

Tax Breaks May Not Be Enough to Jumpstart Crimea's Struggling Economy

By [Delphine d'Amora](#)

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Waves lapping up against a monument to the scuttled ships of the Black Sea Fleet in the bay of Sevastopol.

In an effort to jumpstart Crimea's faltering economy, a government plan could offer tax breaks and other juicy business conditions on the peninsula for the next half century — but even this may not be enough to attract businesses to the badly run-down region.

Russian politicians began talking about creating a special economic zone in Crimea almost immediately after the referendum on March 16, in which more than 90 percent of voters supported leaving Ukraine to become Russia's 22nd republic.

"Our aim is to make the peninsula as attractive as possible to investors, so that it can generate sufficient income for its own development," Prime Minister Dmitry Medvedev said in early April, RIA Novosti reported.

The legislation, which is currently under development in the Economic Development Ministry, provides truly appetizing conditions: residents of the special economic zone are freed from property taxes, land taxes, transport taxes and federal profit taxes, Gazeta.ru reported, citing a copy of the document. These conditions are sure to pique investors' interest, although in the current draft only the largest players will qualify. The price of becoming a resident eligible to receive the zone's privileges costs 150 million rubles (\$4.3 million), putting the status effectively out of the reach of small and mid-sized businesses.

"Crimea is a tourism and service zone, the local population earns most of their income through small businesses. The entry ticket should be affordable," said Andrey Goltsblat, Managing Partner of Goltsblat BLP. This issue is already receiving attention: Russian business lobby group Delovaya Rossia has proposed lowering the limit to 70 million rubles (\$2 million) for medium-sized businesses and 20 million rubles (\$580,000) for small businesses, co-chairman Andrey Nazarov said.

But if the legislation is to achieve its aims at all, it will have to overcome one crucial obstacle that has become the elephant in the room during political and business debates over Crimea. The regions' social and transportation infrastructure has received essentially no investment since the fall of the Soviet Union, and would now be hard put to support an influx of demanding modern businesses.

Foreign investors, meanwhile, are reluctant to put resources into the region while the international community does not recognize the region as a part of Russia.

"Infrastructure barriers will put the brakes on Russian investment, and the political barriers will inhibit foreign investment," said Alexander Deryugin, director of the Center for Regional Reform Studies at the Presidential Academy of National Economy and Public Administration.

There will be no quick and easy fix to the infrastructure problem, Deryugin said. It touches all spheres — from electricity and water supply to transportation, education and health-care facilities — and will take years if not decades to resolve.

"Even if the economic situation improves, I do not think that we can expect any significant improvements for the next three years," Deryugin said. The situation is not exclusive to Crimea, he added: federal and regional budgets are now struggling under the weight of presidential decrees to be fulfilled by 2018, leaving no funds free for developing infrastructure.

The low level of infrastructure inhibits just about every opportunity that Crimea currently has for economic development. In addition to tax breaks, the Economic Development Ministry's bill offers a series of privileges aimed at transforming Crimea into a shipping center: the peninsula's ports will offer simplified customs procedures and zero-percent value-added tax.

But at the moment, there is no direct ground transportation between Crimea and the Russian mainland, meaning that goods imported to Crimea would have no access to the wider Russian market. There are plans to build a bridge across the Kerch Strait, but the project will take five years to complete and cost up to 200 billion rubles (\$5.8 billion), according to Economic Development Ministry estimates.

The bill would also allow regional authorities to set the boundaries of Crimea's very own gaming zone, an idea that Russian and Crimean officials have repeatedly touted as a path to realizing the region's full potential as a resort. But this plan too is stymied by ragged facilities and by Crimea's current reputation as a budget holiday destination — far from the glamorous ethos to which gaming zones aspire, Deryugin said.

The barriers are not insurmountable, but they will require a hefty influx of state funds, and it is not yet clear whether the government is prepared to take on the burden. A preliminary plan by the Economic Development Ministry prescribes investments of almost 1 trillion rubles (\$29 billion) over the next six years, almost exclusively from the federal budget, Itar-Tass reported earlier this month, citing a copy of the plan.

"If you are going to build a sort-of Las Vegas, that requires significant investments from both sides, from investors and from the state. If the state is prepared to make that investment in infrastructure, then it will work. If the state is not, then I doubt many investors will come," Glotsblat said.

Contact the author at d.damora@imedia.ru

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