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Securing the Future
FREE ECONOMIC ZONES: AS EFFECTIVE AS EXPECTED?
Panel Discussion

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Moderator:

Philip Sterkin, Editor of 'Economy', Vedomosti

Panelists:

Yu Dezhi, Director, Harbin Economic and Technological Development Zone

Nurakhmet Dzhanabekov, Chairman of the Board, SEZ Seaport Aktau

Dominique Fache, Member of the Board of Directors, Sophia Antipolis Science Park in Nice

Oleg Kostin, Chief Executive Officer, Special Economic Zones JSC

Wilfred Loo, Vice-President, JURONG Consultants

He Shushan, Chairman, Tianjin Economic-Technological Development Area (TEDA)

P. Sterkin:

Ladies and gentlemen, we are beginning our session on the subject of special economic zones in Russia.

Colleagues from different countries, both developing and developed, have come to help us identify the best in world practice for the operation of special economic zones. I would like to introduce the participants, going from left to right. Mr. He Shushan, Chairman of the Tianjin Economic-Technological Development Area; Dominique Fache, who is here in his capacity as a member of the board of directors of Sophia Antipolis; Oleg Kostin, the Chief Executive Officer of Special Economic Zones; Wilfred Loo, Vice-President of JURONG Consultants, Singapore; Nurakhmet Dzhanabekov, Chairman of the Board of the Aktau Seaport zone in Kazakhstan; and Yu Dezhi, Director of the Harbin Economic and Technological Development Zone.

I would like to note that there are a total of 79,000 hectares of land with projects totalling USD 83 billion under the direction of the people who are participating in this session. That is a lot of money, and for comparison, it is equal to 20% of Russia's total budget revenue.

The institution of special economic zones in this country is fairly young; it is only six years old, and we have a lot to learn. At the same time, we are already in a position to be able to summarize the interim results of this policy: we need to recognize our strong and weak points, and determine what is hindering development in this area, and what can stimulate it further.

I would like to ask Oleg Kostin to summarize these first interim results. What, in your view, has proved itself in the chosen model, what is not working, and what should be changed?

Oleg, your answer?

O. Kostin:

Thank you, Philip. First of all, I would like to thank all of the participants in today's event for attending our briefing.

Special economic zones have existed in Russia for six years at the federal level, and in our view, the moment is ripe for us to talk about current issues in the development of these special zones. I would like to talk about how the history of their development came together. The programme started in 2005, when the Russian parliament passed a special law. This law dealt exclusively with special economic zones. It created the legal and economic framework for their operation.

How is the structure of Russian special economic zones being built? First, this is always a question for agreement between the federal executive body (in Russia, this role is fulfilled by the Ministry of Economic Development), the specific region on whose territory the special economic zone will be built, and the municipal entity. Besides these, one of the participants in such agreements, in accordance with recent changes, is the management company. That is the first condition.

Second, the economic structure of a special economic zone is divided into three parts, and is built on private–public partnership. The internal structure and internal infrastructure of special economic zones must be transferred to the management company, which is financed by the federal budget. Regional authorities and municipal entities finance the construction of the external infrastructure. Afterwards, when the basic infrastructure of the site is completed, investors have the opportunity to start implementing their projects.

The format of the projects and the procedure for obtaining resident status is relatively simple. The Expert Council at the Ministry for Economic Development, which was created in accordance with the recent changes in the law, is made up of representatives of various development institutions, the business community, and business associations. In practice, they evaluate the business project and make the final decision about awarding residency to an investor, whether Russian or foreign.

From the moment they receive official status, which is documented by an agreement, companies receive a benefits package and certain preferences, which I would like to tell you about now. The package has several levels to it. The first is tax benefits. Compared with the baseline rate, there are significant reductions in

corporate tax, income tax, and transport tax. A region has the right to lower the corporate tax rate, for instance, to 2%.

Secondly, there are preferential terms and opportunities the provision of land and leasing of premises. A company that obtains residency status can receive or lease land on preferential terms, and in the future, when their plant has been built or their R&D centre has opened, they have the opportunity to buy the land at a discounted price.

I would like to speak briefly about infrastructure. The federal government foots the bill for construction, with no additional payment required for utility connection. For Russia, this is a very relevant issue, and that is how it is solved in the special economic zones.

Finally, the status of 'free customs zone' is very important, since that is something regional industrial parks simply cannot offer. Such structures are also being created in Russia, and we observe this as well. A company that obtains the status of resident of a special economic zone is able to import equipment and materials duty-free into the zone. They are not subject to duty and export fees because they are operating on the federal level. The necessary customs infrastructure, where the customs officers work, is built at the expense of the special economic zones.

What are the short-term results that we have achieved over recent years? In our six years of existence, as of January 1, 2012, 306 companies become residents in our zones. Forty-four of these companies are non-Russian, from 20 different countries. The volume of investment stated in their business plans totals USD 12 billion. Among these companies are large corporations that are participating in the Forum: Novartis, Air Liquide, Rockwool, Nokia Siemens, Bekaert, and a factory in Lipetsk that was opened by the Japanese corporation Yokohama. All of these companies are our residents. In six years there has been a lot for us to be proud of, but during this period we have also encountered serious systemic limitations, which are going to be a topic for discussion at today's event. We would like to share our thoughts about these issues.

First, as we have already discussed here with Dominique, the Russian special economic zones are in competition with analogous structures in other countries to attract foreign investment.

Second, private regional parks in Russia also work quite well. We know of examples in Kaluga, Moscow Region, and Nizhny Novgorod. These are truly successful companies, and we respect the choice of investors who have chosen these regional structures.

Third, in Russia today, special economic zones are divided into different types: there are industrial zones, innovation zones, tourism zones, and port zones. This sort of categorization, in our view, creates extra complications. A company that does industrial manufacturing, according to our legislation, cannot conduct 'innovation activities', formally speaking. On the other hand, companies that have the ability to develop industrial manufacturing but not tourism experience poor quality social infrastructure and a poor social environment. This, in our view, is a serious limitation and a deterrent to foreign investment.

There are also personnel problems. We have examples of successful special zones; for instance, the special industrial zone in Alabuga, which has seen an impressive influx of foreign investment. The city of Yelabuga, with a population of about 70,000 people, is not far away, and the rapid growth of the special economic zone is provoking difficulties with basic infrastructure and with the provision of sufficient personnel. Would-be residents want to know how and from where they can attract qualified personnel. Educational programmes at higher education institutions that prepare specialists sometimes do not quite meet the needs of the foreign investors and Russian companies that have decided to invest in the special economic zones. So those are some of my insights.

P. Sterkin:

A one-size-fits-all model of support for zones operates in Russia, and is applied to zones of different types. What do our colleagues from other countries think about

such a model? Is it possible that an individual approach, with a broad, tailored range of products and services, is necessary?

What criteria are used in other countries to rate the success of this or that zone, of this or that project?

I would like to remind everyone that, unfortunately, we are short on time, and so we must follow the rules and restrict presentations to about five minutes.

So, to what extent is the one-size-fits-all model justified, and what should be the criteria for rating effectiveness and success? Mr. He, perhaps you can talk about this? What is your view?

S. He:

Thank you very much.

I have come from Tianjin, where I am representing the Tianjian Economic-Technological Development Area. The Chinese Ministry of Commerce holds a competition every year among the special economic zones, and we have won first place for more than ten years in a row. In Tianjin, we occupy 1% of the city's territory, but we account for 17% of the city's GDP. We have the following statistics: USD 36 billion, one twelfth of the city's GDP, 36.8% of industrial production. We already have around 160 projects. We are developing areas like automotive manufacturing, biomedicine, and chemical manufacturing. Those are the highlights for our zone.

First, I will return to the question from the moderator about zone types. We differentiate between the following types: free trade zones, manufacturing zones, and export processing zones.

Second. It is important to clearly understand what you want to accomplish. You should set a clear goal for the establishment of your economic zone.

Third. You should create a structured environment for investors.

Fourth. You should create a government that strives to serve. You should administer the zone in such a way that the atmosphere that investors work in is favourable for them.

I will now speak about characteristic functions of special economic zones. First, provisions for some structural autonomy. The philosophy of special economic zones hinges on the fact that they have special powers. For their activities to be successful, they need to have a high level of autonomy, so the government should not simply give this autonomy, but guarantee them autonomy in the areas of tax administration and provide additional financial resources.

Second is a clear differentiation in the functions of the government and the management company. The government sets the rules of the game, and then the management company should create the infrastructure, but they should complement one another.

Third, the role played by manufacturing. It is necessary to create conditions for different types of enterprises according to where the zone is located, for instance, in the city or near a port. You need to coordinate the development strategy of your zone with the general development strategy of the state and region.

P. Sterkin:

Thank you very much.

Mr. Fache, please, your opinion. In your zone, what criteria do you use to evaluate your project, its success, and its effectiveness?

D. Fache:

I am a little out of place here, not because I am French, but because in Russia, I am known first of all as an energy man. I am the director of a large energy company. I had a different life, during which I was one of the crazy people who built the Sophia Antipolis technological park in Nice, on my native French Riviera. This was a unique project, since at the time it was created, no one was talking about free economic zones, because the criteria for their functioning did not exist. We created them.

Answering questions about said criteria, I would like to note that they are rather simple. You can count how much has been built, how many hectares of land have been sold, and how many jobs have been created. Today, in Sophia Antipolis about

2 million square metres have been built. As they say, beautiful children have many fathers, especially in politics. Politicians love to say that they have created such-and-such a number of jobs.

The question, perhaps, lies elsewhere. What are we talking about? What are we moving: goods or ideas? Where do our priorities lie? You need to count, for instance, how much you have paid in taxes. The 2,000 or so companies at Sophia Antipolis pay around USD 100 million in taxes to the local authorities every year. The question of what they do with that money is also interesting. That, of course, you can quantify.

I will return to the question about criteria. I think that it is the most important. I will cite one statistic. Our region is basically a tourist region; this how it has developed traditionally. Every week I fly home, and on the aeroplane there are usually 99 Russians and one French person, maybe a Japanese person. The turnover of our tourism industry is about USD 5 billion a year. Today, what we created – that is, the high-tech industry – is even more significant than tourism on the French Riviera. That is, I suppose, the biggest, most important criterion that changes everything. We are providing our children with an alternative future. They do not have to become waiters in a hotel; they can work in high-tech. We are giving the South of France a different future, a different kind of development.

Usually they say, 'special economic zone'. Sometimes they write, 'free economic zone'. Does that imply that the other parts of the territory are not free? We should ask ourselves questions about 'infecting' the whole environment, about spreading ideas throughout the entire country.

A few words about Sophia Antipolis. Our work has already been going on for 40 years. You need time. Roads paved with gold will not appear at Skolkovo overnight. I have heard from some leaders at Skolkovo, whom I will not name, that everything is so great – "We have a one-of-a-kind police force there that does not take bribes." That is just ridiculous. That does not happen! Is it an island in the desert? No, you need the development of the country as a whole.

I think that the level of decentralization is very important. The situation in France 30 years ago, I think, is very close to yours today. Then, we made a decision to decentralize, so now there is domestic competition. This competition requires, as has already been mentioned, highly skilled professionals. The number-one problem today is where to find highly skilled professionals and how to train them, because there are none. You need to be aware of what is happening in all of the headquarters of the world, because you have to be included in the decision-making process at an early stage. If you do not have language skills, information, and knowledge, you are not at all competitive.

P. Sterkin:

Thank you very much, Mr. Fache, I absolutely agree with you that you should not create an island of development, but rather spread these development practices throughout the whole surrounding area. The wider its reach, the better. It is not about creating a special police force that does not take bribes in just this separate area.

D. Fache:

Allow me to mention one more aspect, one that was very important for our civilization. I was at the centre of the election campaign that has just taken place in France. You know that we have a new president; we got rid of the previous one. I am not saying that the new one is better. Simply, we had an important question about where we were going: why is the deindustrialization of our country happening, why is manufacturing leaving for China? Is this good, or is it a problem for us, and if it is a problem, then, how can we retain industrial capacity, especially in high-tech? Do not get rid of it just for the sake of high salaries. If you look at China today, you see what Korea was like ten years ago. How can we retain this tradition? Living without an industrial tradition will be very difficult.

P. Sterkin:

Again, thank you very much. I would like to ask Mr. Loo to answer whether common support mechanisms are needed, or whether they should be flexible and individual, different for each kind of zone? What are the criteria for assessing them? What do you think: do we need to revise the model of support for special economic zones, or should it be regional for every type of zone? What criteria do you use to estimate the efficiency and success of the zone? Thank you.

W. Loo:

Thank you. First, I would like to thank the organizers who have invited me to the panel. Before I begin to answer the question, I would like to say that any environment that promotes free trade and enterprise makes economic sense and should be promoted. In terms of special economic zones, basically, these are foreign territories which promote free trade and economic activities free of import and export duties and other encumbrances which are found in the host country. With this, you actually build an environment which promotes free trade and free economic activities within the zone. This is a good thing and should be encouraged. As to your question, in terms of whether it should be regional or federal, it all depends, because it is important when you start your economic zone that the objectives and goals are clear. In fact, it has to make commercial sense in the first place. The fundamentals of the economy have to be right. There has to be a reason for people wanting to be there in terms of commercial value. That means that when investors and other businesses want to locate in a certain country, there are certain fundamentals which are correct in terms of comparative and competitive advantages to locate there. They may want to locate there, but because the host country has other impediments or restrictions which hinder them from doing so, it makes sense to have a special economic zone whereby you actually create an environment where you make advantages for them to be there. The fundamentals have to be correct, and once you have that and you have an enabling environment, it makes sense for people to want to invest in your zone.

P. Sterkin:

Thank you very much. Next I would like Mr. Dzhanabekov to speak about the same topic. How are the special economic zones set up in Kazakhstan? How much of your approach is individual? What assessment criteria do you use?

N. Dzhanabekov:

Good day, thank you very much for inviting me to this Forum.

In regards to your question, in Kazakhstan we have adopted a common model; all of the special economic zones are provided with the same conditions. I believe that the benefits given to special economic zones in other parts of the world are not much different to those given in Kazakhstan. The difference is in management and in providing investors with a range of different services to solve certain problems.

Yesterday I heard the Governor of Kaluga, who said that investors are concerned by four things: bureaucracy, corruption, infrastructure, and taxes. Solving these problems will lead to investors actively participating in special economic zones.

I believe that the assessment criteria are different for every zone. Assessing the activities of a tourist economic zone with the same criteria that you use to assess an industrial economic zone is not right. The question is one of regional development. If the regional management is effective and regional development is happening in that particular region, the authorities will be interested and actively working on this, and the existing problems in the special economic zones will be solved. As we can see, these problems are being solved successfully in a number of countries.

P. Sterkin:

Tell us please, how much has your zone contributed to the development of the country? Can the effect be quantified, or has not enough time passed?

N. Dzhanabekov:

Our special economic zone is located in the west of Kazakhstan. The Aktau seaport is Kazakhstan's only port on the Caspian Sea. This port zone is intended for the

export of industrial and manufactured goods, but it is also a petroleum zone. Kazakhstan's entire oil industry is located in our region. The development experience of our zone is very unique, it is difficult to compare to others. We have a large number of oil companies who buy a lot of goods, labour, and services. The majority of the companies that work in our zone – there are about 50 of them – are focused on the oil industry.

Investors who arrive in the region are immediately interested in the special economic zone and are ready to tackle problems right away. The provision of a range of services is an important factor here. The investors want to do business with one organization, one person, and resolve all issues through him – not to go around to different offices, trying to work out which paperwork he needs to take with him to begin his activities in the special economic zone.

P. Sterkin:

Thank you. Mr. Yu, your opinion on this question?

D. Yu:

First of all, I would like to thank the organizers for inviting me to participate in today's events. I am very glad for the opportunity to talk about my own thoughts and observations regarding special economic zones.

We just heard some remarks from our colleague from Tianjin, Mr. He Shushan. The fact is, the Tianjin zone, TEDA, is quite powerful and is well known among the 330 economic development zones in China. The government should provide appropriate incentives for the creation of such zones, including in the area of tax benefits and in relation to the provision of land. The general plan for development and construction of infrastructure, as well as the particular management system, need to be planned very well.

We note that many similar zones have recently been constructed in Russia. But Russia is still at the beginning stages in this area. In the establishment of such zones, you need to take into account local characteristics: what kind of resources

are there, what kind of workforce, labour reserves, what kind of geoeconomic benefits exist in the region where the zone is being created. It requires an integrated approach, with a 360-degree analysis of the possibilities offered by local authorities and local circumstances.

The Harbin Economic and Technological Development Zone was established in 1991, and in 1993 it was reclassified as a state-level zone. We are one of the top 20 development zones in China, and now we have close ties to Russian regions. Our Heilongjiang Province shares a border with four Russian regions; Harbin, I believe, has the largest amount of professionals that speak Russian. In our schools, even at the primary level, there are students who are studying Russian, and the students who study Russian at our universities are considered the best in China. Harbin, for this reason, has special advantages when it comes to advancing cooperation with Russia. Currently, over 20% of trade and economic cooperation with Russia comes from Heilongjiang Province.

We have already talked about the Alabuga zone. Last year, we visited Tatarstan and I personally saw this zone, which left a deep impression on me. I am certain that such zones in Russia will be successful with state support from the federal government and local governments. The speech yesterday by the President of the Russian Federation at the plenary session increased my confidence that these zones will continue to develop. We have been interested in developing relationships with these zones, and hope that there will be active cooperation between our business communities.

Thank you.

P. Sterkin:

Thank you very much.

We have heard the opinions and positions of representatives of management companies from different special economic zones. It would be interesting to hear the position of a different side, namely the consumers of their services: investors.

As far as the services that are provided and exist in Russia are concerned, is a common service model attractive to investors? Or are a more flexible approach for different kinds of zones and different support mechanisms necessary?

I know that in the audience we have representatives of large investors, and I have been told that we have Kristina Tikhonova, the General Director of Nokia Siemens Networks Russia, in the audience. I would like to ask you: what do you think as a consumer, as a participant? Is it convenient, inconvenient, profitable, unprofitable to invest now?

K. Tikhonova:

Thank you very much for the chance to speak.

I am not a specialist on the subject of special economic zones, but I can speak as a user. It seems to me that for many questions, it is appropriate to go from simple to complex, from basic things to more complicated arrangements. The right aspiration is to clearly define objectives, criteria, and terms, but most of all, you need to have in place basic terms and to have worked out the legal and fiscal arrangements.

We are in the special economic zone in Tomsk, and we have a series of basic questions, such as the VAT refund. The VAT refund is not related to a specific type of zone; the question of the refund of this tax is related to the overall regulations. Truly, it is impossible to improve the investment climate without resolving basic issues. You need clear, understandable, well-developed regulations, and human resources: highly qualified professionals are needed in every zone.

I do not think that it would be good to create more complex models. You need to first work out the first level, and we are currently working on that together. We are glad that we can help Russia with this, because for me personally, as a manager of a foreign company who is also a Russian citizen, I am interested in participating in it: this is both for the benefit of my company and for the benefit of my country. I hope that we can continue our cooperation, and work out this basic level.

Thank you.

P. Sterkin:

Thank you. We have representatives from other companies in the audience. I would like to ask Mr. Masao Fujita, Chairman of the Management Board of Komatsu CIS, to speak.

How attractive is the Russian model; how do you like interacting with a management company? What would you like to change in the model?

M. Fujita:

Thank you very much. I think that the concept of the special economic zone in Russia is perfect in terms of infrastructure, running the system, and creating the system. The conclusion is perfect, because in other places outside the special economic zone, these things never existed in Russia.

We have established our factory. We decided to build a factory four years ago and finished the construction just two years ago, but actually we did not select a special economic zone. I visited Alabuga and Lipetsk, but unfortunately these special economic industrial zones are a little bit far from the port, so they do not fit our transportation or distribution system. My question is: why are there only four industrial-type special economic zones in Russia? Why is there no special economic zone in the Far East? There might be many candidates, investors in the Far East. Of course, we would like to attract high-tech companies to invest in Russia, but there is a lot more employment created by a company like Komatsu or another manufacturing company. So that is my question about the system of the special economic zones, from the viewpoint of the industry.

A second question is about regulation. Running the system is a perfect concept. Actually my colleagues finished the construction and started operations last month, but they have also submitted the paperwork to get the relevant permissions. Of course, we agreed to submit the paperwork to get a construction permit and operation permit. But special economic zones have to have a simplified procedure. Otherwise I believe there will be no big benefit. That is my comment, but the concept is perfect. The main point is how to implement it. In Japan, when we had

high-rate growth in the 1960s and 1970s, we had more than 60 special industrial zones, with electricity and ports and comprehensive infrastructure. Even in Japan, we had 50 or 60, and our Chinese colleagues said that in China 150 special economic zones existed. So how come there are only four special industrial-type economic zones in Russia? Thank you. Thank you very much.

P. Sterkin:

Oleg, perhaps you can answer this question?

O. Kostin:

Yes, thank you very much for your comments.

First, I would like to answer the question about industrial zones. Yes, Russia has four industrial zones – you were completely correct when you named that number. One is in Yelabuga. Another is in Lipetsk Region, not far from Moscow. There is a special industrial economic zone in Tolyatti. This is in Samara Region, near the Russian–French and now Japanese company AvtoVAZ, the largest car manufacturer in Russia and Eastern Europe. There is another zone of this type called Titanium Valley, located in Sverdlovsk Region. The decision to create a special economic zone in Russia is adopted by government resolution. The Prime Minister has to sign the document to create such a zone. The document establishes certain terms of operation and outlines performance criteria.

There is also a separate document that determines where it is appropriate to establish a special economic zone. It is inconceivable that the entire territory of the Russian Federation will become a special economic zone. A special economic zone is a specialized institution of support that assists in leveraging the technological developments that are out there. The role of this institution is to increase export potential. It should help bring advanced technologies and ideas to the Russian Federation – this is why the government is committed to funding, and providing benefits.

P. Sterkin:

Back to the investors. Perhaps there will be more questions that you, Oleg, can answer.

Michael Akim, Director of Strategic Development of ABB.

M. Akim:

Thank you for the chance to speak.

I would like to add to what Dominique said. I think that Dominique is familiar with Russian economic conditions like no other foreigner who lives here.

I would like to focus on the core competencies of industrial development, which still determine everything. Right now, a foresight analysis of Russian industry is being conducted. This is extremely important. Developing every industrial sector is impossible, and developing every region at the same time is also impossible. The presence of certain geographic incubators, the development of islands – in Dominique's parlance – is very positive. We hope that in the future, all of Russia will be turned into a special economic zone.

I will return to my answer to your question. I think that there are key points: proximity to the market, the competence that the market demands, the cost structure that will be determined by the qualifications of specialists and the salaries of those specialists, and, without question, the support of local authorities. These considerations as a whole determine interest in the use of special economic zones.

I would like to direct some questions to Oleg Kostin. How do you view the development of free economic zones in light of Russia's accession to the WTO? Russia's accession to the World Trade Organization significantly changes the legislation and the economic realities. How do you view this development?

Thank you.

O. Kostin:

Thank you, that is a good question.

I spoke about the systemic limitations that we have dealt with in our six years of experience. The question of accession to the World Trade Organization is also quite serious, because participation in the WTO will change a number of legislative provisions and the terms under which we work. For example, free customs regimes in relation to individual procedures and goods will be abolished the moment Russia enters the WTO. For us, this is a serious barrier. We are talking with investors and conducting an active dialogue with them. Many of them are saying that the free customs regime is the most significant of all of our available benefits.

We were just in America, conducting negotiations with large American companies with respect to rates for certain equipment. I know that Nokia Siemens has similar questions. The situation is completely incomprehensible. The cost of products that are imported into Russia is not subject to normal duties and rules, but the cost of the materials for making those products in the Russian Federation is. This is absolutely not beneficial from the standpoint of the international economy and the worldwide calculations that have been done by companies who are localizing their manufacturing in Russia – the free economic zones for now are not having the expected effect.

P. Sterkin:

Thank you.

I would like to ask Aleksey Shipov, Vice-President of Pharmasynitez, to speak.

A. Shipov:

Thank you for the chance to speak, I will try to talk briefly about our experience of working in St. Petersburg.

In the near future, we will invest approximately RUB 2.1 billion and are going to build a plant for the production of cancer drugs. So far, I have had only positive experiences working with St. Petersburg. This is not dependent only on the initiatives of the authorities at the top level, for instance, the Ministry for Economic

Development or the Governor. They give instructions, and they need to have a strong team who fulfil these tasks. That is what I have seen in St. Petersburg.

I do not see any barriers or problems, if the desire is there. What is necessary is to work.

Thank you.

P. Sterkin:

It is good when not only are there no barriers, but when the mechanisms in place also help you to work. The management company should help the work of the investor. That is what it was created for. As I understand it, we are currently discussing changing the management company itself. There are certain ideas and concepts that are being discussed. Should it become a profit-making company; should there be some way to commercialize its work?

Oleg, please, tell us how you view the future development of your management company.

O. Kostin:

Thank you, Philip.

First I will quickly speak about the technological and economic performance of the Russian management company in the special economic zone. Today, Special Economic Zones holds 15,000 hectares of land, 24 kilometres of roads, and vast utility lines. This has all been created for investors and in the name of investors; it is our investment in public-private partnership. Everything that is created for the investors requires significant expenditure to operate and maintain; this is a serious problem for us. We are forced to hire professional teams to operate the facilities. The more benefits we provide to companies, the less economically efficient our project becomes and the greater the strain on our cash flow.

My second point: one of the provisions of Russian legislation is that the land is not owned by our company. We are not landowners. The land is transferred to us rent-free and then we lease it to our investors, who then have the option to purchase it.

We are unable to obtain additional income from leasing. This income goes to the landowner, who is either the municipality or the region. This is an additional problem for us. It limits cash flow and seriously limits us in attracting external funding. Many of you who have dealt with banks understand that having the rights to the land underneath the infrastructure is a basic thing that any bank will ask of you. We do not own this land; therefore we cannot structure these projects properly.

We are trying to develop attendant services. How accurate is the comparison with hotel operators for resident companies? You check in and you do not care how the clean towels appeared in the room or who did it. Your task is to assess the quality, and you assess the quality according to the cost of the room and the number of visits. We are trying to get residents to see themselves in this role. When a company finishes construction and begins full production, we envisage our task as being to provide assistance and solve problems in the future.

For a company that manufactures drugs, we help with the certification of the drugs. For a corporation that publishes software or manufactures industrial equipment, we help with the approval procedures that can delay their activities; we help them get licences and certificates. Our task is to go to the regulatory bodies and represent the interests of our companies.

We certainly have difficulties. We are not too profitable. We understand that only the state can create and invest in a project whose goal is to create favourable and comfortable conditions for an influx of innovative technology, and for the emergence in Russia of creative people with new ideas and with a new view of the future.

P. Sterkin:

Thank you, Oleg.

I have a question for Mr. Loo in his capacity as a consultant. What could be the revenue structure, funding sources, cash flow, and operating profit for the company? At what point can the company become operationally profitable? How much of a goal should this be for the management company?

W. Loo:

Thank you. I have been listening to some of your remarks and comments, especially from end users. I think it is very important that the end users and the investors are serviced from the start, and this is an ongoing process. The special economic zones are like giving birth to a child. You do not just give birth to a child and then leave it alone; you have to nurture and grow the child until it matures. I think the service to the end users and the investors is very important. I have heard comments made by some of the investors that you have lots of documentation to go through. I think one of the tasks that a management company has is to help streamline and simplify these processes. The other aspect would be services to increase the value of presence in the park. For these services, of course, there could be a revenue-generating stream whereby you can actually assist management companies with their cash flow to continue an ongoing process of service to the end users. With this, I would like to mention that we are going to try to assist the Pskov government in the management of their park in Pskov, and also we hope that our experience here in Russia could be edifying, and a learning process in which we will have success in a Russian context.

P. Sterkin:

I have a quick poll for representatives of other economic zones.

What sources of funding are used in each of the economic zones represented here?

Mr. He.

S. He:

The funding source depends on the stage of development of your zone. At the beginning, at the creation stage, of course, a large part of funding comes from the government. For example, when we were established in 1984, we had scant funding from the state and the management company had to take out a large loan. The money was used to create the appropriate infrastructure. After the infrastructure had been built, we got investors. The investors began to pay taxes and invest money,

and the local government began to receive revenue, but at the development stage, the government was not receiving revenue. Then we had governmental support, and that is how the cycle of financing was organized.

P. Sterkin:

Thank you very much.

That is different from what is going on in the Russian management company at the moment.

Mr. Fache.

D. Fache:

Our company was established long ago, and there was a need for crazy people who took the financial risk upon themselves and began this project. At the time, nobody wanted to listen to us. We 'fooled' two banks, who believed that we could do it, and we did it. Additional financing came from the government, not directly for the development of the company, but indirectly, in two forms. First, it was financing for individual projects set up within our zone by state-run companies: universities, technological institutes, factories. Second, it was help in the form of tax credits, which is a system that works very well.

I would like to say one thing: do not believe that help will solve everything. Otherwise you will get the kind of companies that are not viable and not ready for competition; they will just look for grants and hand-outs, and will not address the major issue – the market.

P. Sterkin:

Thank you.

Mr. Loo, what is the revenue structure in your zone?

W. Loo:

Typically, depending on the structure of the zones, you can have a revenue stream from leases, from other services, and from utilities. There could also be value-added services, for instance commercial activities within the zone itself, that provide services for the entrepreneurs, for the workers – for instance, child care centres, tax-related assistance, customs clearance, things like that. All of these could be possible revenue streams for the management company.

P. Sterkin:

Mr. Dzhanabekov.

N. Dzhanabekov:

I need to say a few words about our former structure. Until the middle of last year, all the companies that operated the special economic zones in Kazakhstan had been government agencies. They were financed directly from the budget; their employees were government workers. The law about special economic zones came out last year. In accordance with the law, a management company was created for each of the special economic zones.

Our special economic zone is ranked second in Kazakhstan, and there are companies that have been there a long time, since 2003. By our assessment, we will move to full self-sufficiency by the end of 2013, building up our infrastructure to match. Currently, the government supports us: it invests money in supporting the management company, in building infrastructure, and in connecting utilities.

It is necessary to note the features that differ from the Russian experience: all of the infrastructure belongs to the government and is then leased to the management company at the government rate. Accordingly, the management company in Kazakhstan is not paying all of the taxes that come along with ownership of the property. Its only expenses are administrative expenses for salaries and staff support. Everything else we get from providing utilities to the companies operating in the special economic zone. I do not see a problem with support, at least for us.

According to rough estimates that I have done for myself, at a certain point, when we have completed construction of a series of subzones within the free economic zone, we will be able to relinquish help from the government and operate on a commercial basis.

P. Sterkin:

Thank you.

Mr. Yu, can you talk about the revenue of your company? What are the principles of your financing?

D. Yu:

Typically, there are three factors that determine the revenue structure. First, there is the area of land and how we use it. In China, there is a very strict system for land use, with many limitations. The question is whether we can make money from land use.

The second factor, of course, relates to the funding sources for the establishment and support of the zone. Our zone retains a certain portion of tax revenue for itself. Last year, tax revenues from businesses in our zone totalled CNY 5 billion, of which CNY 2 billion remains with us. This is absolutely not enough for the construction of new infrastructure and for maintaining the current infrastructure.

Third is the question of how much high-tech there is, how advanced the resident companies are.

The revenue sources in our zone are the budget and the portion of taxes that we are allowed to retain. We have the opportunity to obtain income from land use, because the land is provided on favourable terms. We would very much like to be the owners of this land and control it at our own discretion. The value of the land on the open market would grow constantly. The price of land in such zones for us is regulated by the state; at the moment the system of land use in China is being reformed.

The credit-issuing policy of financial institutions and financial organizations is that they require collateral. Getting credit without assets is not easy. There is the possibility to get credit if you have a good project. In recent years, the Chinese government has allowed financial organizations to grant credit to aid government-encouraged projects. This is the third way for our company to get credit. We are also able to issue securities. We can raise capital from bond issues.

I began to work as the Chairman of the Administrative Committee of the zone in 2009. Our financing every year is about CNY 6 billion, but in reality we need a minimum of CNY 10 billion every year to ensure sufficiently rapid development of the zone.

So far, we have only these opportunities; the issue is related to reform in a number of areas in our country.

Thank you.

P. Sterkin:

Tell us, do you make use of the opportunity to raise capital from the market? How actively?

D. Yu:

As for our zone, we cannot raise capital from the market, but companies who are our clients can be listed and attract loans.

We have a platform where companies can receive services; they receive revenue accordingly. These companies can also go to a stock exchange with their bonds. For example, in Tianjin there is a company that provides such services. It is listed on the stock exchange in Tianjin and in Hong Kong. This allows us to improve the services offered to our investors.

P. Sterkin:

Thank you very much.

We are coming to the end of our discussion, and at the end I would like to turn to Mr. Fache, who, as we have already stated, knows Russia better than the vast majority of foreign investors, and many Russian investors will also envy his knowledge.

Tell us please, what would we need to do for the top investor in your zone to come to a Russian zone? What conditions need to be created to attract him?

D. Fache:

First, the outcome of this discussion reminds me of a proverb or saying in English: "If you do not like education, try ignorance."

I would like to say one more thing. If you really want a lot of money, and our friend from China just spoke about this, you need to ask: how much does subsidizing unemployment cost today? The unemployment level in Spain is close to 25%, in France it is officially 9–10%. We borrow money to finance unemployment, and we end up with debt. We need to understand what basic choices society needs to make; where the money is going to go. I think that it is more appropriate to subsidize the conditions for job creation than to subsidize unemployment.

I will return to your question and, perhaps, put on another hat. I will speak as an investor, because my company has already invested EUR 4.5 billion, and we are getting ready to add another EUR 5.7 billion. This is a huge amount of money. Each of our facilities costs around EUR 500 million. We are opening two new power stations, and these are very expensive toys. I think that we need to adhere to three conditions. First, stability of the rules of game, which should not be changed. It should not be one regulation scheme today and price-cap tomorrow: "Oops, too bad, we did not know."

Second: transparency, predictability, so that the conditions can be understood.

And third, a strategic approach. We cannot say, "Tomorrow there is an election, and we need to freeze prices."

For example, in my business, there has not been investment in energy for 25 years. Clearly it is needed today, and there are no miracles. As Molière famously wrote – if you want good soup, you need money.

We absolutely need honest investors. Our friends and clients talked about problems with VAT, about problems with laws. I think that Russia is gradually understanding these problems. I would not like it if that were just noise. For example, it has become very fashionable to call things by English names. I do not like this; as a fan of Russian language, I love to speak Russian. They say 'cluster'; what does that mean? This is nothing; it means nothing. 'Cluster' comes from the Latin word 'clyster', but no one knows this and everywhere, in every region of Russia they say, "Cluster, cluster, cluster". Nobody understands anything.

I would hope that the attitude would not be superficial, and that there would be a truly deep understanding of the processes that lead to the economic development of regions. This is a long process, and in this work, time, as I said, plays a large role. This is work where money – correctly spent money – plays a large role. I would not fantasize in vain about police who do not take bribes.

Thank you.

P. Sterkin:

Thank you very much.

Our discussion has come to an end. Of course, we would want police who do not take bribes in more than just one special region.

Returning to economic zones, from my vantage point it seems that commercialization is necessary and criteria for assessing work are necessary, including the work of the management company itself.

As an economic journalist, I always think that profit is a good criterion to judge the success of a company. In terms of assessing the success of a zone, I suppose that six years is too short a time for assessment. We may have formally created a certain number of jobs, but nothing long-term may ever appear.

I would like to hope that the discussion was interesting and useful to participants, and that some of the ideas expressed here will be implemented in the future for the development of frameworks, that they will not be the kind of abstract concepts mentioned by Mr. Fache. I hope that all of the conditions will exist in Russia for the best investors from each of these zones to come to Russia, and vice versa.

I would once again like to thank the participants in the discussion, our speakers, and the audience. A big thank you to everyone.