

What Can Replace the Kaliningrad SEZ?

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It becomes more evident with the time that the existing SEZ in Kaliningrad will not last for long. Other ideas and options are discussed, including other designs for the Zone as well as its complete abolition. At the end of 2003, Mr. Shuvalov, Deputy Head of the Presidential Administration, was put in charge of working on a federal development concept for the region. The ideas of the Shuvalov's Group are heavily criticized in the Kaliningrad Oblast. Due to the exclave position of Kaliningrad, the mere repudiation of the SEZ regime presents itself as a catastrophic policy option. The question of the replacement for the current SEZ remains open.

1. The inevitability of giving up the current SEZ regime in the medium- and long-term becomes more evident due to the two main reasons. First, it is possible to assume that the specific regime of the customs preferences in Kaliningrad contradicts the GATT norms. Secondly, the impact of the SEZ on the balance of payments as well as on the whole of the Russian economy is ambiguous due to the fact that the SEZ promotes imports creating conditions for the circumvention of the customs duties and indirectly subsidizing imports from the federal budget due to the absence of the VAT. Besides, the current Russian federal economic policy is targeted at the abandoning of the non-monetary privileges in favor of the more transparent monetary schemes.

2. In my opinion, the "Shuvalov's project" contains two correct and two incorrect policy ideas. Let us begin with the correct ones. The project provides a ten-year long transition period when both the old and the new regimes would co-exist. The idea of a prolonged transition period is to be wholly supported. The regional enterprises would need a substantial time to re-orient their production lines and business processes. Acting in a hurry can become disastrous for the Kaliningrad regional economy: it can stop overnight as it already happened once in the beginning of 2001. Securing the minimal term of the SEZ existence (25 years) in the federal Law seems to be the right measure, too.

The concept conceived by the Shuvalov's group contains a dangerous idea of expanding tax preferences only on the large companies that would invest a minimum of 10 mln. Euros over the period of ten years. This would deprive the small and medium enterprises of the right to become the residents altogether. Meanwhile, SMEs are the powerful and most creative growth locomotive. The only viable and very promising regional cluster that arose from the scratch within the last ten years is the furniture industry. It developed rapidly exclusively on the base of the regional SMEs. In fact, the furniture cluster is unthinkable beyond the small and medium companies.

Besides, it is difficult to agree with the idea that long-term preferences on the profit tax for the SEZ residents would be enough to secure the economic development of the region. The question remains open whether the conceived tax preferences are able to provide a favorable investment climate. Numerous studies show that the tax preferences do not play the key role in the investors' considerations.

3. The discussed concept fully abandons the idea of a free economic zone. Meanwhile, the necessity to abandon the current design of the SEZ does not imply the necessity to give up the

SEZ altogether. A free economic zone is a normal instrument of a state economic policy. The usage of this mechanism is a natural choice in the case of a region with specific conditions and needs. The mechanism of a “normal” WTO-compatible SEZ consists of two principal elements. First, a SEZ is excluded from the customs territory of a state. Second, the imports are tax exempt; customs duties are however levied if the goods are transported from the SEZ to the customs territory of the state. This regime would reconcile the SEZ Kaliningrad with the WTO norms and regulations. Technically, various requirements and criteria for the companies to become residents are possible. As an example, the residents shall be obliged to be the net receivers of foreign currency, with no additional requirements to the value added or any minimal requirements to the share of exports in the total productions. Such mechanisms shall ensure the export orientation. Shall the Russian state envisage no specific orientation for Kaliningrad, another set of technical requirements may be construed.

4. Will that be enough for the satisfactory development of the KO? More than likely not. A normal practice is to supplement the basic mechanism of a SEZ with a package aimed at the creation of an attractive investment climate. In the case of the Kaliningrad SEZ, it might prove to be needed to supplement the customs regime with the well-thought proportionate tax preferences, for example, the deduction of capital investments from taxable income. Preferential (railway) cargo tariffs for Kaliningrad are possible, but they shall be guaranteed by the Law in order to provide for a stable economic regime.

5. The EU-Russian cooperation may prove to be not less important for the future of Kaliningrad, above all in connection with the intention to create a Common Economic Space. The conceptual basis for the cooperation of the EU and Russia on Kaliningrad is laid down by the idea of a pilot region. A number of ideas is possible, of which deserve the most serious consideration. First, this is the liberalization of services in the Kaliningrad SEZ, that is, opening of the SEZ for the foreign investments in banking, insurance, and other financial services. Second, the visa-free regime for the citizens of the EU member states in the Kaliningrad Oblast. As the latter is technically feasible, it is purely the question of the Russian political will.

To sum up, the SEZ idea should not be abandoned altogether. On the contrary, it is possible to create a “normal” export-oriented SEZ in Kaliningrad, providing for a prolonged transition period. This SEZ should be supplemented by, first, a package of tax and investment-related privileges, and, second, by the measures within the EU-Russian Common Economic Space. This economic policy on Kaliningrad might present itself as realistic and acceptable for Moscow, Kaliningrad economy, and Brussels.