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Current state and development potential of Russian
Special Economic Zones - Case study on the
example of Saint Petersburg SEZ

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1. Introduction

Special Economic Zones (SEZ) are geographical regions that have economic laws different from a country's typical economic laws. SEZ are used to stimulate private investment and economic development through preferential government policies. The benefits an SEZ offers to companies may include corporate tax reduction or elimination, tariff free trade, or deregulated labour markets (Curtis, Hill, Lin, 2006). Traditionally SEZ are created as open markets within an economy that is dominated by distortive trade, macro and exchange regulation and other regulatory governmental controls. SEZ are believed to create a conducive environment that promotes investment and exports. Perhaps the most spectacularly successful Special Economic Zones were launched in China in the end of the 1970s. Their model was followed in various ways by almost all transition countries across Central and Eastern Europe and particularly in Russia.

In the beginning of the 1990s nearly 20 special economic zones were created in Russia. However the initial expectations were not matched by the results and soon the amount of zones was sharply reduced. Some experts believe the main reasons to be in the absence of a purposeful state policy on development of special economic zones, imperfection of their legislative base, and weaknesses in the organizational system of state control over the zone's foreign trade activities (Moldovan, 2008).

The special economic zones re-entered the focus of Russian policy makers in the beginning of the 2000s. It took several years to formulate the new aims and objectives the government vested into the creation of SEZ and by 2005 a new selection of geographic locations was made for the new zones to be established.

The main purpose of this paper is to review the current state of one such zone established in Saint Petersburg. The report does not aim to enhance the theoretical understanding about Special Economic Zones. Its concrete objective is to present a 360 degrees picture about how the Saint Petersburg zone was established, what it offers and what are the experiences of companies that operate within it. The added value of the paper is perceived in recommendations it offers to policy makers - based on evidence from the ground. In passing by it is worth mentioning that regretfully evidence based policy making is still a rare novelty in Russia.

Besides accommodating the findings of previous narrowly focuses research about SEZ in Russia (Moldovan, 2008) the paper is based on a broader literature review that includes

analysis of legal and policy documents as well three interviews including a key informant from the Saint Petersburg SEZ authorities and two high ranking managers from companies registered in the SEZ.

The paper consists of three parts. The first part gives a short historic retrospective in the development of SEZ in Russia including assessment of the main reasons for their failures and the consequent withdrawal of support from the regional and/or federal authorities. The second part has in its focus the Special Economic Zone in Saint Petersburg. It elaborates on its creation, priorities, objectives and business environment. The third part is based on two interviews with the companies registered in the SEZ – its aim is thus to give the viewpoint of those to whom SEZ are oriented and who expected to produce the results SEZ are created for.

Finally some conclusions are being drawn that summarize the current developments in SEZ Saint Petersburg and attempt to offer a list of policy recommendations that may eventually help optimize the results and bring closer the ultimate goal of stimulating the development of innovation based economy in Russia.

2. Special economic zones in Russia: historic retrospection

The first steps in developing special economic zones in the Soviet Union were made at the end of 1980s. At that time special economic zones were considered as an element of state foreign policy and their main assigned function was to foster international economic relations. Furthermore the zones were planned to be created in regions with the developed scientific and technical potential thus linking domestic technologies and foreign capital (Moldovan, 2008).

The following principles were used to form special economic zones (Danko, Okrut, 1998):

1. Principle of administrative and entrepreneurial risk. The essence of this principle consists in underlining the acuteness in displaying various aspects of business, enterprise activity and competition which inherently contain a situation of uncertainty and risk and strengthen it.
2. Principle of competitive advantages presumes the creation of preferences for enterprise activity in the SEZ territories that possess artificially made organizational, financial and economic privileges in comparison to other territories.
3. The principle of equality in the rights of partnership defines the form of business relations. The given principle requires working out of new system of rules for business.
4. The principle of reflective behaviour defines and corrects behaviour of firms in the SEZ market. It normalizes behaviour of economic subjects in the market. The correct estimation of each situation is necessary before to make capital investments and to generate laws, portfolios of securities, etc.
5. Principle of informative sufficiency. Dynamically changing market of the SEZ environment generates special necessity for the analysis of information streams in order to achieve the purposes of a firm and a zone in the whole.
6. The principle of coordination on the purposes being based on the information on the external market environment surrounding SEZ, problems and the mechanisms defining its strategy of development, the given principle allows to specify positions of different economic institutes SEZ and its organizational rules of law.
7. The principle of profitability and efficiency for SEZ regulates the basic criterion function of management for the given SEZ, being based on tendencies of realization of the law of a supply and demand.

These principles are used to form SEZ in the world practice and thus they were taken as guidelines to form the Russian ones (Moldovan, 2008).

2.1 Early attempts

As mentioned above the main purpose of the newly established SEZ was to link the Russian scientific and technical potential with foreign capital and thus launch manufacturing of high-technology production. Due to this underlying assumption the economic and legal privileges for territories of these zones were applied only to enterprises with foreign participation and within the limits defined by norms of regulation of foreign investments operated in the USSR at that time (Moldovan, 2008).

Still the SEZ operations at that time did not bring any tangible result to the Soviet economy as the system that created them stopped its existence a few years later – a time period too short to make conclusions about the effectiveness of the SEZ. Nevertheless the attempt itself and the idea to promote entrepreneurial activities this way became the first milestone for the further development of the SEZ concept in Russia.

In the beginning of the 1990s a new element in the state concept of SEZ came into being: the regional initiatives. These initiatives were developed as a part of the “sovereignization” of the union republics. The latter process also meant that many issues related to the creation of zones have been officially transferred from federal to a republican level of decision making. Thus in the period July-September 1990 the Supreme Council of RSFSR has accepted offers of 11 regional advice councils about the announcement of their territories of free enterprise zones. Such zones were established in the cities of Leningrad, Vyborg and Nahodka, in Kaliningrad, Sakhalin and Chita districts, in Altay territory, the Kemerovo and Novgorod districts, Zelenograd and in the Jewish autonomous region (Decree of the SC of the RSFSR №106-1 of 14.7.1990, Decree of the SC of the RSFSR №165-1 of 13.9.1990).

In 1990-1991 the Ministerial Council of RSFSR has approved a separate decision for each of the zones fixing its legal status (Statute of the free economic zone near Nahodka in the Primorsky territory. Ratified by the Decree of the MC of the RSFSR №540 of 23.11.1990, Statute of the free economic zone in the Kaliningrad district (SEZ “Amber”). Ratified by the Decree of the MC of the RSFSR №497 of 25.9.1991). It is necessary to notice that those zones were called “free enterprise zones” instead of “free economic zones”. The set of the privileges given to zones was practically identical, and zones were considered to be an intra-economic phenomenon called upon to create counterbalances to the centralized system of managing. Although the decisions made promoted inflow of the foreign capital to the zones (the number of joint ventures grew in Nahodka, Kaliningrad and Sakhalin), they have not been thought over up to the end neither from the point of view of their feasibility, nor of the consequences (Moldovan, 2008). First of all many of the created zones covered not only small territories but also extensive

areas and whole districts – that demanded enormous capital investments that were plainly unrealistic at the times. Secondly the issues of control and monitoring became imminent again due to the sheer size of the declared zones.

Another consequence was that the absence of some precise criteria about eligibility to establish zones led to a mass distribution of zone preferences to separate territorial formations and furthermore provoked a wave of independent emerging of new zones. These were cases when given territory (city, area, seaport, a scientific centre or simply any remote place of Russia) declared the corresponding status, lobbying its approval at the highest levels. The state administration of Russia turned out to be under massed pressure: in 1991 about 150 regions were lobbying the creation of free zones in their territories (Ibid.).

2.2. The Special Economic Zones in the 1990s

At the end of the 1991 and the beginning of 1992 the Russian reformist government launched a series of reforms aiming among other things to open the economy. Thus selective liberalization of an enterprise climate at a level of separate zone territories, which was the underpinning assumption of free enterprise zones, in many respects lost its sense. Legal certificates regulating foreign trade activities accepted during this period in the Russian Federation did not provide exceptions to free zone territories. In addition even if the official status of the free zones was still not revoked, the Russian Federation /RF/ tax authorities have interpreted them as invalid and that actually abolished a significant part of the privileges given to zones before (Law of the RSFSR №1545-1 “About foreign investment in the RSFSR” of 4.7.1991).

Such uncertainty of legislative status of the free economic zones was exactly the opposite of what usually makes zones attractive – an island of legal stability and security in an otherwise turbulent business environment. Naturally such uncertainty caused anxiety among the foreign investors who have regarded this situation as a serious retreat of the government compared with its initial aims and objectives targets when creating the zones.

By the beginning of 1992 this legal limbo led to a joint request of the heads of free zone administrations for the government to confirm the legitimacy of the system of privileges for the free zones promoted. In June 1992 a Presidential Decree not only confirmed the legitimacy of the zones but also extended the foreign trade privileges to Russian only enterprises. The decree also offered some general extra benefits aimed at simplifying the financing of infrastructure building in the zones (Decree of the President of the RF №548 of 4.6.1992).

Nevertheless, to the beginning of 1993 a tendency has prevailed in the government to liquidate the "super zones". The prepared bill of the Russian Federation «About free economic zones» provided formation mainly micro zones of two versions - *free customs areas* and *zones for export manufacturing*. The principle of the combination of their favourable geographical position has been put in the basis of the zone territory selection with minimization of expenses for their infrastructural arrangement that proved necessity of more realistic approach to scaling the zone projects (Moldovan, 2008).

As a result, by autumn 1994 following shapes of the Russian SEZ policy were outlined (Ibid.):

- reduction of the possible sizes of the SEZ up to 1-2 sq. km., that excluded creation of large and complex zones of free business;
- formal copying and applying of the elementary samples from world SEZ practice on the Russian ground without taking into account its perspective tendencies and coordination with a national industrial policy;
- the complicated control system of SEZ resulted in burdensome bureaucratic coordination and the impossibility to create zones by means of initiatives "bottom up".

Again just as with the previous attempt number of regions started intensively working on carrying out projects of local customs areas (arrangement of territory, creation of development companies, etc.) without waiting for corresponding legislative decisions. They have managed to mobilize necessary starting means thus predetermining their future success (Ibid.).

The first SEZ of this new type was in Nahodka and it even got a federal support. In the same way but without federal support acted the government of Moscow district launched a zone (project "Sherryzone"), in Saint Petersburg a free customs area "Harbour" was organized, in Ulyanovsk a free customs area at the city airport (Decree of the Government of the Russian Federation №1033 of 8.9.1994).

In the meanwhile other large territories made efforts lobbying exclusive governmental decisions that will either guarantee reinstalling the old preferences or reception of essentially new individual ones. The government gradually gave up to this pressure. For instance the duty-free trade regime within the borders of the Kaliningrad district has been restored; in July 1994 a zone of economic preference has been created in Ingushetia that in fact resembled closely an offshore zone.

In March 1995 all individual customs privileges in the Russian Federation have been officially cancelled again but the struggle of territories for special privileges has not stopped. In particular,

the Kaliningrad district has achieved in November 1995 the adoption of the Federal Law “About the special economic zone in Kaliningrad district” in the State Duma of the Russian Federation, returning it a mode of customs exterritoriality. On January 22, 1996 this Law has been signed by the President (Decree of the SC of the RF №5343-1 of 7.7.1993, Decree of the President of the RF №2117 of 7.12.1993, Decree of the Government of the RF №1430 of 29.12.1994, Federal Law №31-FL of 13.3.1995).

The struggle between federal government and the regions was typical for the presidency of Boris Yeltsin. The President often promoted people in favour of economic liberalization and market economy as regional governors expecting them to create more open market friendly regional that includes also SEZ. However in reality the procedures and institutions established for special zones seem to have been designed to meet other goals of regional leaders: to retain and expand control over regional economies, to enhance opportunities for corrupt gains, and to provide additional assets that can be mobilized for political purposes – i.e., to hold on to power (Moses 2004). The outcome of this process, however, has been that regional leaders and their networks have personally profited from the establishment of SEZ” (Curtis, Hill, Lin, 2006).

Although SEZ were established in Russia in order to take advantage of their geographical location, they did not benefit from location. Many Russian SEZs were located in coastal provinces. Theoretically this should allow them to take advantage of existing transportation infrastructure. However, these regions “lacked the resources needed to develop the zones so that they would be attractive to outside investors. Infrastructure for effective development of the territory was woefully inadequate, and regional resources were not mobilized for this purpose (Moses 2004, Curtis, Hill, Lin, 2006).

During the second half of the decade of the 1990s nothing significant has happened concerning the development of the SEZ in Russia. The only changes were connected with the abolishment of the SEZ “International Business Centre “Ingushetia” in 1997 and the emerging of a new SEZ in Magadan district in 1999.

2.3 Recent developments

The beginning of the 2000s not much happened in regard to the SEZ and a significant breakthrough came in 2005 with the introduction of the new Federal Law №116-FL of 22.7.2005. It clearly defined that special economic zones are a part of the territory of the Russian Federation in which a special mode of enterprise activity is valid (Article 2, Federal Law №116 of 22.7.2005). It should be taken to consideration that in the Russian literature relevant to

the issues of this research the concept of special economic zones is identical to that of free economic zones.

The law also offered the main activities within which the new zones are to be created (Article 4, Federal Law №116 of 22.7.2005):

- *industrial-manufacturing special economic zones;*

Industrial-manufacturing SEZ are intended in order to attract both investments and technologies to certain areas of Russia. These zones target mass production in the first hand. For the Lipetsk special economic zone home appliances and accessories are among the key competences. Italian concern "Merloni" intends to produce up to 80% of accessories within the Lipetsk special economic zone (Moldovan, 2008).

- *technological-innovative special economic zones;*

Technological-innovative SEZ pursues the goal of bringing new technologies to Russia, as well as their developing in the future. After the Ministry of Economic Development and Trade of the Russian Federation and the Federal Agency on Management of SEZ announced a tender among the regions the winners in receiving federal blessing and support in the creation of technological-innovative type were:

- Dubna (information and nuclear-physical technologies);
- Tomsk (industrial electronics and biotechnologies);
- Zelenograd (micro- and nanoelectronics);
- St.-Petersburg (production of analytical instruments, etc).

Technological-innovative zone in Dubna is aimed at development of innovative, information and nuclear-physical technologies on the basis of the International Institute for Nuclear Research. The most modern and competitive enterprises of the microelectronic industry are located in the special economic zone in Moscow and its administrative district Zelenograd.

Later in 2006 and 2007 respectively two new field of activity were added:

- *tourist-recreational special economic zones (as of the Federal Law №76 of 6.3.2006);*

Tourist-recreational SEZ are created in Russia to stimulate, develop and use the recreational resources, objects of resorts, natural medical resources effectively and also to render the services in the field of the organization of recreation and rehabilitation of citizens, sanatorium treatment and preventive maintenance of diseases (Federal Agency for Management of SEZ, 2006). As of 2008 the Russian government has approved the creation of seven SEZ in Russia corresponding to the tourist-recreational type. Such zones will be created in Krasnodar and Stavropol areas, Irkutsk area, Buryatiya, in Altay territory and Republic Altai, and also in the Kaliningrad area. At the moment the concept for these zones is developed (Moldovan, 2008).

- *port-type special economic zones (as of the Federal Law №240 of 10.30.2007);*

The purpose of port-type SEZ is to conduct domestic and foreign investments for the construction and reconstruction of port infrastructure, as well as stimulation of the development of port facilities and services (Federal Agency for Management of SEZ, 2006).

Picture 1. Location of the SEZ in Russia



Source: <http://www.torgrussia.org/>

In 2007 it was planned to finish basic works on creation of an infrastructure of SEZ, engineering networks, including telecommunication networks, transport communications, and also to register some investors as residents. The Russian Government hopes that the creation of SEZ will stimulate inflow of investments in processing sector of economy. It is supposed that residents of the SEZ will be exempt from property and land tax payment for five years. Experts estimate that the creation of special economic zones will attract not less than \$300 million investments and to make production not less than on 6 billion roubles annually” (Moldovan, 2008).

Technological-innovative SEZs are considered to be the centres of the new Russian economy based on high technologies. It is an effective tool for commercializing the scientific and technical development, growth of production volumes for high technological commodities and services, as well as for the development of an innovative infrastructure. It is also an instrument to attract foreign investments and to achieve a gain in volume of export of hi-tech products” (Moldovan, 2008).

While Russia has not an extremely significant increase in FDI as a result of establishing SEZ, as it happened for example in China, it has managed to encourage value-added manufacturing, which has served as the point of entry for imports later consumed in the Russian market as a whole, providing for a certain level of employment in certain areas and lower import prices in the Russian Federation (Curtis, Hill, Lin, 2006).

Russia's experience with SEZ in the 1990s, however, points to the fact that governments, whether central or local, may encourage the establishment of SEZ for reasons of encouraging market economy reforms and a means for establishing regional and local economic autonomy. This experience also shows that SEZ may be used to achieve goals other than high rates of economic growth, ranging from export-promotion to import-promotion (Curtis, Hill, Lin, 2006).

3. The Saint Petersburg Special Economic Zone

Saint Petersburg is one of the major scientific and research centres of Russia and due to its advantages summarized in Box 1 the city managed to be among the winning applications about the establishment of technology-innovative SEZ.

Box 1. Advantages of Saint Petersburg in establishing a technology-innovative SEZ

According to the expert estimates the city accumulates:

- 11% of scientific potential of the country;
- 14% of the Russian researchers;
- 8% of the Russian students;
- 13% of the Russian post-graduate students;
- 15% of those working for doctoral degrees;
- about 300 thousand citizens involved in scientific work and services;
- 329 scientific institutions with 170 thousand researchers;
- 190 branches of scientific organizations;
- 12 state scientific centres;
- 78 institutions of higher education, carrying out scientific activities;
- more than 300 sectoral scientific research institutes and design offices;
- 2900 small innovation enterprises;
- 8 innovation-technological centres.

Source: (Ivannikov, 2007)

The Saint Petersburg SEZ was created for the time period of 20 years up to 2025 and this period is not a subject to prolongation (Article 6, Federal Law №116 of 22.7.2005). The financing of the SEZ is carried out by means of the Federal and the City budgets in the 50:50 percent proportions. The federal money goes to develop infrastructure of the SEZ while the city subsidizes energy supply. The total amount of financing by both the Saint Petersburg city government and the federal authorities is expected to reach US\$420 million (Ivannikov, 2007).

The resident of a technology-innovative SEZ has the right to conduct only technological-innovative activity in this territory within the limits stipulated by the agreement on conducting of technology activity. The latter is understood as the creation and sale of scientific and technical production, its industrial application and implementation, including manufacturing, test and sales of experimental batches, as well as the creation of software products, systems of gathering, processing and transmission of data, systems of the distributed calculations and rendering of

services on introduction and assistance for such products and systems (Article 10, Federal Law №116 of 22.7.2005).

In order to be a resident of the SEZ in St Petersburg a subject should be an individual entrepreneur or profit-making organization registered on the territory of St. Petersburg and to conclude an agreement with SEZ managing bodies on conducting technological-innovative activity. Moreover the SEZ resident has no right to have representatives and subsidiaries outside SEZ. Non-profit organizations are not allowed to participate in SEZ. This does not concern scientific and educational institutions (Federal Law №116 of 22.7.2005). There are no limitations for foreigners if their proposals suit the demands of the SEZ and the expectations of the steering and expert committees.

The person intending to receive the status of the resident of a special economic zone must submit an application for the conclusion of the agreement on conducting technological-innovative to activity to the authorities of a special economic zone that should contain (Article 23, Federal Law №116 of 22.7.2005):

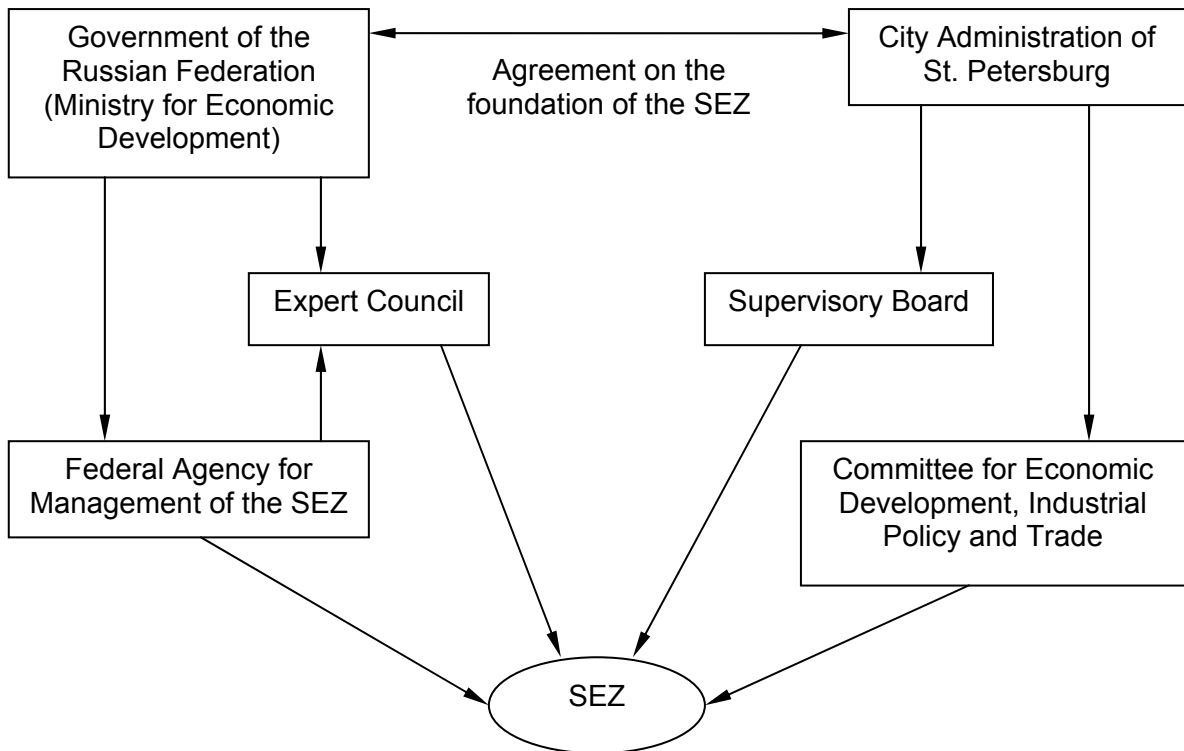
- data on the prospective activity of the applicant corresponding to the type of a special economic zone;
- data about state and/or the municipal property necessary for prospective activity of the applicant;
- copy of the state registration certificate;
- copy of the certificate of registration in a tax body;
- copy of founding documents (for legal persons);
- business plan

In ten days after the receiving of the above mentioned documents the SEZ management informs the applicant of whether the document package suits the initial requirements and will be sent to the expert committee or that the proposal is rejected either because not all the documents were submitted or the field of activity proposed by the applicant is not eligible inside of the SEZ. Rejection may follow in case the SEZ does not have enough resources for the project in question.

In case the project proposal reaches the expert committee it is being considered there for 30 days after which the committee issues a verdict for the project. In any case the applicant is informed about the decision in a three days period. Up to now only about 20% of all applications were rejected. The Committee in turn is created for each separate SEZ and consists of several persons competent in the state of affairs relevant to the existence of each zone. Some

members participate in more than one Committee and thus oversee more than one SEZ. Members of a Committee consider projects proposed by the SEZ candidate residents and make a decision based on the criteria defined by the federal governmental executive body entitled to regulate the functioning of SEZ legally (Par. 7 Art. 23 Federal Law №116-FL of 22.7.2005).

Picture 2. The structure of the management of the SEZ of St. Petersburg



Source: (Alpatov, 2008)

Trying to grasp the inner logic of the Saint Petersburg SEZ and gain first hand knowledge about its creation, present state and current development an interview with a key informant was conducted. As a part of this interview the Territorial Administration of the Federal Agency for Management of Special Economic Zones in the face of its Deputy Director Mr. Vitaly Alejnikov kindly provided sufficient information and support to this research. The Federal Agency is in fact a structure (department) of the Ministry of Economic Development of the Russian Federation.

Vitaly Alejnikov is holding his current position for already a year - prior to it he was the chair of Head of the Department for Innovation Activities of the Administration of Organizing of Scientific Research in the scientific centre of the Russian Academy of Sciences in Saint Petersburg. Having Russian language as his native Mr. Alejnikov is fluent both in English and German. His daily routines consist mainly of administrative duties as well as representing the territorial administration. About 70% of his working time goes to working with the resident companies. The SEZ administration is responsible for all the documentation including the geological,

architectural etc. As for the other members of the administration, they are: the Head of the Administration, his two deputies, one of which is also the treasurer, and three Heads of Departments. Altogether there are six people in it.

Mr. Alejnikov participated in the creation process of the SEZ only indirectly; still he says there were no difficulties in creating the zone. All possible problems are solved within the Federal Agency for Special Economic Zones and the Ministry of the Economic Development of Russia. Picture 1 shows the relationship between the different governmental authorities.

The planned investments the city and the Russian Federation are going to divide in a 50/50 proportion are 3 billion roubles (approx. 80 million euro) in 2007, 3,6 billion in 2008 (approx 96 million euro) and 2,6 billion (approx. 69 million euro) in 2009. The total amount of financing will make approximately US\$420 million (approx. 270 million euro) (Ivannikov, 2007).

The main objectives of the SEZ in St. Petersburg are:

- development of hi-tech industrial branches;
- production of innovative commodities;
- commercializing of the results of scientific activities;
- maintenance of the competitiveness of the Russian economy.

The overall strategy for the functioning of the SEZ in St. Petersburg and its future impact can be formulated as follows:

- A. The functioning of the SEZ leads to the development of the new sectors of economy.
- B. The synergy effects coming from the interaction of the new technologies and the improved quality of manpower trigger the diversification of the national economy.

Interestingly enough although the zone was initially created to be a technological-innovative one, a certain area in it is reserved to suit recreational needs. Furthermore there is still available space in the SEZ territory but Mr. Alejnikov estimates that there is going to be no spare places left by mid 2009. At the moment there are 13 residents in the SEZ and some 20 applications for the status of the resident company at the moment. All of them will be taken to consideration on the new Expert Council.

The Saint Petersburg SEZ has the ambitious target to create by 2010 12 000 new working places. By 2018 the total turnover of the 50 envisaged residents is expected to reach 25 billion roubles (approx 667 million euro). Still, the present reality is that no activities on the sites of the

SEZ have been begun yet. Mr. Alejnikov estimates that the work of the residents will start by the end of 2009 or even in 2010.

The Saint Petersburg SEZ is divided into two areas: territory of the industrial zone “Neudorf” and to the north of the Novoorlovsky forest park. The two parts of one zone possess one single set of tax benefits as well as the same set of services, although the prices for communal services and land differ. The “Neudorf” part of the zone will site robotics and instrument-making industry, while “Novoorlovskaya” will include IT cluster and analytical and medical appliances.

Table 1. Prices for land lease of the SEZ of St. Petersburg

Year	Area	Average price for 1 hectare, RUR
1st	“Neudorf”	9350
	“Novoorlovskaya”	20447
2nd	“Neudorf”	11690
	“Novoorlovskaya”	25567
3rd	“Neudorf”	14020
	“Novoorlovskaya”	30676
4th and further on	“Neudorf”	16360
	“Novoorlovskaya”	35790

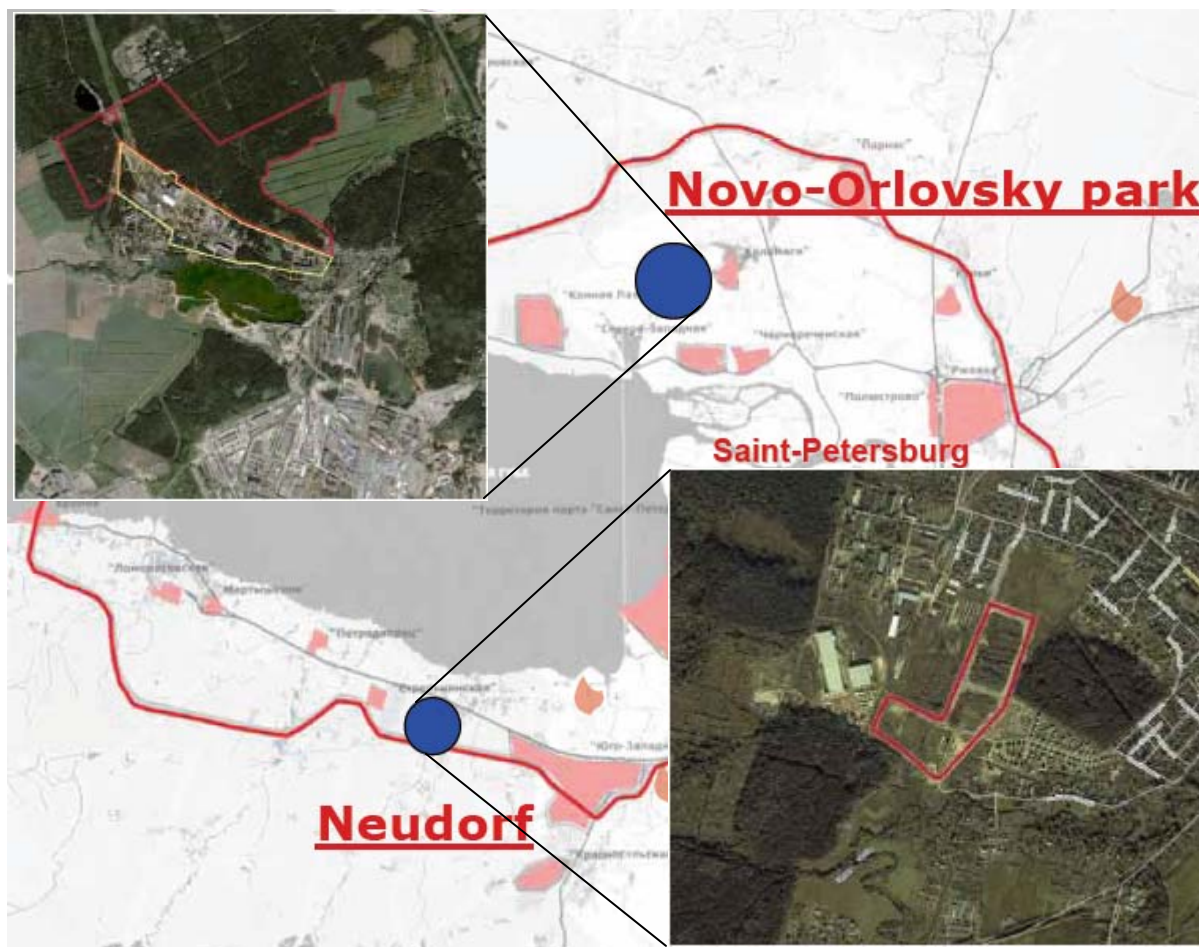
Source: Territorial Administration of the Federal Agency for Management of Special Economic Zones.

St. Petersburg SEZ “Neudorf” is located in Strelna, a village in the Petrodvoretz district of St. Petersburg. The square of the SEZ is 18,9 hectares. Among the considered advantages of Neudorf location is the nearby presence of:

- 12 scientific research institutions;
- Centre for Laser Physics (belongs to the St. Petersburg State University);
- Telecommunication Centre;
- St. Petersburg State University (several faculties, among the are those for natural sciences and the School of Management);
- State Naval Academy of Admiral Makarov;
- several colleges and high schools of the Ministry of Defence of the Russian Federation.

According to SEZ strategy the above mentioned significant number of scientific and educational institutions in the neighbourhood will promote R&D activities among the SEZ residents.

Picture 3. Map of the SEZ of St. Petersburg



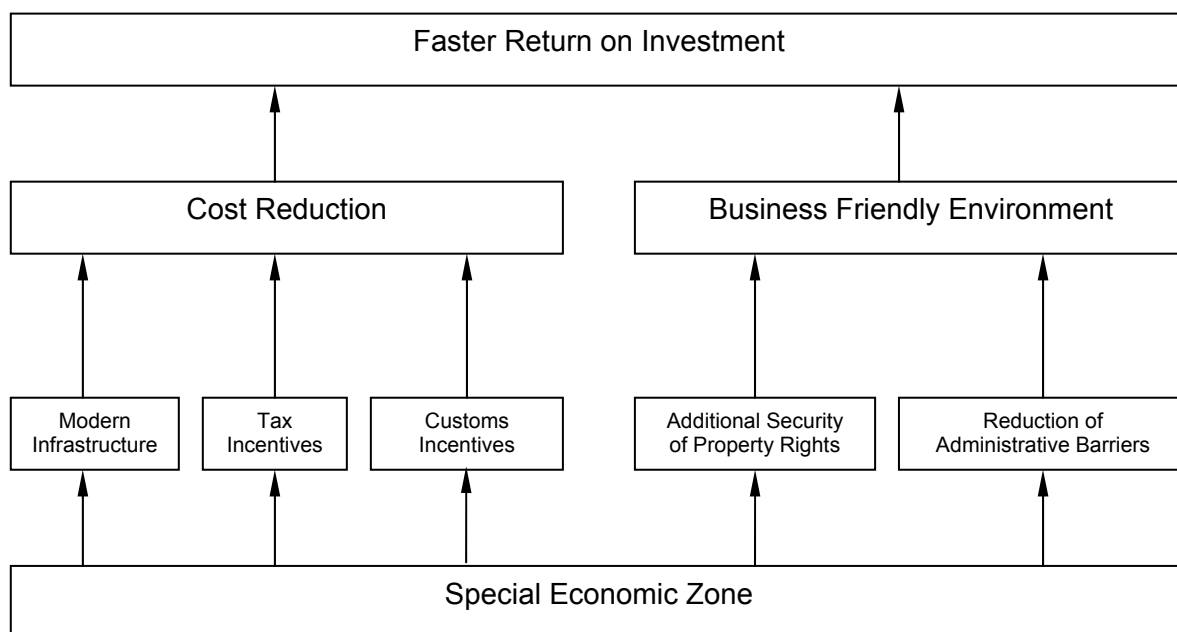
Source: Committee for Economic Development, Industrial Policy and Trade, Territorial Administration of the Federal Agency for Management of Special Economic Zones.

St. Petersburg SEZ “Novoorlovskaya” is located on the territory of Primorsky district of St.-Petersburg to the north of Shuvalovsky career. The area counts 112 hectares but further expansion of the branch is possible due to inclusion of the territories at present belonging the Russian Academy of Sciences.

According to Mr. Alejnikov the Saint Petersburg SEZ was created targeting mainly Russian companies. As for the foreign capital, it is more welcomed in the other type of the SEZ – the industrial-productive zones. Still Mr. Alejnikov names among the main competitive advantages of the SEZ the lower prices for energy and the lower taxation.

Ideally investors should be interested to take part in SEZ due to its attractiveness as summarized in Picture 4. Still in terms of additional security of property rights and reduction of administrative barriers it remains somewhat questionable to what extent SEZ will be able to offer better conditions than the general business environment in Russia.

Picture 4. SEZ Attractiveness Paradigm



Source: Regionrusse.it

As for the cost reduction incentives they are summarized in Tables 2, 3 and 4.

Table 2. Comparative prices for services on the sites of the SEZ of St. Petersburg

Service	Area	Price, RUR
Energy, KWH	"Neudorf"	ca. 1,12 (average)
	"Novoorlovskaya"	ca. 1,41 (average)
Heat supply, GCAL	"Neudorf"	Hot water 680
	"Novoorlovskaya"	Sharp reduced steam 702,5
Natural gas supply, 1000 cub. m.	"Neudorf"	1709,35
	"Novoorlovskaya"	1709,35
Water supply, cub. m.	"Neudorf"	12,26
	"Novoorlovskaya"	13,8

Source: Territorial Administration of the Federal Agency for Management of Special Economic Zones

Table 3 shows the tax incentives that are offered to Saint Petersburg SEZ residents. It is clear that the profit tax reduction is insignificant while the zone offers 12% reduction in the unified social tax. The logic here is perhaps in the aim to attract well paid experts in the hi-technology sectors. There are also some incentives dealing with the property tax and the land tax but these are also negligible.

Table 3. Tax regime for the SEZ of St. Petersburg

Type of Tax	Normal Conditions	Conditions inside of the SEZ in St. Petersburg	Period of Time
Profit tax	24%	20%	For the time of the existence of the SEZ
Unified social tax	26%	14% for the tax basis for each natural person progressive total up to RUR 280000 RUR 39200 + 5,6% of the sum excessive RUR 280000 for the tax basis from RUR 280001 to RUR 600000 51120 + 2% of the sum excessive RUR 600000 for the tax basis higher than RUR 600000	For the time of the existence of the SEZ
Property tax	The tax rate depends on the property. The average is 2,2%	0%	For 5 years starting from the moment of property registration
Land-tax	Maximum 1,5%	0%	For 5 years starting from the moment of
Transport tax	Maximum RUR 200, except air and water transport	RUR 0	For 5 years starting from the moment of

Source: informational leaflets provided by the SEZ Administration

As for the customs treatment of the resident companies the respective regime can be summed up as follows (Table 4).

Table 4. Customs duties, VAT and excises paid by the residents of the SEZ of St. Petersburg and limitations for them

Import to the territory of the SEZ		Export to the Russian Federation		Export to outside of the Russian Federation
Foreign commodities	Russian commodities	Foreign commodities	Russian commodities	
Customs regime of the free customs zone is applicable. Customs duties and VAT are not paid. Economic restrictions and limitations are not applicable. Non-economic restrictions and limitations are applicable.	Customs regime of the free customs zone is applicable (according to the export customs regime). Customs duties are not paid. Excise is paid. Both economic and non-economic restrictions and limitations are applicable.	Customs regime: issuing for free circulation. Customs duties, VAT and excise are paid. The applicable customs duties are calculated as of the date of the issuing of export customs declaration. Rate of duty: a) for foreign commodities imported to the SEZ territory or b) for commodities created in the SEZ territory. Customs value for calculating customs duties: as of the day of the placement of commodities under the customs regime of the free customs zone (excluding the price and the quantity of additional operations, and excluding the price and quantity of the Russian commodities). Common order is used to define customs value and applicable rate for the calculation of VAT. Both economic and non-economic restrictions and limitations are applicable.	Customs regime: issuing for free circulation. VAT and excise are paid. The applicable customs duties are calculated as of the date of the export customs declaration. Customs value for calculating customs duties: as of the date of the issuing of export customs declaration. The value of commodities is taken according to the Tax Code of the Russian Federation, without VAT (or excise). Both economic and non-economic restrictions and limitations are applicable. Customs registration as of the rules for foreign commodities at their issuing for free circulation in the customs territory of the Russian Federation.	Customs regime of export is applicable. Customs duties are paid. Both economic and non-economic restrictions and limitations are applicable. Customs registration as of the rules for commodity export under the export customs regime.

Source: Informational leaflets provided by the SEZ administration

The Saint Petersburg SEZ, it appears, is in the active process of creation. The territory and its type are determined, 13 companies have been registered as future residents and 20 more applications are under review. The zone has ambitious objectives that put onto concrete targets and deadlines look somewhat overly optimistic. The next part observes the same process through the eyes of the companies participating in it.

4. Companies in the Saint Petersburg Special Economic Zone

As of August 2008 there were 13 companies registered in the SEZ of St. Petersburg shown in Table 5. None of them were of a foreign origin. Thus for the means of this research two enterprises were picked to check upon their impressions of participating in the SEZ.

Table 5. Residents of the SEZ of St. Petersburg as of August 2008

Company	Project	Planned Investments, million RUR	Web-Site
Rakurs Engineering Ltd.	Development and implementation of the experimental production of programme-technical sets for energy sector of Russia	n/a	http://www.rakurs.com
Business Computer Centre St. Petersburg JSC	Development and organising of the experimental production of equipment sets for access to multimedia information	277,5	n/a
LEIVO JSC	Development of an effective way for remote administration and storage of means for collective work and business applications in the conditions of Russia	175,1	http://www.leivo.ru
Alfa-Integrator-Infoenergo Ltd.	Development of the automated system for sales of energy resources for generating, transmitting and distributing enterprises of the Russian energy sector	153,6	http://www.infoenergo.ru
Arman Technologies Ltd.	Development of industrial loudspeaker systems, digital commutating systems for industry and transport nodal points and territorially partitioned objects	60,3	http://www.arman.spb.ru
BNT Priboj Ltd.	Development and experimental production of the new generation radio and television equipment	198,4	http://www.bnt-priboy.ru
Engineering Centre "Neudorf" Ltd.	Rendering services for the needs of the enterprises of mining and processing industries in objective and contemporary technologies in geological exploration	326,6	n/a
LOMO-Pribor Ltd.	Development of an integrated automated system to control load and quality of energy resources	381,6	http://www.lomo.ru
Lintex Ltd.	Development of new surgery materials and technological processes of their production	116,5	http://www.lintex.ru
Project Institution "Gasproject" JSC	Development and production of systems for complex security of enterprise energy supply	500	http://www.diakont.com
Laser Systems Ltd.	Development of unique complex solutions for making and sales of hi-tech security systems	150	http://www.lsystems.ru
Transas Technologies JSC	Innovative programme solutions for transport system control	Not less than 500	http://www.transas.ru
Transas JSC	Complex innovative programme-technical solutions for transport system control		

Source: <http://spb.rosuez.ru/>

4.1. Case study “LEIVO”

LEIVO was founded in 1991 as a Russian-Finnish joint-stock company and a subsidiary of Lenenergo. Now it is a part of the group of companies “Optima” that specialize in consulting, system integration, engineering, construction of energy objects, software development and IT outsourcing.

At present LEIVO is solely Russian enterprise and its main field of work is IT. LEIVO provides solutions for Russian energy companies, but also for telecommunication operators some of which are companies with foreign shares. Currently LEIVO employs approximately 350 workers. The person from LEIVO contacted for an interview was Dr. Cyril Ermakov, Chief Power Engineering Specialist. He is working in LEIVO for already three years and at the moment together with three other managers of Optima is also in charge for the issues concerning the participation in the Saint Petersburg SEZ.

LEIVO decided to move part of its activities to the SEZ mainly because participation in a project of such scale can be useful to attract attention to the company’s activities and thus play a certain role both in advertising and public relations. Also the customs and tax benefits were named to be of an importance for an IT company, although Dr. Ermakov gave no estimates as long as he is not responsible for finance or accounting. Finally at the moment “LEIVO” is planning to bring its outsourcing solutions to a wider market. And they consider the participation in SEZ to be a good milestone for that because participation in the projects of the kind helps to attract more attention to the enterprise and to make it more solid in terms of reputation. Also there are better possibilities to place their facilities in the SEZ area, plus the level of services for resident companies is claimed to be much better than their current one. The decision was made in the head-quarters of Optima in Moscow. Still, as long as the SEZ is not operating now, the company is situated in the city-centre of St. Petersburg.

The registration process was not difficult for LEIVO considering that it was carried out in a centralized way through the “Optima”. The LEIVO project that won its SEZ residence status is called “Development of an effective way for remote administration and storage of means for collective work and business applications in the conditions of Russia”. The planned activities for the company are:

- the services for business applications and the means of the corporate work;
- the support for business continuity;

-
- hosting;
 - outsourcing in the sphere of IT infrastructure.

In physical terms the main characteristics for this project are:

- total square of the office buildings – 0,15 hectares;
- the number of employees on site – 103;
- total investments – RUR 175,1 million., including RUR 95 million. invested into the construction of the office buildings.

The source for the investment is the funds of the Optima group of companies (RUR 95 million) The territorial administration for the SEZ advised to the future residents to take part in the venture and apply also for state funding but Optima has not tried this option yet.

As for now the participation in the Saint Petersburg SEZ does not bring any benefits or services as the SEZ itself is not operating and no facilities were constructed up to now. Still the company is looking forward to get the best state and municipal services possible on the SEZ site by the end of 2010. In any case it is impossible to judge about the extent and the quality of the on-site services as long as the SEZ is not working now. Their business-plan was elaborated considering the 2018 horizon. And although the SEZ was initially intended to boost scientific and entrepreneurial activity in the city up to the year of 2025, LEIVO will keep all their facilities build to that time point as their property.

On the other hand there are already some changes concerning the accounting documentation. Although no work has been started yet the company has to submit additional accounts monthly. On the whole Dr. Ermakov is rather not satisfied with the level of bureaucracy and names it along with the land issues among the main – though by far not critically significant – obstacles for doing business in the framework of the SEZ.

He claims that without land-titling carried out it is impossible to state legally to whom belong certain parts of the SEZ area. Land-surveying is the official way to mark the borders of one's land in Russia. It is the same way used to define the square of a piece

of land that belongs to a certain subject or entity¹. After land-surveying it becomes possible to judge about the value of the land one possesses. Thus the contact person for this research wishes to have more transparency and clarity within the governmental activities for SEZ.

4.2. Case study “PRIBOJ”

The Priboj Ltd. /PRIBOJ/ is one of the subsidiaries of the former Komintern Plants. The latter was founded in 1911 with Marconi making it one of the oldest enterprises in Russia. PRIBOJ goes in for developing and experimental production of the radio and television equipment. Currently the group of companies Tira, the parent company for PRIBOJ, employs 1200 people. PRIBOJ grows steadily showing the increase in its annual turnover from RUR 600 million. to RUR 1300 million during the last three years. The main market for its products PRIBOJ is Russia but the company exports certain part of its production to more than 60 countries. Some of the most prominent contractors are France and Italy.

The interview was held with Mr Jury Murov, Director for Innovations and New Technologies. He has been working in his company for 32 years having started just after graduating from the Leningrad Institute for Telecommunications. Mr. Murov shares an optimistic approach in business. He says that although it is very hard to invest into the construction of the new facilities inside SEZ due to high bank rates the company made such a decision for the sake of its future development. Total on-site investments for PRIBOJ were planned and announced to be RUR 198,4 million.

PRIBOJ did not experience any difficulties when registering as a SEZ resident, nor did they perceive any pressure from the side of the government. But just the same way with LEIVO PRIBOJ has not yet started to carry out any activities on the SEZ site, because of the absence of any infrastructure and buildings there. Those are to be completed in 2010. Now Mr. Murov is looking forward to start by the end of 2010.

¹ For both private persons and legal entities in Russia purchase or sale of land should be preceded by surveying of land plots, i.e., implementation of measures on definition of location and boundaries of land plots on the area. Land plot surveying includes the following main steps: 1) - to determine and co-ordinate land plots boundaries on the locality, 2)- to fix boundaries location on the area by surveying signs and determine their flat rectangular coordinates, 3) to calculate land plot area, 4)- to make a plan of land plot boundaries.

PRIBOJ intends to develop and experimentally produce the new generation radio and television equipment.

According to Mr. Murov, in reality all the benefits of participating in the SEZ exist “for tomorrow”. He also states that much of the benefits brought by the participation in the SEZ are of little help considering the level of inflation in Russia. As of his calculations leasing is more profitable than the participation in the SEZ. Besides, considering the current reorganization of the Ministry of Economic Development that is ultimately in charge of all the Russian SEZ including that of Saint Petersburg, little work is done at the moment in order to develop the SEZ.

Mr. Murov considers his company to be very flexible and dynamic and is looking forward to the best. He is also strongly for the further development of Russian technologies rather than for selling the foreign products on the national market.

5. Conclusion

The recent attempt that started in 2005 to re-launch the introduction of the Special Economic Zones in Russia was welcomed with great hopes and expectations. The legislative measures carefully considered the past mistakes and the legislators defined several different types of zones with clear distinction in their aims and objectives. More importantly the new zones were not equivalents of whole regions or vast territories as before. Instead after some competition several regions won the right to build special economic zones in well defined places with adequate but limited area.

Nevertheless based on the example of SEZ Saint Petersburg it is possible to see some weaknesses in the current strategy mode in general and in its implementation in particular. These may result in serious decrease in the performance of SEZ and possibly even lead to the conclusion of yet another unsuccessful try in using them as an economic tool for modernization of the economy. Therefore such weaknesses should be addressed by policy makers as to refine the strategy and put it into more concrete dimensions.

A. Macro level: concrete performance indicators

The zones have been given certain quantitative and qualitative performance criteria. The technological-innovative zones should reach certain number of residents, scientific publications, patent applications, created and implemented advanced technologies, innovation products, researchers (including number of PhD), innovation activity etc. (Alpatov, 2008). Then there are economic indicators such as volume of investments (including foreign), volume of produced products and services (including export production), productivity, and share of SEZ in the regional domestic product, volume of tax contributions to the budget of the Russian federation, return on investments (Ibid.). Finally social indicators are also to be measured such as ability to create working places, average wages, number of trained personnel and number of built residential housing.

But the mentioned above are rather performance criteria and not performance indicators. The only concrete figure that may be found discovered is that technological-innovative zones are expected to break even in 11 years after their establishment (Ibid.), which is also not very precise. There are also some indicators for all the zones until 2025 (Ibid.) – not very concrete and somewhat missing any intermediate targets.

B. Plans versus reality at micro level

The Saint Petersburg SEZ authorities aim to create 12 000 new working places by 2010, which is in 16 months from now. Given the present absence of a single company already operating in SEZ this is quite unlikely. Another figure is to have 50 residents by 2018 with a total turnover of 25 billion roubles (approx. 667 million euro) - this is in 10 years from now. Based on the available data some there is apparent lack of coherent business plan with scheduled activities and concrete milestones / deliverables. Thus at present there is on one hand quite ambitious, short-term and unrealistic objective. On the other hand equally grand long-term target that misses concrete substance in the form of an action plan developed in detail.

The devil is in the detail and the issue of land surveying and land titles should be resolved in a way that is clearly understood by investors both domestic and foreign. This perhaps somewhat small bureaucratic detail may seriously distract companies from registering and thus have tremendously negative impact on the end success and ability of zones to develop innovation capacity and commercial viability.-

C. Attractiveness of Saint Petersburg SEZ

This is the issue where this research spotted the biggest differences between the perception of the SEZ authority and the companies registered in SEZ. According to the SEZ authorities among the main competitive advantages of the SEZ the lower prices for energy and the lower taxation. Still it is questionable to what extent technology-innovative companies might be energy intensive consumers. Significant taxation incentives are given in the form of reducing the unified social tax on salaries. Other incentives among which the reduction of corporate tax from 24 to 20% hardly can be qualified as ground breaking. That can be confirmed by the companies according to which the benefits brought by the participation in the SEZ are of little help considering the level of inflation in Russia. The other opinion was that tax incentives mattered in the decision to register in SEZ but the main reason was that participation in a project of such scale can be useful to attract attention to the company's activities and thus play a certain role both in advertising and public relations.

Still the SEZ authorities would have been able to offer much wider support for the registered companies in their attempt to develop and commercialize innovation such as business incubator, patenting legal advises, venture capital accumulation, international match making etc. In the absence of structures supporting the commercialisation of

innovation in Russia (Dezhina & Zashev, 2007) that really would make the SEZ add value to the companies-residents activities. Instead at present it seems SEZ authorities are delegated the duties to build the infrastructure and maintain it.

D. Domestic orientation

According to the interviewed expert the Saint Petersburg SEZ was created targeting mainly Russian companies. As for the foreign capital, it is more welcomed in the other type of the SEZ – the industrial-productive zones. This, if taken at face value, may be quite counterproductive. In a global economy developing innovation capacity is possible only through intensive networking and clustering that results in building links with various stakeholders in the process – venture capitalists, R&D organizations, subcontractors, end customers and, often, even rivals. The prevailing trend is that all this networking and cluster building is increasingly international. Russian companies (and foreign) will only benefit from having SEZ into real international hubs of innovation – that is highly unlikely in the absence of international companies. In this respect a serious remodelling of the business strategy of SEZ should be considered as there is a real danger for technology-innovative zones to turn into agglomerations of Russian companies with little incentives to seek international competitiveness but rather wait for grand governmental programs and finance schemes.

The current attempt of Russia to stimulate its economy switching its mode from resource based to technology based is again utilizing the idea of Special Economic Zones. Technology-innovative is one of the several types of established SEZ that represents the hope to build an innovation economy. However the example of SEZ Saint Petersburg shows that certain rethinking and fine-tuning of the concept is needed. These deal mainly with the having concrete performance indicators dressed into a scheduled action plan and adjusting it to the present situation, which show some gap between planned and achieved. Furthermore technology innovative zones should be rethought in order to boost their attractiveness through offering not only tax incentives but also wide range of services targeted after the companies-residents. Finally technology-innovative SEZ may only gain from reaching to leading international companies and trying to lure them into establishing in the SEZ. The good new is that what is needed is fine-tuning and not starting all over again. The bad new is that there seem to be certain lack of administrative capacity tot energize the process and turn it into a more target oriented one.

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