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How to Improve Special Economic Zones

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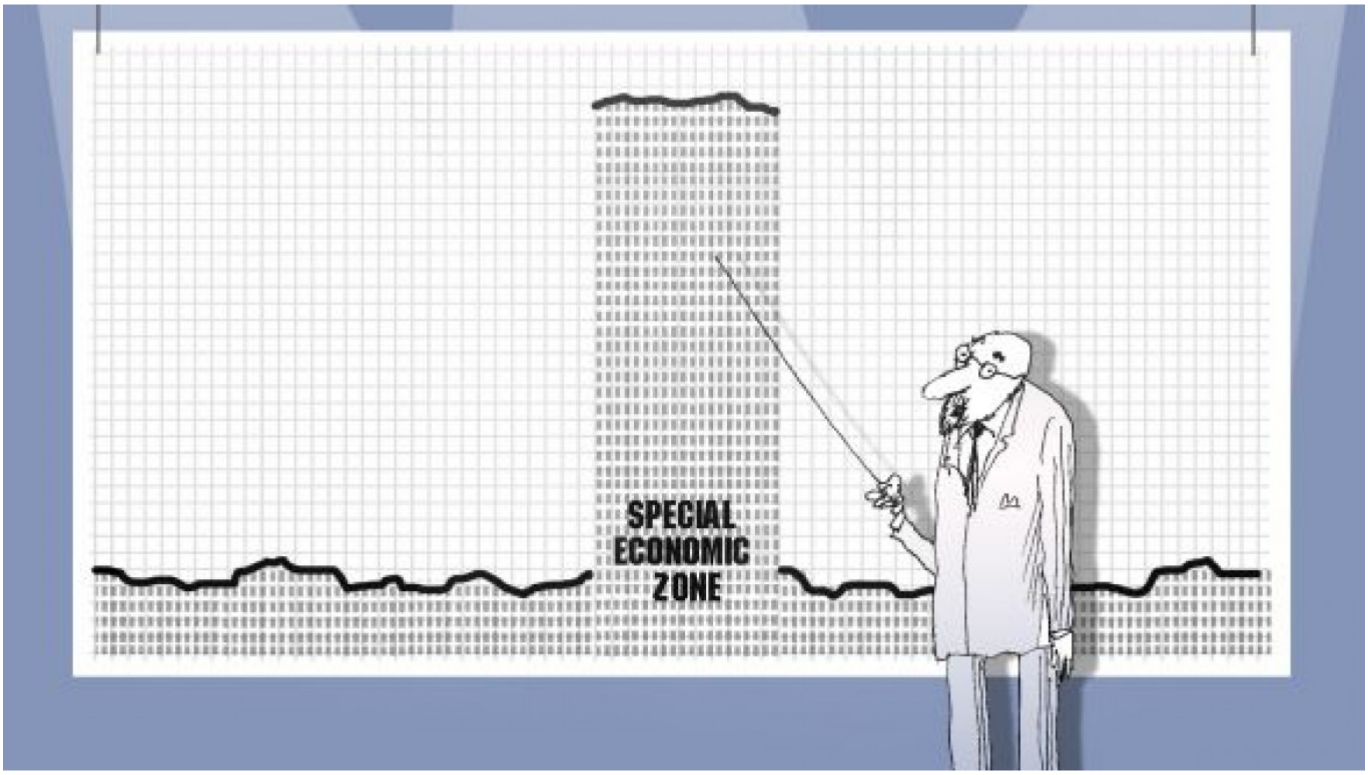

Special economic zones, widely considered a fast track to economic development, will be one of the most important topics of discussion at the St. Petersburg International Economic Forum on Thursday and Friday.

The Shenzhen in China, maquiladoras in Mexico, Jebel Ali in Dubai and the Bataan in the Philippines are good examples of the success stories of economic zones. With the possible exception of Dubai, the standard of living in those zones is three to five times higher than that in other parts of the country.

The formula for success is basically the same in all special economic zones: the abolition of customs duties on imported equipment, a well-established infrastructure, heightened government efforts to minimize corruption in the zone, cheap labor and inexpensive raw materials. It is therefore not surprising that more than 3,000 of these zones have been created worldwide since 1980, and more than 1,000 of them are still functioning.

But as is often the case with global trends, the situation is different in Russia. For example, the special economic zone that operated in Ingushetia from 1994 to 1997 cost the federal budget $1 billion without bringing any benefit to the region. In addition, billionaire Roman Abramovich oversaw a special economic zone in Chukotka from 2001 to 2005, but he did so for the wrong reason: to optimize his own tax liabilities. The project was a large windfall for regional coffers but failed to spur economic growth in the region.

The main problem with Russia's special economic zones is that they offer few attractions for investors. First, they are too small to host large-scale projects. For example, the zones in Zelenograd and Dubna outside Moscow and the zones in St. Petersburg and Tomsk are confined to from 129 to 207 hectares each.

Second, they offer scant advantages in comparison to similar zones abroad. The Lipetsk zone, for example, has cut the profit tax from 20 percent to only 15.5 percent. The social tax on employees' salaries was cut from 30 percent to only 14 percent effective from 2012 to 2017, but after 2017 the rate will jump back up to 28 percent.

Third, they are all impractical from the standpoint of logistics. In other countries, many zones are created near the coastline to take advantage of modern airports, sea ports and major highways leading to the city. But Russia's poor transportation infrastructure makes setting up special economic zones in coastline cities less attractive.

From its beginning, the special economic zone in Kaliningrad was created for the wrong reasons. Instead of trying to promote competitive production for export, the Kaliningrad zone was established to promote import substitution — for example, with meat products, televisions and cognac.

It would be helpful if participants at the St. Petersburg forum discussed why the Russian government and State Duma link the gradual closure of the special economic zone in Kaliningrad with the creation of the Customs Union with Belarus. This thinking seems especially odd considering that Belarussian President Alexander Lukashenko signed a decree on June 5 creating an 8,000-hectare Chinese-Belarussian industrial park in the Smolevichi district of the Minsk region. Belarus will surely benefit from this zone, while Russia will be left on the sidelines. Belarus' zone is the first to appear within the territory of the Customs Union, and it has all the correct elements: The land is sold at a discount, no profit, property or land taxes will be levied for 10 to 20 years and insurance premiums are set at only 9 percent, compared to 30 percent in Russia.

Special economic zones are a standard mechanism to incorporate a newly industrialized country into the global economy. But Russia does not need to reinvent the wheel. For example, there is no need to create exemptions for importing duty-free goods to the domestic market because membership in the World Trade Organization will provide that.

But Russia should concentrate its efforts on creating an export-oriented zone aimed at European investors and the European market. Kaliningrad would be a logical place to start. This could do more to unify Russia and the European Union than a dozen gas pipelines. Technically, this would not be difficult to establish as long as there is political will in the Kremlin. The fact that the region is an exclave makes it ideal for this type of experimental project, one that would eliminate visas and combine Russian tax laws with European anti-trust legislation. It could also include a special gambling zone and focus on developing tourism and hotels and creating a regional center for holding business conventions.

Kaliningrad is the ideal place for Russia's "window to Europe," and with the correct strategy and investment it could become Russia's showcase economic center after Moscow.

Russia needs to learn from other countries' successful experiences with special economic zones. Let's hope the foreign participants at the St. Petersburg forum will offer their insights and advice during the panel discussions, lunch breaks and receptions and that Russia's top economic advisers and officials take good notes.

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