

Promoting New Growth: ‘Advanced Special Economic Zones’ in the Russian Far East

Jiyoung Min and Boogyun Kang

Abstract To become a major manufacturing hub for East Asia, the Russian Far East must overcome various socioeconomic challenges, including an imbalanced economic structure, decreasing population, and a poor investment climate. To address these challenges, the Russian authorities in 2014 adopted a new development mechanism, ‘advanced special economic zones’ (ASEZs). This chapter discusses pros and cons of introducing ASEZs as investment platforms for cultivating export-oriented industry. Much will depend on the domestic and foreign capital inflow over the next years. If the ASEZ policy works out as planned, in the medium and long term there are possibilities for creating a new industrial value chain linking the Russian Far East with Asia-Pacific markets.

Keywords Russian Far East • Economic policy • Industrial policy • Advanced special economic zones • Foreign direct investment

J. Min (✉) • B. Kang

Department of Europe, Americas and Eurasia, Korea Institute for International Economic Policy, Sejong, Republic of Korea

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H. Blakkisrud, E. Wilson Rowe (eds.), *Russia’s Turn to the East*,

Global Reordering, https://doi.org/10.1007/978-3-319-69790-1_4

At the 2014 Asia-Pacific Economic Cooperation (APEC) summit in Beijing, Vladimir Putin declared that the Russian Far East should and must develop into a major manufacturing hub for East Asia (*Kremlin.ru* 2014). Moscow envisages the Far East as a new ‘economic bridge’ between Europe and Asia and is currently enacting a range of investment plans and political strategies aimed at stimulating the economy and building infrastructure in Siberia and the Far Eastern Federal Okrug. Key milestones have been the 2012 establishment of the Ministry for the Development of the Far East, the 2013 adoption of a state programme for the socioeconomic development of the Far East and the Baikal region (revised in April 2014 and in August 2016), and the 2014 approval of a federal law on advanced special economic zones (ASEZs). These domestic efforts are by necessity combined with plans for stronger economic cooperation with the Asia-Pacific region. However, so far, little is known about the consequences of this increasingly urgent economic development focus on the Russian Far East. To fill some of this knowledge gap, we here carry out a close analysis of one of the key policy tools—the ASEZs. We summarize major socioeconomic challenges to the development of the Russian Far East, examine the policy itself, and evaluate implementation of the policy over time.

MAJOR SOCIOECONOMIC CHALLENGES IN THE RUSSIAN FAR EAST

In 2015, due to a combination of plummeting oil prices and Western sanctions, Russia entered an economic recession. The economy suffered from soaring inflation and a significant reduction in investment and consumption. In 2016, the economy seemed to have adjusted to the shocks, and in 2017 it is expected to grow again. However, Russia has a long way to go before its economy is back on track. Although the economic downturn was accelerated by external factors, the fundamental problem is an internal structural one: energy dependency. The oil rents that the Russian economy obtained during the years of high oil prices were not utilized for diversifying the economy. Ever since the 1990s, the investment rate in Russia has been low compared to similar economies. Even in the 2000s the gross capital formation (as percentage of GDP) of the economy has never exceeded 26 per cent, and in 2014 it stood at 21.4—below the world average of 23.3 per cent.¹ Owing to low investment and a skewed economic structure, Russia has been experiencing economic slowdown

since 2012. With the country's current economic growth model reaching its limits, structural reforms are necessary.

Basically, the Far Eastern Federal Okrug faces the same economic challenges as the broader national economy: it is characterized by economic slowdown and heavy dependence on energy revenues. In 2014, the economy of the Russian Far East accounted for 5.5 per cent (3.2 trillion rubles) of the Russian economy, making it the second smallest among the eight federal okrugs (Federal'naia sluzhba gosudarstvennoi statistiki 2016). Even though the Russian government had for several years been implementing various Far Eastern development policies, the economy still did not outpace that of other federal okrugs.

Ever since 2013 the Far Eastern Federal Okrug has been suffering from a downward economic cycle. After the completion of mega-investment projects like preparations for the September 2012 APEC summit in Vladivostok and the construction of the Eastern Siberia–Pacific Ocean 2 (ESPO 2) oil pipeline and the Ulak-Elga railroad, investments shrank considerably (Prokapalo et al. 2013, p.125). While these projects had boosted regional economic growth for a few years, they had very limited mid- and long-term economic impact (Prokapalo et al. 2014, p.113). In addition, tight credit conditions for Russian companies (few chances for borrowing in the international financial market and higher interest rate on loans in domestic banks) due to Western financial sanctions contributed to a continued reduction in investments in 2015 (Prokapalo et al. 2016, p.129).

Industrial production in the Far East stayed in the positive (see Table 4.1) thanks to the mining sector, which recorded 7.7 per cent growth in 2015. By contrast, the manufacturing sector suffered a 10 per cent reduction, linked to insufficient investment due to the higher cost of borrowing (Prokapalo et al. 2016, pp.124–25). Also in 2015, the consumer price index and producer price index stood at 112.0 and 116.5 respectively—the second year in a row that these two indices ended above the 110 mark (see Table 4.1). The main reason was the weakening of the ruble, which led to price increases on imported goods. In particular, prices on non-food items rose, since such goods could not quickly be replaced by domestic products (ibid., p.131). As a result, in 2015 retail sales in the Russian Far East turned negative—whereas the savings rate went up. This can be understood as Russian consumer behaviour shifting to a pattern of saving—not entirely a good sign, as that could further limit consumption. The decrease in consumer demand was partially reflected in imports as well.

Table 4.1 Macroeconomic indicators of the Russian Federation (RF) and the Far East (FE) (in per cent of previous year)

	2010		2011		2012		2013		2014		2015	
	RF	FE	RF	FE	RF	FE	RF	FE	RF	FE	RF	FE
G(R)DP	104.6	106.8	105.4	105.4	103.1	103.1	101.8	99.1	101.3	101.9	96.3	99.4
Industrial production	107.3	106.9	105.0	109.1	103.0	103.4	100.4	102.0	101.7	105.3	96.6	101.0
Investment on fixed capital	106.3	106.1	110.8	126.5	106.8	88.1	100.8	83.2	98.5	93.4	91.6	96.6
Consumer price index	108.8	107.7	106.1	106.8	106.6	105.9	106.5	106.6	111.4	110.7	112.9	112.0
Producer price index	116.7	110.4	112.0	117.7	105.1	108.8	103.7	101.5	105.9	110.4	110.7	116.5
Real income	105.3	102.6	105.6	105.1	105.3	107.7	104.8	106.1	99.5	102.8	95.1	99.7
Unemployment	108.3	109.2	107.3	108.6	106.5	107.4	105.5	106.7	105.5	106.5	105.2	106.4
Export	131.6	155.4	130.1	135.6	101.5	102.9	100.5	108.6	94.4	101.7	69.0	72.0
Import	136.8	155.1	133.6	119.3	103.7	114.9	99.3	116.3	91.0	87.1	63.7	55.1

Source: Federal'naia sluzhba gosudarstvennoi statistiki (2016)

The major trading partners of the Russian Far East are the three biggest economies in Northeast Asia—China, Japan and South Korea. According to the Russian customs services, these three accounted for 77 per cent of the region's total trade in 2015 (Dal'nevostochnoe tamozhennoe upravlenie 2016). As a result, trade volumes were not immediately affected strongly by the 2014 geopolitical instability. With the plunge in the oil prices, however, trade took a nosedive.

As for the labour market, the unemployment rate in the Far East remains higher than the Russian average, although it has been decreasing over time (see Table 4.1). However, this is not attributable to improved conditions on the labour market, but to a shrinking population and workforce (see discussion of demographics below).

The economy of the Russian Far East is highly dependent on the primary sector (see Fig. 4.1). The mining sector makes up 28.6 per cent of the region's economy (compared to 10.6 per cent in the Federation as a whole), whereas the manufacturing sector constitutes a mere 5.1 per cent (17.4 per cent in the Federation as a whole). The latter has been heavily affected by the economic downturn. As shown in Table 4.2, production in the manufacturing sector began to slow already from 2012, turning negative in 2015 (Prokapalo et al. 2016, p.124). Primorye and Khabarovsk were especially hard hit by the 2015 recession, as these two regions stand

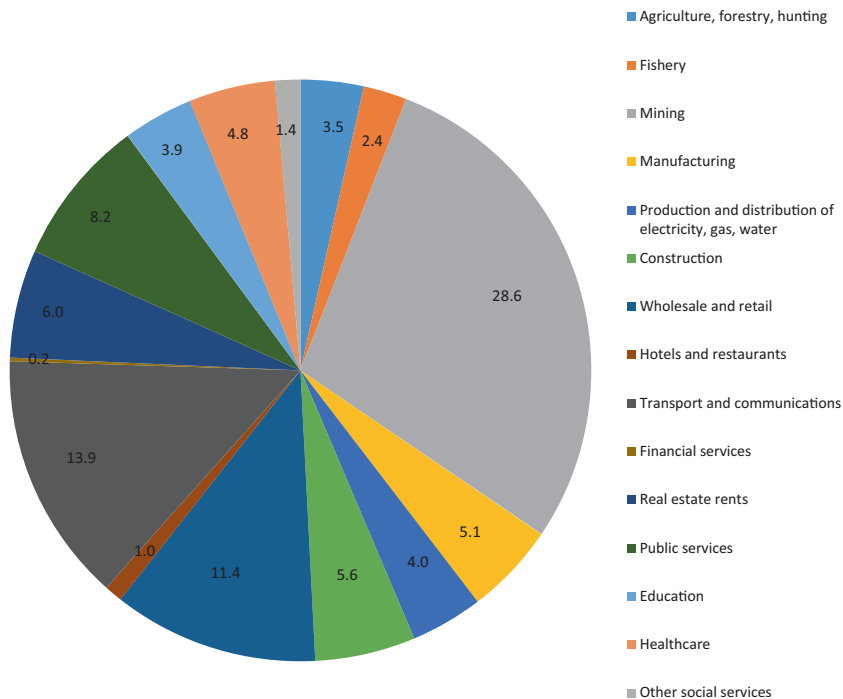


Fig. 4.1 Industrial composition of the economy of the Russian Far East, 2014 (in per cent) (Source: Federal'naia sluzhba gosudarstvennoi statistiki 2016)

Table 4.2 Production index of the manufacturing sector (in per cent of previous year)

	2010	2011	2012	2013	2014	2015
<i>Russian Federation average</i>	110.6	108.0	105.1	100.5	102.1	94.6
Central Federal Okrug	105.3	107.8	106.7	102.3	101.7	97.4
Northwestern Federal Okrug	112.5	113.6	104.7	100.2	96.6	94.4
Southern Federal Okrug	109.3	110.5	108.4	103.9	105.2	103.1
North Caucasus Federal Okrug	105.9	113.5	109.9	110.3	99.8	104.0
Volga Federal Okrug	114.2	114.5	106.7	102.4	103.8	96.5
Ural Federal Okrug	111.2	108.2	107.6	104.1	103.5	98.9
Siberian Federal Okrug	108.5	105.0	103.0	103.1	102.6	97.5
Far Eastern Federal Okrug	114.5	121.3	108.9	104.9	102.7	91.1

Source: Federal'naia sluzhba gosudarstvennoi statistiki (2016)

for over half of manufacturing production in the Russian Far East (car production in Primorye; airplanes and ship-building in Khabarovsk).

In general, economies heavily dependent on raw materials are particularly vulnerable to external factors, first and foremost international commodity prices. To sustain stable economic growth, it is thus necessary to diversify the economic structure through developing the manufacturing sector (Su and Yao 2016, p.13). The manufacturing industry is important in driving economic growth, by creating jobs and in many other aspects of the economy (Maniyka et al. 2012, p.18). In the Russian Far East, reforming the industrial structure has remained a major challenge (Jeh et al. 2014, p.27). Ever since the breakup of the Soviet Union, the Russian government has sought to implement policies for developing the Far East. While largely unsuccessful in the 1990s (see Blakkisrud, Chap. 2, in this volume), since the turn of the millennium there have been more concerted efforts. As will be shown below, the government's new approach to facilitating economic development in the Far East is specifically targeted at attracting investors and promoting the manufacturing sector.

In addition to the macro-economic challenges outlined above, the Russian Far East faces serious demographic problems. The vast territory of 6.2 million km² has a population of only some 6.2 million. While since 2010 the total population of the Russian Federation has begun to increase slightly, that trend is not evident in the Russian Far East (see Table 4.3), where the population has decreased every year since 1991. Likewise, the economically active share of the population in the Russian Far East is also decreasing year by year (see Table 4.4). This, however, is a trend that characterizes the whole of Russia. In general, population is an important factor when gauging the workforce and market size. In such a perspective, the Russian Far East is losing market size and potential for economic growth.

Low living standards due to the high cost of living and poor infrastructure are seen as major culprits in the depopulation of the Far East. In 2015, the average monthly income of the Russian Far East reached 53,862 rubles. Among Russia's eight federal okrugs, the Central Federal Okrug had the highest average income in 2015, followed by the Far Eastern Federal Okrug (see Table 4.5). However, this should not be taken to mean that people living in the Far East are relatively better off compared to other regions because the cost of living is high. To give but one example: in 2014, the average price on the primary housing market in the Far East was 62,140 rubles per square metre, higher than in the Central Federal

Table 4.3 Population (1000 persons/per cent of previous year)

	2010	2011	2012	2013	2014	2015
<i>Russian Federation</i>	142,865 (0.02)	143,056 (0.1)	143,347 (0.2)	143,667 (0.2)	146,267 (1.8)	146,545 (0.2)
Central Federal Okrug	38,445 (0.3)	38,538 (0.2)	38,679 (0.4)	38,820 (0.4)	38,951 (0.3)	39,104 (0.4)
Northwestern Federal Okrug	13,626 (0.2)	13,660 (0.3)	13,717 (0.4)	13,801 (0.6)	13,844 (0.3)	13,854 (0.1)
Southern Federal Okrug	13,851 (-0.02)	13,884 (0.2)	13,910 (0.2)	13,964 (0.4)	14,004 (0.3)	14,045 (0.3)
North Caucasus Federal Okrug	9,439 (0.9)	9,493 (0.6)	9,541 (0.5)	9,590 (0.5)	9,659 (0.7)	9,718 (0.6)
Volga Federal Okrug	29,880 (-0.4)	29,811 (-0.2)	29,772 (-0.1)	29,739 (-0.1)	29,715 (-0.1)	29,674 (-0.1)
Ural Federal Okrug	12,087 (-0.01)	12,143 (0.5)	12,198 (0.4)	12,234 (0.3)	12,276 (0.3)	12,308 (0.3)
Siberian Federal Okrug	19,252 (-0.2)	19,261 (0.05)	19,278 (0.1)	19,292 (0.1)	19,312 (0.1)	19,324 (0.1)
Far Eastern Federal Okrug	6,285 (-0.6)	6,266 (-0.3)	6,252 (-0.2)	6,227 (-0.4)	6,211 (-0.3)	6,195 (-0.3)

Source: Federal'naia sluzhba gosudarstvennoi statistiki (2016)

Table 4.4 Labour market (per cent of total)

	Share of economically active population						Share of population older than economically active population					
	2010	2011	2012	2013	2014	2015	2010	2011	2012	2013	2014	2015
<i>Russian Federation average</i>	61.5	60.9	60.1	59.3	58.4	57.4	22.3	22.6	23.1	23.5	24.0	24.6
Central Federal Okrug	61.3	60.7	60.0	59.3	58.5	57.6	24.8	25.2	25.6	25.9	26.4	26.8
Northwestern Federal Okrug	62.0	61.4	60.6	59.9	59.0	57.9	23.6	24.0	24.4	24.8	25.3	25.8
Southern Federal Okrug	60.3	59.8	59.2	58.4	57.6	56.7	23.6	24.0	24.3	24.7	25.2	25.7
North Caucasus Federal Okrug	61.0	60.7	60.3	59.8	59.3	58.7	15.1	15.4	15.7	16.1	16.5	17.0
Volga Federal Okrug	61.2	60.5	59.6	58.7	57.8	56.8	22.6	23.1	23.6	24.1	24.7	25.2
Ural Federal Okrug	62.3	61.6	60.7	59.7	58.7	57.7	20.4	20.8	21.2	21.6	22.1	22.6
Siberian Federal Okrug	61.9	61.0	60.2	59.2	58.2	57.2	20.4	20.9	21.3	21.8	22.4	22.9
Far Eastern Federal Okrug	63.4	62.7	61.9	61.0	60.1	59.2	19.2	19.7	20.1	20.6	21.1	21.6

Source: Federal'naia sluzhba gosudarstvennoi statistiki (2016)

Table 4.5 Average monthly income (in rubles, December each year)

	2010	2011	2012	2013	2014	2015
<i>Russian Federation average</i>	28,173.2	31,568.0	35,547.9	39,758.0	40,972.0	45,139.0
Central Federal Okrug	38,841.7	44,140.4	49,455.5	51,384.0	54,302.0	61,378.0
Northwestern Federal Okrug	29,020.5	30,211.5	35,986.3	40,978.0	45,938.0	49,452.0
Southern Federal Okrug	21,299.2	23,707.7	28,329.3	31,921.0	34,232.0	37,836.0
North Caucasus Federal Okrug	21,420.1	24,640.8	27,573.5	31,250.0	33,909.0	36,644.0
Volga Federal Okrug	22,791.1	25,501.7	28,728.1	31,356.0	33,984.0	37,211.0
Ural Federal Okrug	31,240.8	35,564.0	39,502.2	42,381.0	43,020.0	45,952.0
Siberian Federal Okrug	21,911.2	24,545.2	28,598.7	31,733.0	32,348.0	34,521.0
Far Eastern Federal Okrug	32,013.8	36,148.6	41,719.8	46,875.0	49,120.0	53,862.0

Source: Federal'naia sluzhba gosudarstvennoi statistiki (2016)

Table 4.6 Cost of goods and services of fixed basket (in rubles, December each year)

	2010	2011	2012	2013	2014	2015
<i>Russia Federation average</i>	8,711.8	9,174.2	9,868.0	10,737.0	12,034.9	13,404.3
Central Federal Okrug	9,471.0	10,182.1	10,985.5	11,986.0	13,481.6	14,978.2
Northwestern Federal Okrug	9,227.0	9,525.6	10,220.3	11,046.6	12,537.9	14,106.0
Southern Federal Okrug	8,393.1	8,528.3	9,099.6	9,834.9	11,362.3	12,735.0
North Caucasus Federal Okrug	7,919.8	8,220.8	8,987.5	9,572.1	11,073.8	12,359.1
Volga Federal Okrug	7,766.9	8,180.7	8,874.9	9,671.5	10,959.3	12,169.5
Ural Federal Okrug	8,878.7	9,393.6	10,122.4	10,954.7	12,029.5	13,406.8
Siberian Federal Okrug	8,072.2	8,446.9	9,185.5	10,023.4	11,116.4	12,382.5
Far Eastern Federal Okrug	11,108.7	11,958.6	12,840.3	14,022.5	15,427.0	16,857.6

Source: Federal'naia sluzhba gosudarstvennoi statistiki (2016)

Okrug, and much higher than the Russian average of 51,714 rubles (Federal'naia sluzhba gosudarstvennoi statistiki 2016). The cost of the fixed basket of goods and services in the Far East is the highest among the Russian federal okrugs: thus, consumers in this federal okrug are paying more than the average Russian for the same goods and services (see Table 4.6). When the average monthly income and the cost of goods and services are taken into consideration,² the purchasing power of those living in the Far Eastern Federal Okrug falls to fourth place among the eight federal okrugs.

Cost levels are related to the huge distances and poorly developed transport infrastructure in the Russian Far East. For example, the proportion of paved public roads in the okrug in 2014 was 66.6 per cent, lower

than Russia's average of 70.5 per cent. Likewise, railroad density per 10,000 km² in the Russian Far East was only 14 km in 2014, the lowest among all federal okrugs. The national average was 50 km per 10,000 km²—and in the Central Federal Okrug it was 262 km.³ Transport fees in the Russian Far East are higher than elsewhere, and the weakly developed transport infrastructure discourages private investors. To improve the quality of local lives and realize industrial development, not least the promotion of export-oriented industries in the ASEZs, the transport infrastructure of the Far East has to be upgraded.

In recent years, the investment climate in Russia seems to have improved greatly. Simplified administrative procedures helped Russia to jump from being ranked 120th among 183 countries in 2011 to 40th among 190 countries in 2016 on the World Bank's Doing Business Index (World Bank 2012, p.6; 2016, p.7). However, the current economic recession and the limited availability of international financing due to Western sanctions have become major stumbling blocks for new investments, also in the Russian Far East.

The Far Eastern Federal Okrug is faced with a whole range of socioeconomic challenges—including economic slowdown, imbalanced economic structure, decreasing population, low living standards, and poor investment conditions. These challenges are partly interrelated and will need to be dealt with through long-term strategies. Cognizant of this, the Russian government has devised a new approach to Far Eastern development, to which we now turn.

RUSSIA'S NEW DEVELOPMENT STRATEGY FOR THE FAR EAST

From the onset of Putin's third term, Russia has been searching for more forceful ways of accelerating development in the Far Eastern Federal Okrug. In May 2012, the government established a separate ministry—the Ministry for the Development of the Far East. This ministry oversees the development of the region and implementation of the state programme 'On the Socioeconomic Development of the Far East and the Baikal Region until 2025', adopted in March 2013 and revised in April 2014 and August 2016. Moreover, to ensure momentum, a separate commission, the Government Commission on the Socioeconomic Development of the Far East, over which Prime Minister Dmitrii Medvedev personally presides, was added in 2013 (Jeh et al. 2014, pp.124–25, see also Blakkisrud, Chap. 2, this volume).⁴ At the heart of these efforts aimed at

improving the situation of the Far Eastern Federal Okrug stands the plan to create ‘territories of advanced socioeconomic development’ (*territorii operezhaiushchego sotsial’no-ekonomicheskogo razvitiia*), commonly referred to as ‘advanced special economic zones’ (ASEZs).

The idea behind the ASEZs is to foster a business and investment friendly environment and to cultivate export-oriented industries targeting the Asia-Pacific region. This is to be achieved through the introduction of an institutional mechanism backed by unprecedented tax benefits, infrastructure development, and administrative support. Why has Russia taken these steps? There are two main reasons. First, ever since the breakup of the Soviet Union, Russia has continued to push forward with development projects in the Far East—without tangible results (*Government.ru 2013a*). The Russian Far East still lags far behind other federal okrugs on various indexes (quality of life, social conditions for developing the labour force, social infrastructure, etc.). As investment incentives decreased sharply after the 2012 APEC summit in Vladivostok, the Kremlin had to devise a new policy to attract private and public capital.

Second, while the Russian Far East has recorded relatively low economic growth, it has great potential for economic development linked to the Asia-Pacific region, if it can capitalize on resources, transport, and logistics advantages. The Russian government has noted that the Asia-Pacific region, including China, Japan and South Korea, has emerged as a primary supplier of global financial resources and a logistics hub. Moreover, the government hopes to mitigate workforce shortages in the Russian Far East by drawing on the labour mobility and technology development capacity of the Asia-Pacific region (*Minvastokrazvitiia 2016b*, p.2).

Russia has needed to set a new direction so as to transform the currently underdeveloped Far East into a new growth engine. In the following, we examine the content of this policy and the primary characteristics of the ASEZs, and discuss the future prospects and challenges for the ASEZs regime.

ASEZs: AN INVESTMENT PLATFORM TO CULTIVATE EXPORT-ORIENTED INDUSTRY

One option for the Kremlin would have been to focus on the import-substituting industry in the Far East and turn the region into an internal supply base for all of Russia. However, given the limits to growth described above, it was deemed difficult to produce swift changes with tangible

results along these lines. Instead, based on an assessment of the geographical proximity to the Asia-Pacific region with its huge markets, the Russian government opted to cultivate export-oriented industries as the new development model for the Far East. As the Russian Far East has a weak manufacturing base, substantial investments would be required to implement this model. Therefore, in parallel to developing a plan for regional development, the Russian government had to design a plan for attracting investors. The answer came in the form of a new strategic development model: the ASEZs (*Government.ru* 2013a).⁵

The new development model was introduced in October 2013 by Aleksandr Galushka, Minister for the Development of the Far East, at a meeting of the Government Commission for the Socioeconomic Development of the Far East. According to Galushka, the new model would be based on

- (1) increasing the export of finished goods (including services) produced in the Russian Far East to countries in the Asia-Pacific region
- (2) creating a competitive investment environment, and attracting direct investments, including foreign, to revitalize businesses and help small- and medium-sized companies develop
- (3) developing competitive territories of advanced development [*territorii operezhaiushchego razvitiia*], including special economic zones in the form of industrial, techno- and agro-industrial parks. (*Government.ru* 2013b)

President Putin picked up on the idea in his annual address to the Federal Assembly in December that year, emphasizing the development of the Russian Far East as the top national priority of the twenty-first century (Putin 2013). He proposed the establishment of a network of economic development zones to nurture the export-oriented manufacturing industry in the Russian Far East, thus giving further shape and momentum to the plans for introducing ASEZs.

The federal law on ASEZs was introduced with unprecedented swiftness. The basic principles for the creation and operation of the ASEZs were approved by the federal government in February 2014 (*Government.ru* 2014a). A bill was forwarded to the State Duma in October 2014, only one year after the idea was first discussed. President Putin signed the law on 29 December 2014 (*Government.ru* 2014c), and it entered into effect on 30 March 2015.

The ASEZs is a key component of the 2013 state programme ‘On the Socioeconomic Development of the Far East and the Baikal Region’. When this programme was revised in April 2014, it was with the goal of accelerating the development of the Far East and improving socio-demographic conditions there (*Government.ru* 2014b). The August 2016 revisions focus on new mechanisms designed to achieve this accelerated development, including the ASEZs, the Free Port of Vladivostok and infrastructure support to major investment projects (*Government.ru* 2016). This illustrates how important the ASEZs are to current Russian Far Eastern development policies.

Content and Characteristics

What are the primary characteristics of the ASEZs? Intended as a new policy tool for enhancing the global competitiveness of the Russian Far East, the ASEZs are economic zones that enjoy a wide range of deregulations and tax benefits, while also serving as investment platforms (Minvostokrazvitiiia n.d.). The federal law on the ASEZs stipulates that the zones are ‘a part of Russian territory (...) in which (...) a special legal system is established for business and other activities in order to create favourable conditions for attracting investments, ensuring rapid socioeconomic development and creating comfortable living conditions for the population’ (Federal’nyi zakon 2014). While the bill was originally promoted as legislation targeting the Far East and ‘other special areas’, it became a law covering Russia as a whole: to be implemented first in the Russian Far East, and then, in three years, to be extended to the rest of the Federation.

The new Russian Far Eastern development model focuses on the innovation of institutional mechanisms, illustrated by the establishment of an integrated governance structure composed of the Ministry for the Development of the Far East and its affiliated organizations, accompanied by the introduction of preferential laws and regulations. Table 4.7 outlines the main features of the ASEZs.

Whereas previous development policies have been pushed forward by the unilateral efforts of the Russian government and self-reliance, the new policy also relies on attracting domestic private as well as foreign investments. To facilitate this, it is considered necessary to offer tax benefits, lower administrative barriers, and create the necessary infrastructure essential to investors. In fact, this had already been attempted. When the idea of introducing ASEZs emerged, Russia had already created a number of SEZs: as of the end of 2016, there were 5 technology innovation SEZs,

Table 4.7 Key features of ASEZs

Category	Highlights		
	On Territories of Advanced Socioeconomic Development		
Governance	The Ministry for the Development of the Far East (<i>Minvostokrazvitiia</i>) and its affiliated organizations: the Far East Development Corporation (infrastructure provision and ASEZ operator); the Far East Development Fund (project financing); the Far East Investment and Export Agency (attracting investment); and the Far East Human Capital Development Agency (providing workforce)		
State-funded infrastructure	Covered by the federal budget, budgets of the federal subjects and local budgets as well as extra-budgetary sources: Installation of infrastructure like roads (but not railroads), gas, water, sewage, electricity, etc., is split 50/50 between federal and regional budgets		
Administrative benefits	- expedited permits (subject to special control system at the federal and regional government levels) - possibility to attract skilled foreign manpower in a rapid and preferential way - subject to the custom procedures regulating customs-free zones		
Tax preferences		ASEZs:	General tax rate:
	Profit tax	0% for at least the first 5 years, 10% for the next 5 years after this	20%
	Property tax	In general, 0% for at least the first 5 years, 0.5% for the next 5 years, but tax rates will differ among federal subjects	2.2%
	Land tax	0% for the first 5 years	1.5%
	Social security and payroll tax	7.6% for the first 10 years	30%, from 2017 34%
	Customs	Tax exemption (customs-free zone)	Tax imposition
	Mineral resource taxation	Discount factor: 0% for the first 2 years, 0.2% for years 3 to 4, 0.4% for years 5 to 6, 0.6% for years 7 to 8 and 0.8% for years 9 to 10	Various tax rates, ranging from minimum 3.6% (potash) to maximum 16.5% (petroleum)

Source: Compiled by the authors

8 industrial production SEZs, 15 tourism and recreational SEZs and 3 port SEZs. Three of these were located in the Russian Far East: the Vladivostok Industrial Production SEZ, the Russkii Island Tourism and Recreational SEZ and the Sovetskaia Gavan Port SEZ (the first two in Primorskiĭ Krai and the third one in Khabarovsk) (*Minekrazvitiia* n.d.). Why, then, create the ASEZs in addition?

First, the Russian Far East needed to secure special means for backing up investors: a new type of investment platform. The existing SEZs fell within the portfolio of the Ministry of Economic Development. And while the industrial production and technology innovation SEZs were seen as successful, the tourism and port SEZs were not functioning as planned: they did not reflect what investors were calling for, and they were not equipped to push forward with relevant projects themselves (Byun 2014). To enhance the efficiency and implementing power of the development policy, the Russian government wanted the Ministry for the Development of the Far East to have responsibility for the economic zones in the Far East.

Second, to boost the development of the Far East, Russian authorities intended to rely partly on private investment. To attract such investment, they would have to offer more effective tax cuts than in the existing SEZs. Also other laws were amended in order to offer a wider range of benefits to those who made investments in ASEZs. Thus we find a clear difference between the SEZs and ASEZs: while the former focus on creating competitive investment environments with a minimum level of incentives, the latter are based on a concentrated effort to attract more investments through unprecedented benefits. The Ministry for the Development of the Far East emphasizes that ASEZs are fundamentally different from the existing SEZs: ASEZs provide basic infrastructure, a guarantee of an extendable 70-year operation period (with the SEZs, there is a non-extendable 49-year operation period), an extensive preferential regime (including reduced corporate tax and simplified administrative procedures) and one-stop service for residents.

Third, the ASEZs are intended to offer better business environments than elsewhere in the Asia-Pacific region, with states in the latter offering conditions more similar to those of Russia's existing SEZs. The Ministry for the Development of the Far East is convinced that the ASEZs will prove more competitive than these SEZs as a result of the additional emphasis on swift administrative procedures, tax benefits and crucial infrastructure (see Table 4.8) (Minvastokrazvitiia 2016a).

Initial Results

As of the end of 2016, a total of 14 ASEZs have been designated since the federal law went into effect in March 2015. Three zones had been selected in advance, in February 2015: Nadezhdinskaia in Primorskii Krai and

Table 4.8 Comparison of characteristics of SEZs in Asia-Pacific countries

	Korea	China	Singapore	USA	Canada	Japan	Russia	Russian ASEZs	Unit
Corporate tax	10	15	17	33	23.5	26.4	13.5	10	% on operating profits
Transportation costs	700	550	440	1,320	1,660	970	1,800	440	USD/ 20ft container
Electricity charges	7.3	7.4	13.6	6.9	7.4	17.9	11.7	6.9	cent/ 1kWh
Payroll tax	8.8	26.7	16.0	7.7	8.7	25.6	14.0	7.6	% on wages
Time needed to obtain construction permit	29	67	26	27	163	193	244	26	number of days
Connection to energy supply system	28	41	36	68	142	105	254	28	number of days
Export support policy	5	4	4	4	5	3	2	5	points
Intellectual property protection	2	3	4	5	4	5	3	5	score on IPRI ranking
Professional manpower availability	High	High	High	High	Average	High	Low	High	
Supplier availability	High	High	High	High	Average	High	Low	High	

Source: Titov (2014)

Khabarovsk and Komsomolsk in Khabarovskii Krai. Selection criteria had been the potential demand for attracting investment, the number of investors, and the plans for infrastructure construction.

After the law entered into force, another six zones were designated in August 2015: one each in the Sakha Republic, Kamchatka Krai, Chukotka Autonomous Okrug and Primorskii Krai, and two in Amur Oblast. These were followed by another five new zones in 2016: one each in Primorskii Krai, the Jewish Autonomous Oblast and the Sakha Republic, and two in Sakhalin Oblast. The only Far Eastern federal subject without

an ASEZ is thus Magadan. The new ASEZs were designated according to the specialization principle, in line with the specific characteristics of each area. The individual ASEZs will specialize in fields like industry, logistics, food processing, wood processing, etc., as appropriate (see Table 4.9).

As of October 2016, a total of 194 investment applications had been submitted by Russian and foreign companies; out of these, the authorities had concluded moving-in agreements with 91 companies. The size of planned investments by these 91 businesses is more than 400 billion rubles, and the investments are expected to create a total of 20,533 new jobs. The great majority of the businesses are Russian: 81 out of 91. As to foreign companies, there are five from China, two each from Japan and Australia, and one from Lithuania.⁶ An additional 16 foreign companies have applied.⁷ The total planned investment of these 26 foreign companies would be 171.3 billion rubles, and they are expected to create 4778 new jobs.

EVALUATION OF POLICY IMPLEMENTATION AND PROSPECTS FOR DEVELOPMENT

The plan of the Russian government is to use the ASEZs as a new policy means for developing its Far Eastern backwater. In recent years, the government has been pushing forward with its development policy more briskly than ever before. The reason behind the Kremlin's new, proactive approach is not only that previous instruments failed and that Russia needed a new model for regional development: it also decided that the time had come for Russia to maximize its growth potential by connecting with the Asia-Pacific region. Today, the Russian government appears set to take all necessary steps to attract more investors; there seems to be a new approach to listening to what investors need, rather than simply expecting investors to contribute to the state's plans for development.

Since the ASEZ regime was introduced only in March 2015, it is still in a transitional, formative period. Those working on ASEZs will need clearer policy directions, budgets and operational know-how: detailed development concepts or development strategies have yet to be formulated. Although each zone specializes within a field where it is deemed competitive, there are no unique identities, concrete action plans, or synergy policies among the ASEZs—a problem seen as major hurdle (POSCO 2016).

Table 4.9 Designated ASEZs

Name (federal subject)	Designation date (adoption of government decree)	Specialization	Expected investment (billion rubles)		Job creation (number of people)
			Private capital	Government budget	
Nadezhdinskaia (Primorskii Krai)	June 2015	Light industry, food, logistics	36.0	3.9	5,800
Khabarovsk (Khabarovsk Krai)	June 2015	Industry, logistics	39.4	2.5	7,800
Komsomolsk (Khabarovsk Krai)	June 2015	Industry (aircraft manufacturing)	16.2	1.2	3,500
Mikhailovskii (Primorskii Krai)	August 2015	Agriculture and livestock, grain production	56.5	4.44	5,700
Priamurskaia (Amur Oblast)	August 2015	Industry, logistics	136.5	0	3,150
Belogorsk (Amur Oblast)	August 2015	Agriculture	10.2	0.046	1,860
Kamchatka (Kamchatka Krai)	August 2015	Industry, tourism	22.1	8.5	2,918
Beringovskii (Chukotka Autonomous Okrug)	August 2015	Mining industry	11.6	0	450
Kangalassy (Sakha Republic)	August 2015	Industry	4.28	0.2	350
Bolshoi Kamen (Primorskii Krai)	January 2016	Shipbuilding	148.5	3.2	11,000
Gornyi Vozdukh (Sakhalin Oblast)	March 2016	Tourism	9.9	10	624
Iuzhnaia (Sakhalin Oblast)	March 2016	Agriculture	10.6	1.46	2,091
Amuro-Khinganskaia (Jewish Autonomous Oblast)	August 2016	Agriculture and livestock	17.1	0	1,292
Iuzhnaia Iakutia (Sakha Republic)	December 2016	Industry	24.7	0	2,900

Source: General Consulate of the Republic of Korea in Vladivostok (2016), *Iasia.ru* (2016), Minvostokrazvitiia (2016c)

Concerning tax benefits, the single greatest advantage offered by the ASEZs, there are competing perspectives on specificities and timelines, with the relevant agencies at odds with one another over the benefits of attracting investments versus the loss of state revenues (POSCO 2016). The period for corporate tax exemption has already been reduced from ten to five years.

When it comes to the government's decision to back infrastructure development, another key advantage of the ASEZs, the construction of such infrastructure suffers from the failure of the cash-strapped regional authorities to ensure matching funding. This is critical, since the central government and the regional authorities are equally responsible for securing funding for infrastructure construction projects (see Table 4.7 above). As it often takes several years to get proper infrastructure in place, concerns have also been raised about the considerable sunk costs that will accrue (KOTRA 2015).

Finally, as mentioned, the initial idea had been to promote the ASEZs as a special tool for developing the *Far East*. Then, with the adoption of the federal law, it became—with a delay of three years—applicable to all of Russia. From March 2018, it will be extended to other regions as well. That entails the danger of potential investors preferring to invest in other regions with more favourable geographical conditions or more well-balanced development than in the Far East. And that may weaken the original aim of attracting investment to the Far East by offering the most competitive benefits in the Asia-Pacific region (Byun 2014, p.69).

It is still too early to say whether the ASEZs will be a success. This is a long-term project; stakeholders should approach it with a macro-perspective. It has also been argued that in order to promote such specialized industries Russia should first set about developing and improving public health, education, social infrastructure and living conditions (Isaev 2016). The Russian Far East needs to attract skilled manpower—but, to achieve this, the authorities will have to improve the quality of living, offer residents and newcomers a wider range of benefits, and implement special measures to back and develop small- and medium-sized companies.

Russia's strained relations with the West after 2014 gave an impulse and further motivation to the Far Eastern development policy. However, the most important factor is to be able to accrue sufficient 'capital input'. Due to the Western economic sanctions, investors are experiencing difficulties in financing their projects in Russia. And as Russia is undergoing an economic recession and has adopted an austere fiscal regime, also from the

side of the authorities, there is not much room for allocating large volumes of investment to Far Eastern development. In the August 2016 second revision of the state programme, the overall budget for Far Eastern development was cut back: whereas 3.8 trillion rubles had been allocated for the period 2014–25, the budget for 2016–25 was now adjusted to 466.52 billion rubles in federal funding (Jeh et al. 2014, pp.81–82; Eastern Economic Forum 2016). This huge cut reflects the current internal and external economic conditions that have forced the Kremlin to budget more realistically. The ASEZs can therefore be understood as a focused approach for advancing development in the Russian Far East under the recent budget constraints: The Russian government intends to continue to push for the development of the Russian Far East, despite deteriorating internal and external economic conditions.

All the same the success of the ASEZs will hinge on being able to attract huge domestic and foreign inflows of capital. In a short-term perspective, it is hard to be optimistic about the future of the Russian Far East. However, in a medium- and long-term perspective, if the ASEZs policy proves functional, there is a real possibility for the formation of new industrial value-chains linking the Russian Far East with the Asia-Pacific market. In that case, the ASEZs will not only facilitate the sustainable development in the Russian Far East but also contribute towards its integration into the economy of the wider Asia-Pacific area. But there are many challenges remaining before this vision can be realized.

NOTES

1. On Russia's gross capital formation over time, see World Bank data at <http://data.worldbank.org/indicator/NE.GDI.TOTL.ZS?locations=RU>. Accessed on 27 February 2017.
2. The fixed basket of goods and services represents the purchases of the average consumer, and refers to a relatively fixed set of consumer products and services valued on an annual basis. This is used primarily to calculate the consumer price index or inflation of a certain market.
3. Calculated based on data from the Federal'naia sluzhba gosudarsvennoi statistiki 2016.
4. At the first meeting of the Government Commission on the Socioeconomic Development of the Far East in October 2013 Prime Minister Medvedev emphasized that this commission—besides the one on the North Caucasus—was the only such commission over which the prime minister presided in person (*Government.ru* 2013a).

5. Although various experts have long held that the Russian Far East should adopt an export-oriented industrial development model targeted at the Asia-Pacific region, their ideas failed to gain official approval. Since the breakup of the Soviet Union, the Russian government has sought to revitalize its economic relations with the global community, but as far as the Russian Far East was concerned, such an approach was seen as posing a serious threat to territorial integration. Accordingly, the Russian government paid more attention to boosting trade between the Far East and European Russia. However, given the high costs of transportation, this model could not work without government subsidies. As a result, the Russian Far East found itself in a situation where it could neither trade profitably with the rest of Russia nor foster its own export-oriented industries (Jeh et al. 2014, pp.91–92).
6. The five Chinese companies are the Amur Energy Company (oil refinery) and S Technology (cement plant) in Priamurskaia ASEZ; STK (road construction equipment) in Khabarovsk ASEZ; Sato (textiles) in Nadezhdinskaiia ASEZ; and Sakha Clay Pits (building materials) in Kandalassy ASEZ. The two Japanese companies are JGC Evergreen (greenhouses) in Khabarovsk ASEZ and Sayuri (greenhouses) in Kandalassy ASEZ. The two Australian are Port Ugolnyi (modernization of coal terminal) and Beringugol (coalmine development) in Beringovskii ASEZ. Finally, the Lithuanian company is SakhaLipsnele (boilers) in Kandalassy ASEZ (General Consulate of the Republic of Korea in Vladivostok 2016, pp.6–7).
7. Eight from China, two each from South Korea, Singapore, and Italy, and one each from Kazakhstan and Israel (General Consulate of the Republic of Korea in Vladivostok 2016, p.6).

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