Sitnina, 2013).

9. When planning the concept of Port SEZs the interest of companies currently operating on the territory of existing ports have not been taken into consideration, which hinders integration of SEZ residents with existing enterprises, the key to enabling the spill-over effect.

When studying the example of Murmansk port zone, we have found out, that there are currently at least 80 owners of property operating within the boundaries of projected SEZ, on the territory of Murmansk Sea Fishing Port; of them three operators have already informed the stevedore they would not join the port area, and six owners are still weighing up the project (Port News, 2012). For current enterprises the investment burden required to become a resident of a SEZ is too high or unnecessary due to the nature of their business activity, however the opinions thereof need to be considered beforehand.

10. Most of SEZs have failed to attract investors or proceed with construction of planned objects due to weak infrastructure (road and railway capacity, power supply and etc.). Weak infrastructure in general can be considered one of the biggest challenges of Russian Port SEZs and all SEZs in general.

No doubt well- developed infrastructure is the key to success of any project of a SEZ type. When we studied the example of Khabarovsk Port SEZ, we have found out that all energy supply there is provided by 2 channels: Komsomolskaya – Vanino power line (388 km) and old Mayskaya Hydropower plant (with capacity of 93 MW). The current energy supply is not sufficient even for the existing consumers. Not to mention

²⁴ И это еще не все проблемы, связанные с портовой ОЭЗ. "До настоящего времени у нас с федеральным Минэкономразвития не согласована планировка территории, хотя бы первый этап. Конкурс выиграла московская компания "Финансово-организационный консалтинг". Они в позапрошлом году все должны были разработать и согласовать, но до настоящего времени ничего нет. Из-за этого мы не можем сделать инвентаризацию участков (Sitnina, 2013).

the fact that the power supply is extremely unreliable, there are many accidents occurring on the line which lead to power loss and the need to switch to expensive autonomous diesel generators²⁵ (Ogonek Magazine, 2013).

²⁵ Конечно, самое важное – инфраструктура. И энергетическая инфраструктура в первую очередь. В настоящее время электроснабжение Ванино – Советско-Гаванского энергоузла (ВСГЭУ) обеспечивается двумя каналами: линией электропередачи "Комсомольская – Ванино" протяженностью 388 км и выработкой малоэкономичной и старой Майской ГРЭС (установленная мощность – 93 МВт). Этих мощностей для потребителей не хватает. Но это не единственная проблема. Прежде всего, электроснабжение ненадежно. На линии электропередачи возникают аварии, что приводит к потере 75 МВт в узле и к необходимости пуска пиковых генераторов, использующих дорогостоящее дизельное топливо (Ogonek Magazine, 2013).

OPPORTUNITIES

1. The opportunity lies with more intensive promotion of SEZ potential abroad to attract a target group of new investors, not only the companies currently operating in Russia.

The marketing activities of the SEZs are weak inside Russia, and non-existent outside the country. In fact, it is difficult to find any public information on these zones [in a language rather than Russian], even if one would be aware of their existence (Liuhto, 2009). The Port SEZs should be better represented at Logistics Fairs and Exhibitions of international importance.

2. Re-think the approach to Port SEZs and after sanitation of inefficient zones of any type consider the possibility of creation of Logistics SEZs in places historically and geographically suited for logistical operation, such as the regions of Kaliningrad, Krasnodar, Leningrad.

As logistics is an extremely logical sphere of business, supporting anything unnatural with administrative benefits will turn out to be expensive and non-sustainable (Liuhto, 2009).

3. New residents can be attracted if the law regarding the inability of any company's subsidiary / filial to apply for the residency in SEZ will be reconsidered. The subsidiaries can be engaged in totally different activities than the main company which can be beneficial for SEZ development, and this measure has already proven to be inefficient to prevent re-transferring of production (which was apparently the original aim of the mentioned restriction).

Murmansk Port SEZ which is in an urgent need for residents and pending closure has faced the following problem, when some applications from potential investors have been cancelled on the mere ground that the applicant is a subsidiary of existing company²⁶ (Sitnina, 2013).

²⁶ В законе сказано, что резиденты должны регистрироваться в МЭР. У нас несколько компаний обращались, но одних завернули, потому что они филиал, что запрещено законом, а у других не приняли документы просто потому, что не создана управляющая компания, куда можно было бы их направить (Sitnina, 2013)

4. The opportunity lies with the local projects of improving existing infrastructure (for example, strengthening power supply), which will benefit SEZs as well as the whole region.

The problem of infrastructure of Sovetskaya Harbour SEZ can be partly solved when “RusHydro” will complete the project of constructing a new power plant in Khabarovsk region. The reliability of power supply and capacities will drastically increase, not to mention the saving potential of more than 100 thousand tons of fuel per year for the region due to the new equipment ²⁷ (Ogonek Magazine, 2013).

5. Regional and National projects for improvement of transportation system can be viewed as a solution to the problem of weak transport infrastructure and as an opportunity to remove one of the biggest hindrances to the Port SEZ Projects. However, the information on such programs should be received in advance before granting the status of SEZ, and better coordination with and information about such programs should be presented to potential investors.

In Khabarovsk Region the following projects are being implemented in the framework of Federal Program “Development of Transportation System of Russia (2010 – 2015)”: reconstruction of the airport complex “Novyi” (Khabarovsk city) and waterways of the Amur river; the safety of approaches to the De-Kastri and Vanino ports is being increased and so on. The planned budget funds for these purposes amounts to 706, 2 billion RUR.

In 2012 the Governmental Program “Development of Transportation System of Khabarovsk Region” has been ratified. The Program includes measures of developing road infrastructure, construction and reconstruction of sea ports, renovation of sea and river fleet and so on. The Program will be implemented up till 2020 with the planned financing of 93 billion RUR ²⁸ (Maritime News of Russia, 2012).

²⁷ “РусГидро” начинает строительство ТЭЦ в Советской Гавани... хорошо скажется, поскольку ветхую технику заменят новой. Кроме того, резко повысится выдача тепловой мощности, то есть надежность и масштаб теплоснабжения существенно возрастут. Что касается экономии, то одно только снижение удельного расхода топлива хотя бы до среднего по краю уровня позволит сохранить более 100 тысяч тонн топлива в год (Ogonek Magazine, 2013).

²⁸ На территории края реализуются мероприятия в рамках ФЦП «Развитие транспортной системы России (2010-2015 годы)» в части реконструкции аэропортового комплекса «Новый» (г. Хабаровск), водных трасс на р. Амур, объектов глобальной системы связи

6. The opportunity to save Sovetskaya Harbor Port SEZ from closure is in uniting the existing SEZ territory with the territory of neighboring Port of Vanino into one joint investment project to solve a problem of weak infrastructure.

The Port of Vanino is the biggest transport hub of Khabarovsk Region, processing around 70% of cargo volume of the Region, and belongs to ten biggest ports in Russia (Maritime News of Russia, 2012). The idea of uniting two ports into one SEZ has been already approved in Moscow (AmurMedia, 2012). The director of OOO Sovetskaya Harbour Sea Port Igor Chudinov thinks, that this is a vital step for the Port SEZ. Now, when the capacities of SEZ have been realistically evaluated, the sustainability of Sovetskaya Harbor as a special zone without good railway connection seems like a pure utopia. Port of Vanino has a well-developed port infrastructure and good railway connection. Thus, Sovetskaya Harbour can serve as a legal springboard without losing any economical benefits. If the project will not be implemented, Sovetskaya Harbour will be good for fisheries only ²⁹ (Kommersant (Khabarovsk), 2012). What is more important from our point of view, is a possibility to utilize the lobbying power and current investors of Port of Vanino, the impression gained from reading various sources is that Vanino is relatively strong in both aspects. The idea of uniting two ports looks even more lucrative to investors after opening in November 2012 of Kuznetsovsky tunnel (connecting both ports), which added 20 million tons to existing railroad capacity (Port News, 2012).

при бедствии, обеспечения безопасности на подходах к морским портам Де-Кастри и Ванино. Запланированный объём финансовых средств по данным программным мероприятиям на 2012 год составляет 706,2 млн рублей.

В 2012 году утверждена государственная целевая программа «Развитие транспортной системы Хабаровского края», которая начнёт действовать с 2013 года. Программой предусмотрен перечень мероприятий, направленных на развитие дорожной инфраструктуры, строительство и реконструкцию зданий аэропортов местных воздушных линий, обновление парка речных и воздушных судов. Действие Программы рассчитано на период до 2020 года с объёмом финансирования в размере 97,3 млрд рублей (Maritime News of Russia, 2012).

²⁹ Директор ООО «Советско-гаваньский морской торговый порт» Игорь Чудинов считает, что включение в проект ПОЭЗ портовых мощностей Ванино жизненно необходимо. «Мы реально оцениваем возможности Совгаванского порта, и без железнодорожного сообщения эта ПОЭЗ — утопия. Ванино имеет хороший задел в развитии припортовой инфраструктуры, железнодорожного сообщения. Мы в этой ситуации выглядим юридическим плацдармом для ПОЭЗ», — объясняет он. Совгавань при этом отнюдь не потеряет экономических выгод, в противном случае «здесь будет заниматься нечем, кроме рыболовства».

7. Opportunity of improving the management of SEZ and solving the problem of delayed decision making and lack of control and accountability lies in creation of Regional Management Company for Port SEZs.

According to authorities of Khabarovsk Region main Management Company Stock Company Special Economic Zones (SEZ JSC) failed to create any administrative body or assign someone in the Region to deal with the problems of the Port SEZ. Nowadays the functions of Management Company have been taken over by the Regional Administration, which is not very good ³⁰ (Interfax, 2012). Moreover, the amendments to the main law about Special Economic Zones approved in 2011 allow creation of private Management Companies with the share of private investment in the share capital.

8. Opportunity of creating an international joint venture - Managing Company with participation of group of companies from another country, which has previously had a good experience with managing SEZ (for example, China) in order to transfer best managing practices and principles and generate the same level of success.

The Group of Companies from North-East province of China is ready to invest no less than 150 million USD for creation and management of Port SEZ in Khabarovsk Region. The share of Russian side in the share capital according to the offer from Chinese company is going to be 75%. After signing of the contract the Chinese side is ready to take over the responsibilities for planning, design, construction and management of Port SEZ for 49 years ³¹ (Mail.ru News, 2013).

³⁰ За три года с момента объявления о создании зоны управляющая компания ОАО "Особые экономические зоны" (ОАО "ОЭЗ") не решилось создать в регионе какую-либо структуру, которая бы занималась ПОЭЗ "Советская Гавань. В регионе надо бывать, здесь нужно проводить изыскания, заниматься объектом. Сейчас функции управляющей компании несет правительство Хабаровского края, и это не лучший вариант.

Он добавил, что этот вопрос может быть решен благодаря принятым в декабре 2011 года поправкам в федеральное законодательство, которые позволяют создавать региональные управляющие компании с долей частных инвестиций в уставном капитале (Interfax, 2012)

³¹ Китайская сторона (Группа компаний китайской северо-восточной провинции Ляонин) готова вложить не менее 150 миллионов долларов в создание и управление портовой особой экономической зоны. редложила создать совместную инвестиционно-управляющую компанию «Советская Гавань», в которой доля российской стороны

THREATS

1. There is always a threat of SEZ (all SEZs, not only Port SEZs) being misused by the companies which are merely re-transferring their existent operations to the territory of SEZ to avoid taxes.

Even more of secondary SEZ costs come from non-received tax revenue. For example, Dutch company Rockwool, producer of insulation materials, has saved more than 12 million USD on avoiding customs duties, since the special zone regime offers residents 0% VAT and 0% import duties. Rockwool already has 4 factories in Russia, and 3 factories are operating under normal conditions. Thus, Rockwool has already paid customs duties 3 times, and would be ready to pay for the fourth time since the market for construction materials in Russia is immense, but suddenly SEZ became an obstacle for millions of USD to enter Federal budget. Another example is Air Liquide, which managed to save 2, 5 million USD on electricity connection ³² (Sitnina, 2013).

2. Since the heads of Management Company Stock Company Special Economic Zones (SEZ JSC) are changing too often, it can be viewed as a warning of non-consistency of SEZ policy and possible threat for stability for investors.

Last week [March 2013] the General Manager of SEZ JSC has changed – Mikhail Trushko has been appointed instead of Oleg Kostin. This re-arrangement proved the “fatal” character of this position. The people previously occupying this position were changing each other pretty quickly and always under mysterious conditions: Yuri

составляла бы 75%, китайской — 25%. После регистрации СП предполагается подписание взаимовыгодного договора, по условиям которого российская сторона сможет поручить инвестиционно-управляющей компании взять на себя планирование, проектирование, строительство и управление ПОЭЗ сроком до 49 лет (Mail.ru News, 2013).

³² Еще больше косвенных расходов — за счет недополученных доходов. Например, датская компания Rockwool, производящая теплоизоляционные материалы, сэкономила \$12,6 млн за счет таможенных льгот. Особый режим предлагает нулевую ставку НДС и ввозных пошлин на импортное оборудование. При этом у Rockwool в России четыре завода, и три из них работают на обычных условиях. Здесь в особой зоне построен самый новый. Получается, что три раза Rockwool эти пошлины заплатил и заплатил бы еще раз, российский рынок стройматериалов огромен, но на пути миллионов долларов в бюджет встали особые зоны. Другой пример: компания Air Liquide, которая сэкономила \$2,5 млн на подключении к электросетям (Sitnina, 2013).

Zhdanov (left in 2006), Mikhail Mishustin (2007), Andrey Alpatov (2009), Igor Kosov (20011) ³³ (Sitnina, 2013).

3. The financing of SEZ Project from the Federal budget has already been delayed for many SEZs due to the economical crisis of 2009, and the threat still exists due to uncertain geo-political situation in the light with current Ukrainian – Russian crisis and possible economical sanctions.

According to the announcement of Russian Government [as of 2010] Khabarovsk Port SEZ will receive 3, 15 billion RUR of budget money, out of which 3 billion RUR will go for engineering design and construction of objects, 20 million RUR for concept development and 104 million RUR for territory planning and geodesic work. However, this financing is planned in Federal budget only for the period from 2011 – 2013³⁴ (Kommersant, 2010)

4. Solving the problem of weak infrastructure, especially in relation to “weak spots” with low capacity of BAM (Baikal – Amur Railroad) which is really critical for Khabarovsk Port SEZ, cannot be done on a local level and need to bring about the major reconstruction of railroad network. The reconstruction according to all estimation will come at a big cost for the end users – passengers of RZHD (Russian Railroad monopolist), which does not make an SEZ project very attractive in the eyes of most stakeholders if the tariffs for railroad tickets are going to be increased.

Total planned reconstruction announced by RZHD to be implemented in this transport corridor till the end of 2020 will cost 1 billion RUR (Kommersant, 2014). The investment

³³ На прошлой неделе сменился генеральный директор ОАО ОЭЗ: на место Олега Костина был назначен Михаил Трушко. Перестановка подтвердила распространенное мнение о "расстрельном" характере этой должности. Занимавшие ее люди сменяли друг друга часто и почти всегда при загадочных обстоятельствах: Юрий Жданов (ушел в 2006 году), Михаил Мишустин (2007), Андрей Алпатов (2009), Игорь Косов (2011) (Sitnina, 2013).

³⁴ В опубликованном в понедельник постановлении правительства отмечается, что бюджетные ассигнования на создание ПОЭЗ Khabarovsk со стороны РФ составят 3,15 млрд руб., из них — 3 млрд на проектирование и строительство объектов ПОЭЗ, 20 млн. на концепцию развития и 104 млн руб. — на планировку территории и геодезию. Однако предусмотрено это финансирование в федеральном бюджете будет только с 2011 по 2013 год (Kommersant, 2010).

program of RHDZ in general depends on railroad tariffs as a means of getting a return on investment.

5. The biggest threat at the moment is connected with Russia – Ukraine political tensions, which have already jeopardized the investment climate attractiveness of Russia. If the political climate does not stabilize, the future of SEZ project will be highly questionable.

4.4 Recommendations for improvement based on SWOT

According to the data, collected in the course of our research, the SEZ project still has quite high potential for success. In our mind, this is a time for big re-evaluation for Ministry of Economic Development, which preferably should be done by means of attracting independent competent auditors / analysts to avoid relying on the biased results presented by Managing Company with subsequent sanation / closing of inefficient SEZs. No other SEZs of any type should be created until in-depth structural analysis is conducted and the policy is revised on the basis thereof. The analysis from our point of view should concentrate on few main points:

- The actualized detailed investment overview creation and asset re-evaluation (to detect allocated but unused funds, to find individuals and institutions accountable for non-targeted use of governmental funds, to create an investment timetable for overall SEZ project (which type of financing will be received and when, on which level – governmental or regional, what is still missing, which project steps should receive priority financing etc.).
- All planned / current / already implemented Federal and Regional programmes applicable for SEZ host regions should be summarized and the revised timetable should be created indicating when and on which conditions the programs (related to SEZ efficiency) will be implemented. The main idea is to avoid isolating SEZ project from the rest of economical activity, to utilize the potential of already planned measures to maximize the potential of SEZ project and avoid “re-inventing the wheel” (for example, looking for investors to improve infrastructure when it is already planned in the framework of some Regional development program).
- Revise the legislative base and find the weak / non-transparent / ineffective places which are hindering the SEZ development.
- A great deal of marketing and promotion work is ahead of SEZ program developers – what can be done to spread the awareness of SEZ potential worldwide, which events / exhibitions / forums / etc. of international importance should be used as a platform for communicating the benefits of investing into SEZs.
- Analyze functioning of SEZ in the context of urban and regional development (make a fair assessment of newly created job places, analyze the potential of strengthening the cooperation with neighbour non-residents, find the places and

potentials for deeper integration and creation of cluster which will include both – SEZ and neighbouring environment to maximize positive spill-over potential).

- Come up with the fair and unbiased assessment of current Managing Company efficiency, and change the managing structure when needed (possible structural changes have been suggested in SWOT analysis).
- Work on a program of R&D transfer to foster the transfer of technologies and know-how and create the base for qualitative improvement of local industries.

Upon implementation of suggested measures the chances of SEZ staying viable will increase even after Russia access to WTO.

5 Conclusions

The research has hopefully succeeded in presenting a multi-facet nature of SEZs, and explaining the mechanism of their creation and functioning.

The scenario of development offered is supposed to ensure, that SEZs will not only attract FDI to Russia, but will foster qualitative changes in economy by acting as a binding force between innovations and industrialization, as well as a platform for testing new policies, approaches with their possible subsequent integration into main policy line. Thorough analysis attempt was made in the thesis to justify the continuation of SEZ policy under current geo – political and economical conditions.

It is worth to say, that the research conducted was a challenging one due to several reasons. Because of governmental involvement in the functioning of free economic zones, we had to deal with the factual data on their performance with a sound criticism, since the performance of such zones is a criteria of a country's success and favorable image. The multi-lingual nature of this research was also in researchers' mind – we were striving at minimizing the risk of any omissions, misinterpretations or translation errors to insure the credibility of our study.

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Revised Kyoto Convention of the World Customs Organization

Chapter 2

Free zones

Definition

For the purpose of this Chapter:

E1./ F1.

“free zone” means a part of the territory of a Contracting Party where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs territory.

Principle

1. Standard

The Customs regulations applicable to free zones shall be governed by the provisions of this Chapter and, insofar as applicable, by the provisions of the General Annex.

Establishment and control

2. Standard

National legislation shall specify the requirements relating to the establishment of free zones, the kinds of goods admissible to such zones and the nature of the operations to which goods may be subjected in them.

3. Standard

The Customs shall lay down the arrangements for Customs control including appropriate requirements as regards the suitability, construction and layout of free zones.

4. Standard

The Customs shall have the right to carry out checks at any time on the goods stored in a free zone.

Admission of goods

5. Standard

Admission to a free zone shall be authorized not only for goods imported directly from abroad but also for goods brought from the Customs territory of the Contracting Party concerned.

6. Recommended Practice

Admission to a free zone of goods brought from abroad should not be refused solely on the grounds that the goods are liable to prohibitions or restrictions other than those imposed on grounds of:

- public morality or order, public security, public hygiene or health, or for veterinary or phytosanitary considerations; or
- the protection of patents, trade marks and copyrights,

irrespective of country of origin, country from which arrived or country of destination.

Goods which constitute a hazard, which are likely to affect other goods or which require special installations should be admitted only to free zones specially designed to receive them.

7. Standard

Goods admissible to a free zone which are entitled to exemption from or repayment of import duties and taxes when exported shall qualify for such exemption or repayment immediately after they have been introduced into the free zone.

8. Standard

Goods admissible to a free zone which are entitled to exemption from or repayment of internal duties and taxes when exported shall qualify for such exemption or repayment after they have been introduced into the free zone.

9. Recommended Practice

No Goods declaration should be required by the Customs in respect of goods introduced into a free zone directly from abroad if the information is already available on the documents accompanying the goods.

Security

10. Recommended Practice

The Customs should not require security for the admission of goods to a free zone.

Authorized operations

11. Standard

Goods admitted to a free zone shall be allowed to undergo operations necessary for their preservation and usual forms of handling to improve their packaging or marketable quality or to prepare them for shipment, such as breaking bulk, grouping of packages, sorting and grading, and repacking.

12. Standard

Where the competent authorities allow processing or manufacturing operations in a free zone, they shall specify the processing or manufacturing operations to which goods may be subjected in general terms and/or in detail in a regulation applicable throughout the free zone or in the authority granted to the enterprise carrying out these operations.

Goods consumed within the free zone**13. Standard**

National legislation shall enumerate the cases in which goods to be consumed inside the free zone may be admitted free of duties and taxes and shall lay down the requirements which must be met.

Duration of stay**14. Standard**

Only in exceptional circumstances shall a time limit be imposed on the duration of the stay of goods in a free zone.

Transfer of ownership**15. Standard**

The transfer of ownership of goods admitted to a free zone shall be allowed.

Removal of goods**16. Standard**

Goods admitted to or produced in a free zone shall be permitted to be removed in part or in full to another free zone or placed under a Customs procedure, subject to compliance with the conditions and formalities applicable in each case.

17. Standard

The only declaration required for goods on removal from a free zone shall be the Goods declaration normally required for the Customs procedure to which those goods are assigned.

18. Recommended Practice

Where a document must be produced to the Customs in respect of goods which on removal from a free zone are sent directly abroad, the Customs should not require more information than already available on the documents accompanying the goods.

Assessment of duties and taxes**19. Standard**

National legislation shall specify the point in time to be taken into consideration for the purpose of determining the value and quantity of goods which may be taken into home use on removal from a free zone and the rates of the import duties and taxes or internal duties and taxes, as the case may be, applicable to them.

20. Standard

National legislation shall specify the rules applicable for determining the amount of the import duties and taxes or internal duties and taxes, as the case may be, chargeable on goods taken into home use after processing or manufacturing in a free zone.

Closure of a free zone**21. Standard**

In the event of the closure of a free zone, the persons concerned shall be given sufficient time to remove their goods to another free zone or to place them under a Customs procedure, subject to compliance with the conditions and formalities applicable in each case.