

European Union



Organisation for Economic
Co-operation and Development



North-West
Investment Agency



**OECD WORKSHOP
INVESTMENT AND BUSINESS CLIMATE IN THE RUSSIAN FEDERATION:
A REGIONAL PERSPECTIVE**

ST. PETERSBURG, 9-10 NOVEMBER 2005

**INVESTMENT AND BUSINESS CLIMATE
IN THE ASTRAKHAN REGION¹**

Introduction

1. This study reviews the recent foreign direct investment (FDI) situation in the Astrakhan region in the larger context of Russia's FDI developments. It analyses the advantages and drawbacks of the regional economic position, including its natural resources, human potential, economic policy and legal framework relevant for existing and potential foreign investors. It describes regional investment promotion and facilitation efforts, such as the plans to create a special economic zone in the region, and considers other initiatives aimed at improving the investment and business climate in the region. Finally the study proposes several policy options to promote foreign investment at regional level, in particular by suggesting the creation of a regional zone.

1. Foreign direct investment in the Russian Federation

1.1. Recent developments

2. Russia suffers from a low rate of capital investment which limits its economic growth potential. Rather than resulting from insufficient domestic savings, this situation mainly stems from a lack of confidence by Russian investors in the investment climate, as also indicated by persistently high capital flights.² According to the Federal Service for State Statistics, Russian investments abroad outstrip foreign investment in Russia, with the main recipients being Belarus (16%), Iran (15%), Cyprus (13%), Netherlands (12%), followed by Liberia, Moldova, Armenia, Virgin Islands, United States and Germany.

3. The strategy of rapid switch from plan to market reduced considerably many formal obstacles to foreign investment, allowing FDI inflows to rise in the mid-1990s, peaking at USD4.9 billion in 1997, the year before the economic crisis. Since 2002, FDI has recovered its past trend, thanks to the economic recovery and an improved business environment. In 2004, annual FDI inflows reached USD9.4 billions, an

1. This report was prepared by Jean-Marie Burgaud for the OECD. The author used data collected during the first half of 2005 during his assignment as a team leader of the TACIS project for the set-up of a Special Economic Zone in the Astrakhan Oblast. The views expressed in this study are those of the author and do not necessarily reflect those of the OECD or the governments of its member countries.

2. According to some estimates, net capital outflows might reach USD3 billions in 2005 (Bloomberg Agency quoted in "Moscow Times" April 28, 2005).

increase by 39% compared to the previous year, and represented 23% of total foreign investment inflows. By the end of 2004, Russia's total foreign investment stock (including FDI) amounted to almost USD82 billions coming mainly from the following countries: Cyprus (16.8%), Netherlands (14.6%), Luxemburg (14.5%) and Germany (11.4%).³

4. However, Russia's FDI stock (USD26.1 billion by the end of 2003) remains significantly below the performance of most Central and Eastern European countries and represents less than half of China's annual inflow for 2003 alone.⁴ As a result, the impact of FDI on overall growth and productivity of the Russian economy is limited, also due to its strong concentration in the oil sector (more than half of all non-financial FDI). Foreign investment is also very unevenly spread geographically, in spite of diversified natural and human resources.

5. Russia, which inherited from the former Soviet Union 14 bilateral international investment treaties, then signed 34 with other countries. Russia also concluded a Partnership and Co-operation Agreement with the European Union and has come close to WTO membership.

1.2. Investment barriers

6. The 1994 Constitution protects the property and other economic rights of foreign investors. The law on foreign investment passed in 1999 (amended in 2002 and 2003) stipulates national treatment for foreign investors, guarantees compensation for expropriation, and repatriation of profits and capital. In the banking and insurance industry, foreign participation is limited respectively to 12% and 25%. In 2004, the new Customs code simplified customs procedures.

7. Given a limited number of explicit foreign investment restrictions, the low attractiveness of Russia is mostly due to institutional factors. This has been recently confirmed by a survey conducted at the beginning of the year 2005 by the Foreign Investment Advisory Council (FIAC) for the Ministry of Economic Development and Trade among 158 large foreign enterprises. On one hand, a majority of companies (80%) assessed the results of their activities during the last two years as satisfying: 70% declared to have increased their profits by more than 20% and half of them expect to develop their investments in Russia. Most of the companies (54%) also expect that the investment climate in Russia would improve in the next two years. Among the advantages of investing in Russia, 88% quoted the market potential, 77% the stability of the economic development, 55% the quality and the low cost of manpower, 46% the political and macro-economical stability.

8. On the other hand, the survey indicates that foreign investors still continue to face important barriers. Among the main obstacles, 71% of interviewed firms quoted the bribery, 66% the administrative barriers, 56% the selective interpretation of the law, 51% the inadequacy and contradictory aspects of law and 29% the conflicts between the State and the business community. In sum, confidence of present and potential foreign investors remains undermined mainly by administrative practices, enforcement of administrative rules and justice decisions, and continuing corruption pressures.

2. FDI developments in the Astrakhan Region

9. Russia's financial situation and business environment has improved in some regions that have gained a reputation for being business friendly, notably Moscow, Leningrad, Samara, Khabarovsk, Novgorod, Saratov and Nizhnii Novgorod. Over the years, the Moscow region attracts between half and a

3. Federal Service for State Statistics: "On foreign investment in the economy of Russia in 2004", available (in Russian) at <http://www.gks.ru>

4. OECD Investment Policy Review: Progress and Reform Challenges, OECD, 2004.

third of total foreign investment inflows. The Astrakhan Region does not, however, belong to this group of relatively attractive regions, in spite of its significant economic and human potential. There are two main reasons for this unfavourable situation in the Astrakhan region:

- Similarly to many other Russian regions, Astrakhan suffers from a lack of international competitiveness, owing to a poor investment climate.
- Compared to some other regions, Astrakhan does not offer large local market consumption.

2.1. The Astrakhan Region

Geography

10. The Astrakhan Region occupies only 0.3% of the total Russian territory. It belongs to the Southern Federal District of the Russian Federation and shares borders with the Kalmykia Republic in the West, the Volgograd Region in the North and Kazakhstan in the East. Regional climate is continental and droughty. Deserts and semi-deserts cover 70% of the total land in the region. The population of the region is very diverse, representing some 100 groups of different ethnic and national origins, the largest groups being: Russians (72%), Kazakhs (12%) and Tatars (7%).

11. From the 18th century until the 1917 Revolution, Astrakhan was one of the most developed trading regions in the Volga basin (fish, salt and oil). Today, the Region is a small market of less than one million consumers, i.e. 0.7% of the Russian Federation. In 2003, the regional GDP (USD 2 billions) was only 0.5% of the total Russian GDP. Astrakhan is the “Caspian Gate”, a water transportation hub (ports in the city of Astrakhan and the sea port Olya) along the shortest route linking Europe with the Middle East, Asia and India.

Natural Resources

12. The Astrakhan Region has rich natural resources:

- Huge gas field *Astrakhanskoye* with over 2.5 trillion cubic meters of gas concentrate.
- Oil deposits in the northern part of the Astrakhan Region estimated at up to 5 billion metric tons. The Russian part of the Caspian Sea in Astrakhan could hold another estimated 2 billion metric tons.
- Sturgeon and caviar, but the stock of sturgeon has decreased dramatically.
- One of the world’s largest salt lakes, *Baskunchak* (100 sq km) supplies 25% of all the salt in Russia.
- Construction materials, such as gypsum, mineral paints and glass sand.

Production

13. The Astrakhan Region is no longer an “orchard of Russia”. According to the latest regional statistics,⁵ industry is the main economic sector (30%), followed by public works and construction (13%). The share of agriculture is only 6%. The fishing industry accounts for about one third of agricultural

5. “Report on social and economic situation in the Astrakhan Region”, Committee for Statistics of the Astrakhan Oblast, April 2005.

output, and meat and dairy products for less than 8%. During 1997-2003 the gross regional product increased by 58%, output of industry by 87%, but output of agriculture by only 20%.

14. The industrial sector is dominated by energy and fuel (70%), machine building and metal working (11%), food industry (10.3%) and building materials (4%). Machine building and metal working are decreasing, except repair works. During the last ten years, light industry has declined and the main production units are limited to one hosiery and knitting company. The chemical and petrochemical industry (only 2% today) is expected to develop if Gazprom's production plans materialise.

15. The tourism industry is growing steadily thanks to the water and hunting attractions of the Volga delta, and should become an attractive sector for FDI. At the beginning of 2004, 89 tourist companies were registered and operated in the Astrakhan region. Their total turnover was Rbl 102 million rubles in 2003 against Rbl 60.7 million in 2002, with 692 full-time employees and 134 part-time workers. The region was visited by a total of 174 000 tourists in 2003.

Main sectors and companies in Astrakhan

The traditionally largest sector, oil and gas, is dominated by Lukoil and above all "Astrakhangasprom Ltd", the largest enterprise of the Region and an affiliate of OJSC "Gazprom". Its share in the fuel industry of the Region in 2003 was 98.4%, in total industrial output 59.4%, in gross regional product 31.2%, in the income of profit-making enterprises over 70%, and in regional salary fund 18.4%. "Astrakhangasprom" is the most important producer of sulphur in Russia (about 80%).

Machine building has become an important industry, thanks to shipbuilding and ship-repairing. Enterprises of this sub-branch produced 2.5% of gross regional product in 2003. According to the regional administration, oil extraction in the Caspian Sea could create a demand for about 17 billion USD in the near future. Opportunities for shipbuilding exist also thanks to the development of Caspian transport and fishing. The major company in the sector is the JSC *Shipbuilding Yard "Red Barricades"*, with a share in the shipbuilding sector of 37.6%, and in machine building of 25%.

JSC "Astrakhanenergo" is the main producer of electric energy in the region (its share in electricity production is 78.2%).

The main chemical industry enterprises are OJSC "Astrakhan fiberglass plant" and "Astrachem Ltd" (rubber articles for the medical and pharmaceutical industries).

CJSC "Mineral-Knauf" is one of the oldest enterprises in the Region, the most important producer of construction materials made of gypsum in the South of Russia. In 2003 a new plant for high quality production was launched with a capacity of 60 thousand tons per year.

The food industry in Astrakhan is divided into a fish-processing and vegetable-processing cluster. Fish, water melons, potatoes, table salt are produced in the region. The main companies in the sector are OJSC "Bassol" which develops the Baskunchak salt field, OJSC "Astrakhan distillery" (vodka and liquors), OJSC "Astrakhan distilling plant", (spirits and over 12 kinds of vodka).

Foreign trade

16. According to regional statistics,⁶ the Astrakhan region's exports amounted in 2003 to USD325.5 million and its imports to USD125.4 million. The main export markets were Kazakhstan (29%), Iran (28%), Italy (13%), Azerbaijan (7%), Netherlands (5%), Tunisia (5%) and Ukraine (1%). The main exported goods were:

- mineral products: 53% (USD172.5 mn)
- cars, equipment and transport devices: 34.4% (USD111.8 mn)
- timber and pulp and paper products: 5.2% (USD16.8 mn)
- food products and agricultural raw materials: 3.5% (USD11.3 mn).

17. The major sources of regional imports in 2003 were Iran (23.5%), Great Britain (20.4%), the United States (12.6%), Germany (10.1%); and main imported products were:

- equipment (44.6%)
- foodstuffs and agricultural raw materials (31%)
- metals and metalwork (14.8%).

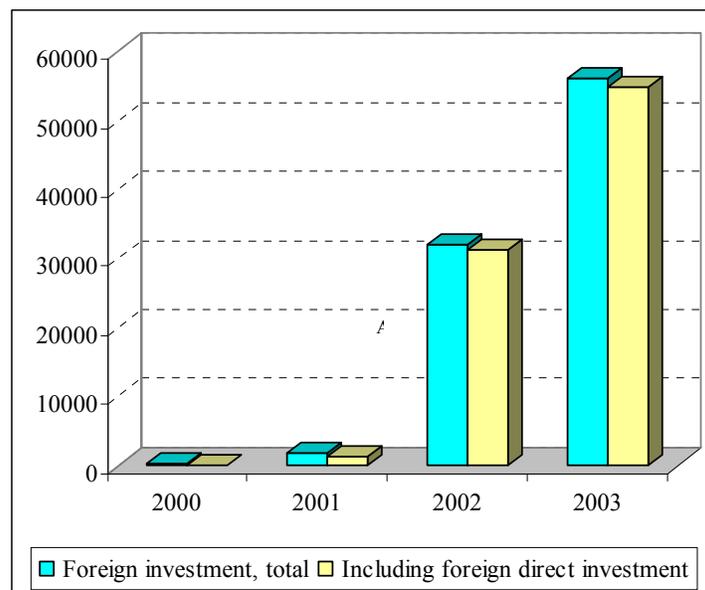
18. According to the Astrakhan Customs, the major exporting firms in 2003 were JSC "Astrakhangasprom" (10.1%), JSC "Red Barricades" (7.7%), JSC "LUKoil-Nizhnevolzhsknefteproduct" (9.3%), JSC "Tactic military rocketry" (11%), JSC "Almaz" (7.5%) and transport company "Erotrans Ltd".

2.2. Recent foreign direct investment inflows

19. Despite their recent increase in 2002-2003, foreign investment inflows to the Astrakhan region remain modest. Foreign direct investment largely dominates total foreign investment inflows (see Figure 1). The recent surge in investment is almost entirely due to production modernization of the CJSC "Mineral-Knauf" (see below).

6. "Programme of social and economic development of the Astrakhan Region for 2004-2007", Ministry of Economic Development of the Astrakhan Region, 2004.

Figure 1. Flows of total foreign investment and FDI



20. More detailed data on regional FDI are not available, but the following list provides information on major FDI projects in Astrakhan:

- CJSC “Mineral-Knauf” (Russian-German joint venture founded in 1998) is the leading gypsum producer in Russia. Astrakhan’s gypsum deposit is estimated at 280 million tons. The agreement between the local company Minera and Knauf, leading supplier of modern construction materials signed in 1997 stipulated modernization of the production and processing equipment. Most of the extracted gypsum is exported to Knauf’s production facilities in Europe.
- CJSC “AstraN” (Dutch-Russian venture) specialised in maritime transport.
- JSC “Astrakhan grain terminal” (Russian-Kazakh firm) specializing in cereals transport.
- LLC “Turash” (Russian-Turkish-Iranian company) provides maritime transport; it operates two transport vessels connecting Astrakhan with Iran.
- Astrakhan branch of Dutch company “Agip-Energy B.V.” (a subsidiary of Italian trust “Ani Agip”) conducts oil exploration. In 2001 Agip-Energy B.V. and Astrakhanneftprom signed an agreement on joint development of the North-Astrakhan oil field.

2.3. International comparisons

21. The Astrakhan Region is not amongst the most investment-attractive regions in Russia. The latest available rating of the consulting company “Expert RA”⁷ rated the Astrakhan Region “3B2” corresponding to “insignificant potential – moderate risk”. Moreover, the ranking of Astrakhan’s rating among Russian regions deteriorated and plunged from 17th position in 1995-1996 to 54th place in 2002-2003.

22. The investment climate in Russia and therefore in Astrakhan compares unfavourably with other neighbouring countries. In its 2004 World Development Report, the World Bank published an Investment

7. “Expert” Nr 45, 29/11 – 05/12/2004.

Climate Survey of 53 countries, carried out in 2002/2003. Table 1 shows the data on the countries that could be considered as potential competitors for Russia and Astrakhan (Iran was not included in the World Bank Survey).

Table 1. Investment climate indicators: World Bank Investment Climate Survey

Part I.

| | Policy uncertainty | | Corruption | | | Courts | | Crime | | |
|--------------------------------------|--------------------|---|--------------------|--------------------------|-----------------------|--------------------|--|--------------------|----------------------------|------------------------------------|
| | Major constraint % | Unpredictable Interpretation of regulations % | Major constraint % | Report bribes are paid % | Average bribe % sales | Major constraint % | Lack of confidence courts uphold property rights % | Major constraint % | Report losses from crime % | Average loss from crime % of sales |
| Armenia | 32.0 | 51.6 | 13.5 | 35.7 | 4.8 | 8.2 | 44.1 | 3.6 | 9.4 | 14.1 |
| Azerbaijan | 6.7 | 48.3 | 19.5 | 63.5 | 6.0 | 4.4 | 31. | 2.6 | 6.5 | 12.9 |
| Georgia | 44.3 | 73.4 | 35.1 | 81.5 | 4.4 | 11.2 | 59.0 | 19.0 | 27.6 | 7.0 |
| Kazakhstan | 18.2 | 52.7 | 14.2 | 69.2 | 3.8 | 4.0 | 48.5 | 8.4 | 29.2 | 3.5 |
| Turkey | 53.8 | 40.6 | 23.7 | 71.8 | 0.6 | 11.9 | 33.1 | 12.2 | 5.8 | 2.7 |
| Ukraine | 46.9 | 67.5 | 27.8 | 70.2 | 4.4 | 15.3 | 49.0 | 19.6 | 27.9 | 4.7 |
| Uzbekistan | 27.2 | 42.3 | 8.7 | 57.7 | 2.6 | 7.6 | 25.4 | 7.0 | 6.7 | 10.4 |
| <i>Russia</i> | <i>31.5</i> | <i>75.1</i> | <i>13.7</i> | <i>78.0</i> | <i>2.3</i> | <i>9.5</i> | <i>65.3</i> | <i>12.4</i> | <i>36.4</i> | <i>2.9</i> |
| Russia's ranking (the best:1) | 4 | 7 | 6 | 7 | 2 | 5 | 8 | 6 | 8 | 2 |

Part II.

| | Regulation and tax administration | | | | | Finance | | Electricity | Labour | |
|--------------------------------------|-----------------------------------|----------------------------------|---------------------------------|-----------------------------------|--------------------------------------|--------------------|---------------------------|--------------------|------------------------------|----------------------------------|
| | Tax rates as major constraint % | Tax admin. as major constraint % | Licensing as major constraint % | Dealing with officials % mgt time | Avg. time to clear customs (in days) | Major constraint % | Small firms with a loan % | Major constraint % | Skills as major constraint % | Regulation as major constraint % |
| Armenia | 35.5 | 37.7 | 9.0 | 7.4 | 3.7 | 25.9 | 11.1 | 15.8 | 6.0 | 1.8 |
| Azerbaijan | 18.8 | 17.5 | 10.1 | 7.3 | 2.6 | 12.3 | 4.9 | 20.2 | 4.5 | 1.3 |
| Georgia | 30.5 | 47.1 | 9.9 | 14.7 | 3.2 | 14.2 | 19.6 | 22.4 | 8.6 | 4.0 |
| Kazakhstan | 13.8 | 14.3 | 9.0 | 14.6 | 5.3 | 14.0 | 13.3 | 3.6 | 6.3 | 0.8 |
| Turkey | 38.1 | 33.1 | 5.8 | 8.0 | 3.7 | 23.2 | 11.3 | 17.3 | 12.8 | 8.7 |
| Ukraine | 39.6 | 34.9 | 18.2 | 15.4 | 5.8 | 29.1 | 6.5 | 5.9 | 13.0 | 5.8 |
| Uzbekistan | 19.9 | 22.7 | 7.7 | 12.1 | 6.0 | 20.6 | 2.3 | 4.8 | 4.9 | 1.7 |
| <i>Russia</i> | <i>24.6</i> | <i>31.8</i> | <i>14.6</i> | <i>14.1</i> | <i>6.9</i> | <i>17.0</i> | <i>8.8</i> | <i>4.6</i> | <i>9.9</i> | <i>3.3</i> |
| Russia's ranking (the best:1) | 4 | 4 | 7 | 4 | 8 | 4 | 5 | 2 | 6 | 5 |

Source: World Development Report, World Bank, 2005

3. Investment climate in the Astrakhan Region

3.1. Political, legal and administrative context

Political risk

23. The political risk in the Astrakhan Region is mainly related to the overall political environment in the Russian Federation, but it is also influenced by the situation in neighbouring countries. Astrakhan is in the neighbourhood of a trouble area marked by the Chechen and Caucasus crisis and a large Chechen community is settled in the Region. Astrakhan is situated in the middle of the Muslim crescent which goes from Caucasus to South Ural (autonomous Republic of Bashkortostan) to autonomous Republic of Tatarstan. It is also a strategic zone between South west of Russia populated with nations of Central Asia

(autonomous Republic of Kalmukia) and West Kazakhstan, populated by Kazakhs and also former Russian emigrants. For these reasons, the federal authorities devote special attention to the political stability of the Region.

24. Compared to the Caspian countries, the Astrakhan Oblasts represent a lower political risk and this relative advantage can be reinforced in the future, given long term risks associated with the consolidation of authoritarian regimes in Central Asia and its possible consequences within the Caucasus region.

Legal framework

25. The Astrakhan Region is essentially regulated on the basis of the federal legal framework. This framework is less developed than in some regionally competing countries like Turkey, but it is more favourable than in most Caspian countries. Russia's accession to the WTO will further contribute to improving its legal and regulatory framework.

Administrations

26. The 2005 FIAC survey (see above) indicates that foreign investors consider the following as the main obstacles to their activities in Russia: bribery, administrative barriers, inadequate discretionary interpretation of the laws and contradictory laws and conflicts between State and the business community. In all these aspects, the role and functioning of various federal and regional governmental agencies are crucial.

27. According to a survey carried out regularly by the federal tax authorities, Astrakhan has one of the best tax administrations among 89 "Subjects" of the Federation. It was rated first in 2002, 10th in 2003 and in the first half of 2004.

28. The new Customs Code, enforced since 2004, introduced amongst other innovations the concept of risk management, but many trade operators continue to see customs administration as inefficient and subject to widespread corruption pressures. The main problems concern the determination of customs value, clearance procedures and delays. According to the analysis of declarations, carried out by Astrakhan customs authorities, the situation in this last area is better in the region than in most others parts of Russia: 60% of all cargo were cleared in one day, 38% in three days, and only 2% in more than 3 days.

29. However, insufficient capacities of customs warehouses represent a serious handicap for the development of international trade activities in the Region. Only two customs warehouses and eight temporary storage warehouses operate under customs control. The limited capacity of customs warehouses causes high charges and many companies thus prefer to pay customs duties immediately rather than use these facilities.

3.2. Economic context

Economic policies

30. Since 1999 the GDP of Russia has increased by 40%, and living standards have improved. Progress is due to a mix of internal and external factors, combining sound macroeconomic policy and pursuit of key structural reforms, associated to continuous high prices for commodity exports (oil, gas and raw materials). However, several discretionary interventions by the authorities, targeting some specific companies, have increased uncertainty among investors regarding interpretation of the laws as also reflected in the World Bank survey. Social and political environment also suffered from governmental attempts to introduce monetization of in-kind benefits.

31. Russia's future accession to the WTO will have an important impact on the country's economic policy and development. It will stabilise its access to markets of its main trading partners, improve its resource allocation and facilitate its modernisation due to enhanced domestic and import competition. It will also improve the quality and technological level of its services as a result of lowering of foreign investment barriers in services. According to the World Bank study,⁸ Russia will gain about 7.2% of the value of Russian consumption in the medium-term from WTO accession and up to about 24% in the long run, when the potential positive impact on the investment climate is taken into account.

Local resources

32. The Astrakhan Region is endowed with significant local resources. Despite its weakening, the regional agricultural sector remains an important supplier of fruit and vegetables in Russia. Caspian sturgeons are world famous for caviar, and fish breeding and farming are developing. Astrakhan's gypsum deposit can also provide high quality sand for glass production. Sulphur, salt and gas could be used as raw materials for a chemical industry. The region hopes to receive important investments from Gazprom.

Fiscal and exchange regimes

33. Taxes are collected mostly at the federal level. VAT of 18% is levied at the federal level on a majority of domestic sales of goods and services, and on imported goods. The corporate profits tax rate is 24%, of which 5% is payable to the federal government, 17% to the regional government and 2% to the local government. Regional governments may reduce their portion by up to 4% thus reducing the overall rate to 20%. Property tax is a regional tax which may be levied at rates of up to 2.2% by regional authorities. Russia has tax treaties in force with over 60 countries.

34. A more flexible exchange rate policy, departing from a long-standing policy of keeping the rouble stable, attracted large amounts of foreign capital. A number of banks are operating in Astrakhan, including the largest Russian Banks such as Sberbank and Vneshtorgbank.

Foreign trade regime

35. Since 2002, Russia's average import tariff is slightly over 11%. Some products for social use are duty-free, a few goods are subject to the rates above 20%. Customs rates for most product categories are at 5%, 10%, 15% or 20%. Under certain conditions, goods imported as capital contributions for foreign investment projects may be exempted from customs duty. VAT is applied on the customs value of imports, plus import duty; imports of technological equipment contributing to foreign investment capital are exempted from VAT. Russia uses the Harmonised System of customs nomenclature. Most goods do not require export licences. Export duties are levied on some raw materials such as timber, oil and metals. A passport of transaction is necessary to ensure repatriation of hard currency proceeds to Russia.

36. The WTO accession is expected to have a differentiated impact on various sectors. According to the already mentioned study by the World Bank, export intensive sectors, such as ferrous metals, non-ferrous metals, chemicals and timber, wood, pulp and paper products are the sectors that will benefit from Russia's WTO accession. The likely FDI inflows to business services will increase the demand for labour and offer opportunities for Russian firms to form joint ventures with multinationals. However, wholly-owned Russian firms that would not form joint ventures with multinationals will decline.

8. Economy-Wide and Sector Effects of Russia's Accession to the WTO, Jesper Jensen, Copenhagen Economics, Thomas Rutherford, University of Colorado and David Tarr, The World Bank, May 26, 2004. http://siteresources.worldbank.org/INTRANETTRADE/Resources/Topics/Accession/Jensen-Rutherford-Tarr_effectsaccession.pdf

37. In Turkey, which has a free trade agreement with the EU, Astrakhan-based companies enjoy a situation comparable to that of companies based in the other countries of the large Caspian region. In Iran, competitive pressures on Russian and Astrakhan-based companies are lessened due to US imposed trade sanctions.

3.3. Human potential

38. Non-qualified labour is relatively inexpensive in Russia compared to the West. Some 60% of the labour force is estimated as belonging to trade unions, which are relatively passive. Russia's workforce is strong and well-educated, but there is little geographical labour mobility and consequently regional disparities in salaries remain significant. According to an Ernst & Young survey,⁹ the salaries in the Low Volga region are among the lowest in Russia and 40% below the level in the Moscow region.

39. At present, the situation of the labour market in Astrakhan is similar to that of neighbouring sites in the greater Caspian region. However, current demographic trends and likely sustained economic growth in Russia may make Astrakhan more attractive.

40. Thirteen state and six private institutions of higher education operate in the region. The number of students in higher education in state institutions has grown considerably (from 208 in 2000 to 314 per 10 000 people in 2003). The Astrakhan region ranks as 49th among the subjects of the Russian Federation by number of students per 10 000 residents in higher education at state institutions. It ranks second for the number of students in specialized secondary schools. The number of students in specialized secondary education establishments grew from 198 to 237 students per 10 000 people. According to Astrakhan businessmen, qualified workers are available for most activities and are considerably cheaper than in major Russian urban centres.

41. The active international trade contacts with Iran raised a growing need for Persian-speaking staff. In May 2001, a faculty of Persian language and Iranian studies was opened at the State University and there is an active Association of Caspian Universities. Astrakhan can have an advantage compared to some neighbouring countries if it succeeds in attracting Russian qualified workers. According to Astrakhan managers, administrative staff is also less expensive in Astrakhan compared to other Russian urban centres.

42. However, there is a lack of qualified managers in Astrakhan. Many private business schools, sometimes with external support, have opened in Southern Russia and several prestigious universities such as the Saratov Law and Economic University established branches in the region. The Region has also benefited from the "Presidential Initiative" programme: there are a number of young business people in Astrakhan who successfully accomplished this program, including a period of professional training in Western countries. According to Astrakhan business circles, executives are cheaper than in major Russian urban centres. Availability of training in foreign languages, including Iranian language, represents another advantage. As with the rest of Russia and most neighbouring countries (except Turkey and Iran) Astrakhan lacks the network of SMEs that would provide a reservoir and help in training of managers.

43. The city and the Region of Astrakhan enjoy an attractive natural environment, important hunting and fishing opportunities and a well-known label, which all represent a considerable tourism potential. Regional resorts have started to develop but further efforts to modernise and build up new hotel infrastructures and ensure adequate services should be pursued and accompanied by policy promoting tourist attractiveness of the region in Russia and neighbouring countries.

9. "Moscow Times", December 2004.

3.4. Infrastructures

44. The Region covers 80% of its needs in *electricity*, but modernization and reconstruction of electric lines is required in order to eliminate power cuts. The transmission losses currently represent 28-30%. Both major providers significantly increased their tariffs in 2005 (Astrakhanenergo at Rbl 1,062/kw and Astrkommunenergo at Rbl 1,322/kw). However, regional tariffs remain among the lowest in the South Federal District. Reliability and favourable price levels of electricity distribution to regional industries will probably be maintained in the short and medium term.

45. At present, the situation of the region in *telecommunications* services compares relatively favourably to most other Russian regions and neighbouring countries, but this comparative advantage is likely to be gradually reduced.

46. The Region has important transit *land transport* activities between Central Asia and Western Europe. For instance, the railway carries 30 000 tons of gypsum per day. The promising route is the North South corridor connecting Iran to Russia through the port of Olya on the Caspian Sea, now served by the railway. Olya, at 60 km away from Astrakhan city, is connected with Kazakhstan and China and also with central Russia. 75% of the transit cargo goes from Kazakhstan to the West and from the Black Sea through Astrakhan. Most of this traffic is gasoline originating from the production of Tengiz field; other transported products are mainly cotton and building materials.

47. Russia's *river transport* routes are usually blocked for 3 months by ice. Owing to many large dams having been built at the time of the soviet planning, the Volga River is now silted up and therefore accessible only to small vessels with a capacity of around 1 500 tons. It is therefore necessary to develop *railway transport* in the region. The main project in this area is the electrification of the line between Astrakhan and Volgograd (400 km) which should start in 2006 and be achieved in 2009.

48. The Astrakhan airport cannot handle long haul planes as the landing strip is too short. Astrakhan airport is strongly disadvantaged for developing air trade links with foreign markets. This is similar to the situation in most neighbouring regions but this problem is likely to be resolved in the future.

49. As regards *sea freight*, the Astrakhan 11 terminals have the annual capacity of some 2 million tons. This insufficient capacity has caused the increase in sea freight costs: for example during 2004, the costs of shipping across the Caspian Sea went up from USD20 to USD35 per ton. Limited warehousing facilities (currently limited to 3000 sq meters) represent an additional limitation of Astrakhan harbour. The lack of capacity and outdated equipment are considered to be a major disadvantage for sea freight activities.

50. The port of Olya is the main hope for Astrakhan's maritime development. The traffic was about 6 to 700 000 t/y in 2004 and is expected to reach 1.5 million tons in 2005. It is a federal harbour, whereas other Astrakhan ports are private. There are plans to build a grain terminal in Olya as well as a terminal for gas and oil refined products for export to Iran and Kazakhstan. The container traffic and imports of other products, including car imports from Iran should allow increasing the capacity to 12-14 millions tons. The port of Busan, not far from Astrakhan, is specialised in the export of sulphur all over the world.

51. Astrakhan is one of the main ports of Russia for external trade, probably the fifth largest port in Russia, behind St Petersburg, Novorossiysk, Murmansk and Vladivostok. It specialises in relations with the Caspian countries, mainly Iran but also with India and Turkmenistan and promises to develop rapidly. Before 2010 the Astrakhan harbour traffic is expected to reach 16 million tons/year.

52. However, to improve its position Astrakhan port should considerably modernise as competition in the region intensifies. Iran plans to develop the Ports of Khazar-Amerabad and Noshar, both on the Caspian Sea, when Anzali becomes too small. For the moment, Baku does not seem to be a serious competitor, mainly due to its poor management and security issues. With the planned extension and equipment of the Port Olya, Astrakhan's sea freight can further improve its competitiveness.

53. At present, regional *air transport* is underdeveloped and the improvement can come only in the long term with possible development of tourism. There are two air carriers operating in the region: "Astrakhan airlines" and "Aeroflot". The main directions of flights are: Moscow (twice a day), Aktau (Kazakhstan), Yerevan (Armenia) and UAE. In the past, there was also a direct flight between Astrakhan and Baku, but it was interrupted. It is urgent to establish a regular direct flight from Astrakhan to Iran as currently it is necessary to transit through Moscow and the costs (approximately USD800) are high.

Professional services

54. Professions of lawyers and jurists are not well developed in Astrakhan since the Law Faculty does not have as good a reputation in Russia as for instance the University of Saratov. Similarly, there is a lack of accountants in the regions and of specialised audit offices. Local faculties emphasise the teaching of foreign languages, including Persian and Turkish. English language knowledge is increasing and excellent interpreters are available on the market.

4. Regional investment promotion

4.1. Responsibility for investment promotion

55. Investment promotion and facilitation are the responsibility of the Deputy Head of Government for Investment Promotion and the Ministry of Economic Development and Trade. In addition according to the Law "On investment activity in the Astrakhan Region" (Article 9),¹⁰ the Investment Council is in charge of the "control of the implementation of the investment process in the Region". Despite several administrative structures and agencies, which should promote investment in the region, the only Russian website on investment in Russia ignores completely the Region of Astrakhan.¹¹

4.2. Regional investment programmes

56. The economic development of the Astrakhan region is currently regulated on the basis of the following regulatory and legal acts of the Oblast:

1. The law of the Astrakhan region No. 2 of 24.02.1997: "On territorial forecasting and programs of social and economic development of the Astrakhan region". This law determines the budget procedures for the Region's support to investment projects.
2. Law of the Astrakhan region No. 23/2001-RL of 07.05.2001: "On development budget of the Astrakhan region".
3. Law of the Astrakhan region No. 46/2001-RL: "On budgeting in the Astrakhan region".

10. 28 July 1998, Astrakhan Oblast, amended by Law No. 5/2003 of 24.03.2003.

11. Investment opportunities in Russia www.ivr.ru

4. Law of the Astrakhan region No. 30 of 29.07.1998: "On investment activities in the Astrakhan region" and the Law of the Astrakhan region No. 54/2004 of 29.10.2004: "On territorial forecasting and target programs of the Astrakhan region".
5. Law of the Astrakhan region No. 17/2000-RL of 07.04.2000: "On taxes, dues and other charges in the Astrakhan region".

57. The investment policy of the Region has so far been carried out under the framework of the Law of the Astrakhan region "On investment activities in the Astrakhan region" and the Law of the Astrakhan region "On the development budget of the Astrakhan region".

58. Under the first Law, during 2001-2003 and the first half of 2004, 14 projects received the status of "very important investment project" and 15 projects the status of "approved investment project". For enterprises implementing "very important investment projects", the regional profit tax was reduced to 13%, and corporate property tax to 0.2%. For enterprises, implementing "approved investment projects", the regional profit tax was reduced to 15%, and corporate property tax to 1.1%.

59. In application of the second law, the Region spent Rbl 41 million during the period 2001-2003 and the first half of 2004 in the form of contributions to lower interest rates and participation in the capital of companies compared to total investment from other sources of Rbl 354 million. Therefore, it could be considered that Rbl 1 spent from the regional budget to finance investment projects helped attract Rbl 8.7 from other sources. The authorities estimate that the contributions from regional budget allowed maintaining 483 jobs and creating 405 new ones. The average budgetary cost of one maintained or newly created job was thus Rbl 46 171. This is an acceptable cost by international standards.

60. For 2005, a specific program on "Attraction of investment in the Astrakhan region in 2005-2008" (No. 18/216) was approved in December 2004. However, the decision procedures are discretionary and lack transparency and cast therefore a negative image on the Region. However, these essentially company-specific direct subsidies are not in compliance with the WTO Agreement on Subsidies and Countervailing Measures.

4.3. Special Economic Zone

61. In the beginning of the 1990s the territories of 11 regions of the Russian Federation were declared "Free Economic Zones" (FEZ) and received specific federal tax exemptions. Some regions had succeeded in mobilizing the initial start-up funds, in some cases public and in other cases of private origins. The FEZ "Nakhodka" was created in 1994, followed by "Sherryzon" (in Moscow), "Gavan" (in St. Petersburg harbour) and many others. The law creating a Special Economic Zone in the Magadan region was passed in 1999. These zones offered customs, tax, financial and administrative advantages but, with the exception of the FEZ in Kaliningrad, Nakhodka and Magadan, other zones were not actually operational. Many FEZ, for instance in Altai, Uglich, Ingushia or Kalmukia, became offshore centres where enterprises were registered as FEZ residents but their production activities were carried out elsewhere. After the reform of the second part of the Tax Code, these zones lost the major share of their benefits and stopped operating.

62. Following this experience and the shortcomings of the previous legislation, the Ministry of Economic Development and Trade prepared a new Federal Law on Special Economic Zones (SEZ), which was adopted in July 2005 by both houses. The first SEZ according to the new legislation should be created in 2006.¹² The Astrakhan Region intends to take advantage of this new Law.

12. A new law "On the Special Economic Zone in the Kaliningrad Region" is also under preparation.

5. Policy options to promote FDI

5.1. The new Federal Law on Special Economic Zones (SEZ)

63. It could be questioned whether the new SEZ law can become an instrument for regional development in the region such as Astrakhan. Based on the Final Report of the TACIS project “Special Economic Zone in Astrakhan”, European Union Policy Advice Programme (May 2005), which provided a detailed assessment of Astrakhan industrial sectors under the conditions of the draft SEZ law (see attached annex), this section suggests several improvements to the new law and presents several options adapted to the Astrakhan region.

64. It is generally admitted that in today’s highly competitive world economy environment, a SEZ programme should be a part of overall economic strategy. In order to attract national and international investors, such a law should be simple, clear and short (10 pages maximum) and detailed administrative and implementation procedures should be referred to only in broad lines and detailed separately.

65. Although it is premature at this early stage to assess concrete effects of the new law, several of its provisions seem to limit its positive impact. Article 4 of the Law sets up the size limit for technological-and-innovative SEZ (the so-called technoparks) to 2 sq.km, which seems adequate. The size of industrial-and-production SEZ, initially of 10 sq km in the draft law, was increased by the Duma to 20 sq.km. However, most export platforms (called Export Custom Free Zones, Processing Zones, Free Trade Zones or Industrial Free Zones) have been created in more than 120 countries in the territory under 10 sq.km. The SEZ concept thus appears to go well beyond the concept of export zones, which target essentially exporting companies.

66. Article 6, section 6 of the new Law stipulates that “a SEZ shall be created for a term of 20 years. The term of a SEZ’s existence shall not be extendable”. For some capital-intensive investors, this lifetime can represent an important limitation. In many countries, the existence of SEZ is on average for 50 years.

67. According to Article 12, section 2 of the Law, the SEZ company should invest at least the equivalent of EUR10 million. This large amount is likely to dissuade many potential investors, especially in relatively small regions such as Astrakhan.

68. Article 4, section 5 of the new Law excludes a number of sectors and companies which would be potential candidates for SEZ. In particular, the following activities are not allowed on the territory of SEZ:

- Extraction of minerals and metallurgical production
- Processing of minerals and processing of ferrous and non-ferrous metal scrap
- Manufacturing and processing of excisable commodities (except for passenger cars and motorcycles).

69. This contrasts with similar legislation in most countries, including nearby Iran, which established processing zones for minerals and oil resources. Excluding these sectors and activities thus disadvantages Russian economy compared to some other countries. Furthermore, it seems that the access to the new SEZ regime is restricted to new companies or activities, which leaves out many companies already operating in Russian regions and which have a potential for growth and exports.

70. Article 13, section 2 requires that companies asking for the SEZ resident status, should submit their business plan certified by a credit organization. International experience shows that potential investors are often reluctant to hand over their business plan, which is a major asset of any business

venture. There is no guarantee that all potential investors will trust the bank or that the banks will not be inclined to accept fake business plans.

71. Article 5 states that a SEZ “may be only established on the land plots that are in the state and (or) municipal ownership”. Art 7 provides that “the management of SEZ shall be placed upon the federal executive body authorised to exercise the functions of managing SEZ and upon the territorial bodies thereof”. In most countries, SEZ are public property, often regional or municipal. However, there is a growing trend to allow and encourage the private sector to venture into the business of setting up and operating zones. Most countries consider that the management of the zone, given the increasingly complex and competitive nature of the SEZ business, can be better implemented by companies experienced in real estate and service management.

72. In its final version, the new SEZ Law does not provide clear indications on tax incentives. Article 36 states only that “residents of a SEZ shall be taxed in compliance with the laws of the Russian Federation on taxes and fees”. The initial Draft Law was more explicit and indicated that tax incentives are to be granted only by the regions and the municipalities. This would mean that tax incentives have to be entirely financed by regional and local entities.

73. Another potentially controversial aspect of the new Federal Law is that the disputes concerning the establishment and functioning of a SEZ are to be settled in court according to the legislation of the Russian Federation, which means that parties are not allowed transferring disputes and conflicts to a court of arbitration.

74. In more general terms, it should be stressed that successful investment promotion strategy has to first address the issues of political stability and governance, ensure a stable and coherent legal framework, including for competition policy, based on a fair and efficient judiciary system. Such strategy should also encompass clear rules for foreign investment promotion schemes, especially in the context of economies with scarce financial resources.

5.2. Development of regional SEZ

75. At present, the Russian Federation perceives the SEZ programme as a pilot experience and intends to limit the total number of such zones approximately to 10, out of which half are likely to be technological-and-innovation SEZ (technoparks). Even if Astrakhan is qualified to establish a SEZ, it is questionable whether this will respond to its current development and investment needs. To be in conformity with new legislation, such a SEZ should exclude a number of sectors and be located in a single territory. Some sectors with the best economic potential in the region seem not to qualify, in particular building materials, oil processing and fish-farming. In any event, the creation of a SEZ should not be considered as a substitute for a comprehensive development strategy.

Optimum location

76. Regional Zones (RZ) could offer ready to use, relatively low-cost and favourably located areas for industries and services. Presently, the Region and the municipalities dispose of large idle land properties, some of them “brownfields” (with closed industries), some of them “greenfields” (unused land). Some are well located at the crossroads of key networks (river transport, railroads, highways, electricity, water and telecommunications). The RZ could be not only a tool of development strategy, but also a means for urban planning and environmental protection.

Private management

77. Such RZ should be managed by private and/or mixed real estate companies, capable and eager to sell directly or attract services, including for example transportation, catering for executives and workers, recreational areas, office facilities, security, repair shops, banking, maintenance of common grounds, etc. Private zones tend to cost more for users, but many firms are willing to pay for better services and facilities. Privately owned and managed REZ would also relieve the government of the burden of initial investment costs and ongoing management. Moreover, competition among zones in attracting investors improves their efficiency.

Tax incentives

78. The RZ will be in principle able to benefit from regional and municipal tax incentives, but there are some important limitations. The Region and municipalities could grant tax incentives to resident newly established companies only in accordance with federal regulations. Due to the provisions of the Constitution of the Russian Federation, the Region cannot grant tax incentives to the limited space of a RZ. According to the WTO rules provided for in the WTO Agreement on Subsidies and Countervailing Measures and the Agreement on Trade Related Investment Measures and according to the Russia-EU Partnership and Co-operation Agreement (PCA), fiscal incentives cannot be sector specific and cannot be related to export performance.

79. The Region would have therefore to grant tax incentives to all companies in the Region. In such case, it would be better rather than introduce tax exoneration to offer investment incentives, for example tax credit based on amount of new investments. As the deduction for losses is limited by the Russian tax code to 30% of future profits, a tax credit is an attractive tax incentive. The tax credit could apply to the share of authorized exoneration for the Regions (4%), to company property tax (based on 2.2% of property, in spite of usual undervaluation), which represents a significant incentive. Such form of tax incentives will support new investments of all companies developing their activities, new or expanding their activity, unlike the SEZ draft law that, with tax exoneration, seems to provide support only to new companies established in the SEZ. The region has already used tax incentives and financial incentives in order to attract or retain investors (see above). However, as already mentioned, the decision procedures have been discretionary and are considered less efficient than the proposed tax credit. Furthermore, these existing "specific" direct subsidies (in this case company-specific) are not allowed by the WTO Agreement on Subsidies and Countervailing Measures.

80. Another financial incentive for investors could be a subsidized access to land. The Region and municipalities could lease the land to the private or mixed developers at a subsidized rate under a contract that would guarantee subsidized access to the industrial park for investors for a limited number of years. Zone developers would also benefit from the same investment incentives.

Customs regime

81. RZ companies would have a less favourable customs regime than envisaged by the new SEZ Law. They would not operate under the free customs zone regime, but instead only under the customs warehouse, duty drawback or temporary admission regimes.

Administrative facilities

82. The RZ management could be authorized to exert within the RZ some powers and responsibilities of the Region and municipalities, in particular regarding land use, construction permits, building occupancy or environment.

5.3. Free port

83. The Region could also consider the creation of a Free Port, although this requires the authorisation of the Federal Government. Free ports have a long tradition, for instance Hong Kong became a free port in 1848 and more recently, large free ports have been established on Grand Bahama Island, in Labuan Island in Malaysia or Jebel Ali in Dubai. The free port concept is a variant of the free trade zone concept as defined by the "Kyoto Convention"¹³ and offers several unique advantages compared to other types of zones:

- duty- and tax-free imports by registered enterprises or individual residents
- duty- and tax-free merchandise can be sold at the retail or wholesale level
- large areas offer a greater location flexibility to the firms
- no restriction in market orientation (domestic or export sales)
- no restriction on activity (manufacturing or services, including trade and tourism)
- individuals can reside permanently or temporarily.

5.4. Tourism free zones

84. Tourism has become one of the largest “industries” in the world, representing some USD4500 billion annual earnings, equivalent of approximately 10% of the world’s GDP. It is the largest source of export earnings for many countries. Job creation in tourism has been growing in the last 20 years much faster than in other sectors. Not surprisingly, a number of countries have introduced various types of tourist zones attracting large-scale private sector investors and property developers to a designated area. A tourism zone can create a “safe haven” – offering the convenience, cost savings and risk avoidance of operating in an efficient, modern, well serviced, administratively transparent and bureaucracy-free environment. Tourism zones can be invaluable in helping to stimulate start-up companies.

5.5. Location alternatives

85. Several localities in the Astrakhan region seem suitable for creating proposed various zones:

- A SEZ for housing assembly industries could be developed in the Port of Olya, under construction, provided that planned adequate transport infrastructures (sea, river, road, railway) will be built.
- A RZ could be developed in Kaisaris for petrochemical and chemical industries (including sulphur), close to the resources developed by Gazprom.
- A RZ could host potential extension near Aktubinsk, where the gypsum industry is already operating (Knauf); some other activities such as an additional glass factory could also be envisaged.

13. The International Convention on the Simplification and Harmonization of Customs Procedures of 19 March 1979 (Kyoto Convention) defines free zones as being "part of the territory of a State where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the Customs territory and are not subject to the usual Customs control. In commercial free zones, goods are admitted pending subsequent disposal; goods admitted to industrial free zones may be subjected to authorized processing operations".

- A RZ could be developed at Ikryanoie for fish and other water species research, breeding and processing operations. It could also host agro-industrial plants, preparing feed for the same species and also processing agricultural products, when and if Astrakhan revives its agricultural production.
- A RZ close to the Kigatch River could receive trade activities, with the railroad and warehouses allowing the acquisition of shares on the Kazakhstan market. Trade activities could also be developed within the harbour of Olya, targeting other Caspian regions and beyond the markets of the North-South Corridor, including of course the Russian market.

5.6. *Elimination of administrative barriers*

86. To attract investment, the countries have to reduce their administrative barriers to investment, offer high quality public and private goods, lower corruption, and limit the scope of unofficial economic activities. Although most of these tasks must be handled at the national and federal levels, the Russian regions can also contribute to national efforts, especially by simplifying regional and local administrative procedures.

87. The Astrakhan Region established a working group, which has started to draw the list of administrative barriers to investment, at regional and municipal levels. The next step should be a systematic review of administrative regulations to eliminate undue and obsolete procedures and to simplify remaining procedures. The task is demanding and involves a considerable change of administrative culture, in particular to privilege facilitation over controls. It will also require tedious technical work and changes in the regulations adopted by the Regional Parliament, and frequently by the municipalities. However, experience of many countries has proved that such efforts can bring good results by considerably improving business and investment environment in specific areas. Administrative simplification would be useful not only to attract foreign investors, but also encourage domestic investors, especially among SMEs, which are a key factor of successful development strategy.

5.7. *Investment promotion*

88. It is generally agreed that an effective Investment Promotion Agency (IPA) should be able to both create and convey competitive advantage in its efforts to attract foreign direct investment. At present, the responsibility for promotion of investment is not clearly defined in the Region and this confusion also adversely affects the regional investment attractiveness. It could be questioned whether the region needs an IPA or whether it has rather to clarify and better distribute responsibilities among existing structures. Given the small economic size of the Region, and its budget constraints, an IPA should have only limited staff and budget. Its main tasks should be to advise the authorities on economic development and help in building a positive image of the Region. It should also provide support to investors, working together with authorities to reduce administrative barriers and possibly by creating a one-stop shop facility for investors.

89. In the past, the function of “marketing the region” (travels abroad, press invitations, international seminars, glossy brochures, etc.) proved to be in many cases very costly and often inefficient. In fact, thanks to e-marketing, this function could be today ensured with considerably less funds, for example through a good investment promotion website. In this context, the recent experience of some small countries in merging export and investment promotion¹⁴ or even tourism promotion could be useful.

14. See for instance the FIFTA of Mongolia :<http://www.investmongolia.com>

ANNEX

SUMMARY OF RECOMMENDATIONS OF THE REPORT ON SPECIAL ECONOMIC ZONES IN ASTRAKHAN (EUROPEAN UNION POLICY ADVICE PROGRAMME)

1. The Draft Law on SEZ will not give the region an edge over competing sites of the Caspian region and beyond, unless it is at least amended on the following issues:

- 1) set up specific objectives of the Law within the economic development strategy of Russia
- 2) turn it into a promotional instrument
- 3) simplify the agreement procedure for SEZ resident status
- 4) eliminate restrictions of size and duration of SEZ
- 5) eliminate restrictions of sectors, minimum investment and limitation to new activities
- 6) balance federal, regional and municipal tax incentives
- 7) introduce a “free zone regime” independently of location into a SEZ
- 8) authorize innovative management structures.

2. In the meantime, the Region has certainly valuable assets, which have to be integrated into a strategy putting the emphasis on the improvement of the business climate.

Development of Regional Zones

3. Regional Zones (RZ) could offer ready to use, low cost, and favourably located areas for industries and services alike. Presently, the Region and the municipalities have large expansions of idle land, well located at the crossroad of key infrastructure networks. The RZ can be tools for orderly urban planning and environment protection. These RZ should be managed by private and/or mixed real estate companies.

4. The RZ would only benefit from regional and municipal tax incentives. The Region cannot grant tax incentives to the limited space of a RZ, mainly because of WTO rules and provisions of Russia-EU Partnership and Co-operation Agreement (PCA) that both prohibit sector-based incentives. The incentives also cannot be related to export performance. The Region would have therefore to grant tax incentives to all companies of the Region. The best form would be investment incentives (tax credit based on amount of new investments). The region has already used tax incentives and financial incentives in order to attract or retain investors. Another financial incentive for investors could be a subsidized access to land. The Region and municipalities could lease the land to the private or mixed developers at a subsidized rate. Zone developers would also benefit from the same investment incentives.

Localizing of SEZ and RZ

5. The best location for a SEZ seems to be the Port of Olya, under construction but with planned adequate transport infrastructures (sea, river, road and railway).

6. A RZ could be developed in Kaisaris for petrochemical and chemical industries. A RZ could host potential extension near Aktubinsk, where the Gypsum industry is already operating, some other activities such as a glass factory could also be favoured. A RZ could be developed at Ikryanoie for fish and other water species research, breeding and processing operations. It could also host agro-industrial plants, preparing feed for the same species and also processing agricultural products. A RZ could host trade activities close to the Kigatch River, along the railroad, with important warehouses in order to gain market shares on the Kazakhstan market. A RZ could host trade activities within the harbour of Olya, targeting other Caspian regions and beyond the markets of the North-South Corridor, including of course the Russian market.