



# Russia: New SEZ law

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## Summary

This report highlights the new law on Special Economic Zones in the Russian Federation issued on July 22, 2005. The new SEZ law allows for establishment of the first two types of zones, namely industrial and innovative. The report provides information on the initial SEZ selection process and describes the focus and benefits of the selected zones. The report goes on to describe some of the favorable tax and administrative benefits that the government is ready to offer for businesses operating in these zones. The report concludes by a brief outline of other SEZ related initiatives pursued by the Russian Government and other types of zones that are also envisaged in the law.

## SEZ law overview

The new legislation differs from the previous method of creating “free zones” in post-Communist Russia and limits the possibility of abusing this mechanism. First, the new legislation establishes uniform conditions for SEZ, i.e. it rules out “direct negotiations” with regional authorities and interested businesses on the special zone mechanism. Second, the law has introduced a competitive procedure for the selection of SEZ. Aspiring regional and municipal authorities must display their material interest in creating such a zone by allocating financial resources for the development of necessary infrastructure.

Third, the initiative has done away with most of other so-called “special economic zones” which arose in throughout the 1990s, except for those SEZs operating effectively in the Kaliningrad and Magadan Regions). Fourth, the new zones are oriented to the attraction of investment in new technologies, and to the diversification of the economy, rather than to the solution of the problems of regional inequality or economic backwardness.

## Types of special economic zones

From the over 70 proposals submitted for the establishment of SEZ in the initial competition, the Russian Government has chosen two industrial zones (to be established in the Lipetsk Region and Tatarstan’s Yelabuga) and four innovative zones (Zelenograd, St. Peresburg, Dubna and Tomsk). The following is a brief description of the zones:

### ***Zelenograd – micro and nanoelectronic products***

The town of Zelenograd, located 37 km outside of Moscow with the population of 215 thousand people (2002), was founded in 1958 as a center for the USSR electronics industry. Today Zelenograd has many research centers and institutes. The SEZ will focus on producing micro and nano electronics, opto electronics, information and communication systems, bioinformation and biosensor technologies, nano technologies and nano materials. The first resident companies include “Zelenograd Innovation and Technology Center” (ZITC) and “Alfachip”. ZITC has set up research facilities on the territory of the Moscow State Institute of Electronic Engineering to conduct research on production of integral and optical elements. “Alfachip” develops super scale integration circuits to be used in modern electronics, computer equipment, communication, and household appliances.

### ***Dubna – information and nuclear physics technologies***

The town of Dubna is located 125 km north of Moscow and has the population of 67.8 thousand inhabitants. First innovation activities began after WWII, when research laboratories were set up in Dubna to study nuclear processes, followed by the construction of the Unified Center for Nuclear Research in 1956. Dubna has traditionally been heavily defense sector related, but has actively pursued the development of small and medium sized businesses over the past decade. The Dubna SEZ will focus on information and nuclear technologies. It will house the largest computer center in Russia. “Luksoft-Dubna” and “Dubna-Systema” are the first resident companies. “Luksoft-Dubna” will offer IT outsourcing for Russian, USA, and EU companies

including Boeing and Motorola. "Dubna-Systema" will specialize on development of ionic-plasma technologies as well as the introduction of nano technologies in new materials manufacturing.

#### ***Lipetsk region – household electronics***

Lipetsk is a regional center located 508 km to the south of Moscow at the intersection of important transportation lines that connect Moscow with Northern Caucasus and Russia's western part with its Volga regions. The region's territory is 21.1 thousand square km and the population is 1.19 million (67% urban and 33% rural). A major industrial area of Central Russia, the city stands out for its scientific, technical, and industrial achievements. The region is one of the successful Russian territories and boasts "above average" rating by the Ministry of Economic Development and Trade with regard to economic and social performance. The region has a favorable investment climate and ranks 22<sup>nd</sup> in investment risks among 89 regions of Russia.

Five industries – ferrous metallurgy, machine building and metalworking, food industry, electric power engineering, and construction metals industry – have made the biggest contribution to the industrial advance of the region in recent years. The Lipetsk Region imports products of machine-building and petrochemical industries, food and products for its production, and metals.

The SEZ will support manufacturing for a wide range of products by domestic and foreign companies. It is expected that 19 businesses will be established in the zone between 2006 and 2008. Several foreign companies have already volunteered to be the main residents of the zone including: Italian VERNIGLASS (glassware) and INDESIT COMPANI (washing machines); Swedish ELECTROLUX (washing machines); Dutch AKZO NOBEL (pharmaceuticals, coatings and chemicals); German BOSCH und SIEMENS (car spare parts, household appliances, security systems, and industrial equipment), Finnish SISU DIESEL (engines), and others.

#### ***St. Petersburg – hi-tech production***

St. Petersburg is Russia's northern capital - a major industrial, scientific, innovation, logistics and cultural center - located on the Eastern shore of the Baltic Sea. The population is 4.6 million (3.2 % of Russia's population) and the total area is 1 400 square km. The SEZ will focus on development of precision and analytical instrument making, medical equipment, software products, electronics and communications, biotechnologies and new materials. These projects will be pursued in cooperation with the institutes of the Russian Academy of Sciences. Initial residents will include ZAO "Transas" and ZAO "Transas Technologies". These Russian companies hold leadership positions in development of on-board radio and electronic equipment for aircraft and helicopters.

#### ***Elabuga region, Republic of Tatarstan – cars and automotive parts, petrochemistry***

The Republic of Tatarstan lies in central Russia and covers the total area of 67.8 thousand square km with the population of 3.77 million inhabitants. The Republic of Tatarstan is generally considered to be one of the most investment attractive regions of Russia. The industrial manufacturing zone in Elabuga will focus on manufacturing auto components, chemical products and household appliances. A wide range of countries have expressed interest in setting up their facilities, including U.S. (NALCO), South Korea, Austria, Germany, Switzerland, Belarus, Turkey, Luxemburg and Slovenia. The Russian company "SeverStal Auto -Elabuga", in cooperation with FIAT, plans a project to manufacture commercial vehicles and auto parts representing a 4.4 billion Ruble (\$165 million) investment and 1,700 jobs. In addition, the plant is projected to have a maximum manufacturing capacity of 100,000 diesel engines per year.

#### ***Tomsk – new materials***

Tomsk region lies in the south of Western Siberia and has the total area of 316,9 square meters with the population of 1 million inhabitants. Tomsk in Siberia, region's center, is the only Russian city east of the Ural Mountains to be chosen as an SEZ site. Despite its remoteness, Tomsk offers good prospects for foreign investors seeking to develop promising innovation technologies. Tomsk has high intellectual capacity with its universities traditionally rated among the best in Russia. More than 3,500 specialists in electronics, IT, control systems, chemistry, biotechnology, medicine, etc. graduate each year. About 80 innovation-oriented

companies, seeking to utilize the creative capabilities of the Siberian universities have already applied for resident status in the zone.

The Tomsk SEZ will focus on development of IT, telecommunications, electronics, biotechnologies, nano technologies and new materials. “Sibur-Tomskneftehim” is the first resident company already established in the zone. This project combines efforts of OOO “Tomskneftehim”, OAO “Sibur” with the Institute of Catalytics of the Siberian branch of the Russian Academy of Sciences. The project will help manufacture Russia’s super molecular polyethylene and titanium-magnesium catalysts to be used in a wide range of industries.

### **SEZ benefits and conditions**

Businesses operating in industrial zones (resident enterprises) will be entitled to accelerated procedures for reimbursement of R&D costs, lifting of restrictions on transferring losses to subsequent taxation periods, and rapid depreciation of fixed assets. Businesses operating in innovative zones will enjoy reduced unified social tax rate (14%). In addition, property and land taxes will not be payable during the first five years.

The SEZ will also be placed under a free customs regime: foreign products can be brought to SEZ without paying customs duties and VAT. Foreign and domestic products can be transported from SEZ to other Russian regions without paying customs duties (except for excisable goods). However, residents will have to pay import and export duties, if they transport foreign and domestic products from SEZ to outside of Russia.

There will also be a considerable reduction of administrative barriers foreseen. Special economic zones will be managed directly by the Federal Government, which will issue permissions and perform administrative duties on behalf of all government agencies. This will help avoid bureaucracy and make licensing and certification procedures less time-consuming.

The area to be allocated for industrial zones will cover no more than 20 square kilometers. Innovative zones will cover the maximum area of 2 square kilometers. The area of the zones must not be used to extract minerals or to set up metallurgic manufacturing facilities inside the zones. It is not allowed to conduct processing of minerals and scrap of ferrous and non-ferrous metals. Other activities that are not permitted include manufacturing and processing of excisable products (except for cars and motorcycles).

Industrial zones require Russian and foreign companies to invest at least 10 million Euros (\$11.72 million) to become an official resident entitled to tax and customs privileges (1 million Euro – during the first year). Businesses operating in innovative zones are not required to meet an investment target. Both types of zones will operate only for 20 years.

### **Chart of cost reduction for SEZ resident enterprises\***

<b>Costs</b>	<b>Industrial manufacturing zones</b>	<b>Technology innovation zones</b>
Administrative barriers	5-7%	3-5%
Infrastructure	10-12%	8-10%
Concentration of production	5%	7%
Taxes	3-5%	5-7%
<b>Total</b>	<b>23-29%</b>	<b>23-29%</b>

\*The Chart is based upon the presentation materials by the Federal Agency for SEZ Management

### **Other SEZ related initiatives**

#### ***High-tech parks***

The Russian Government plans to create 5 high-tech parks that will support innovative entrepreneurship in 5 promising Russian regions. These regions did not win the SEZ contest for industrial and innovative zones, but are still considered to possess significant scientific and technical potential. They include Novosibirsk (information and biotechnologies), Tyumen (technologies for extraction and processing of hydrogen), Kazan (technologies for

chemical and petrochemical production), Nizhni Novgorod Region (information, energy technologies, environmental protection and medical equipment) and Obninsk (biotechnologies, pharmacology and new materials). These high-tech parks will serve as incubators for “growing” future resident enterprises and will increase chances of these territories to win SEZ contests in future. Unlike SEZ, the high-tech parks will not offer tax and customs benefits to their resident enterprises, however, the Russian Government plans to allocate 2 million rubles (\$70 million) for the parks’ infrastructure development in order to facilitate economic growth of residing enterprises.

### ***Tourist and recreation zones***

On June 3, 2006, the Federal law on special economic zones was amended to include tourist and recreation zones to stimulate and develop Russia’s recreational resources, and to attract foreign tourists. Such zones will house hotels and health centers, will develop hiking and skiing routes, mineral springs, curative mud and other health related natural resources. Potential sites for tourist and recreation zones are: Lake Baikal, the Black Sea shore, the Republic of Karelia, the Krasnodar Region, Kaluzhskaya and Vologodskaya Regions among others. The first tourist and recreation zones SEZ contest has been announced for August 2006 and the Government plans to select the maximum of 3-4 zones. These SEZ will offer a 14% reduction of the unified social tax and abolish a 30% limit on transfer of losses to the next tax period. They will also relieve investors of the property and land tax for five years, and make it possible for them to develop mineral springs and curative mud deposits. Unlike industrial manufacturing zones, the new SEZ will permit housing construction. To date, applications from 28 Russian regions have been received and selection is in process.

### ***Port zones***

In addition, three to five special port zones may be created in Russia. The goal is to build new port infrastructure, upgrade old facilities, introduce customs-free import regime and develop port services. The north port of Murmansk is an example of Russia’s seaports in dire need of modernization. Murmansk Region Governor Alexander Ruzhankin has estimated that a developed infrastructure would help transport companies to save 3 or 4 days and “millions of dollars per tanker”. Port zones are expected to have the most stringent requirements for investors, compared to other types of zones. The minimum investment target for seaports is 250 million Euros (\$320 million). A new cargo terminal or airport investment target is 50 million Euros (\$64 million) and modernization for an existing cargo terminal must exceed 10 million Euros (\$12 million). To date, the draft law on port SEZ is in the final stage of review by the Ministry of Finance before being submitted to DUMA, the legislative body of the Russian Federation.

## **Resources & Key Contacts**

The Federal Agency for SEZ Management has been set up to manage and monitor special economic zones. The Agency assigns a support team of 10-15 specialists to each SEZ. Besides, the Federal Agency helps each SEZ form a Supervisory Board, consisting of representatives of local authorities, trade chambers and the SEZ resident enterprises. It will also make a hotline available to allow future investors report any possible misuse of authority on the part of local governments or other violations. The Russian Federal Agency for Management of Special Economic Zones maintains a website in Russian at: <http://rosoez.economy.gov.ru>.

## **For More Information**

If you wish to obtain more information or are interested in SEZ opportunities, please contact the U.S. Commercial Service in Moscow, Russia via e-mail at: [vladislav.borodulin@mail.doc.gov](mailto:vladislav.borodulin@mail.doc.gov); Phone: +7(495) 737-5036; Fax: +7(495) 737-5033 or visit our website: [www.buyusa.gov/russia](http://www.buyusa.gov/russia). Contact person: Vladislav Borodulin, Commercial Specialist. FSC maintains close contacts at the Federal Agency for Management of Special Economic Zones and can assist in arranging informational meetings and site visits for interested U.S. firms.

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