

# Guide to investment

2008 edition

Volume 2: Alabuga Special Economic Zone





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## Introduction



Relative political stability and a rapidly expanding economy have created significant investment opportunities in Russia. Although Russia is highly attractive as an investment location, the economy is heavily based on natural resources and there are several perceived and actual administrative, legal, tax and other barriers for both foreign and local investors.

In order to stimulate diversification of the Russian economy, a number of special economic zones (SEZ) have been established across the country to simplify and facilitate the investment process. This document highlights the advantages of investing within the SEZ framework, with a particular focus on the industrial SEZ located near Elabuga in the Republic of Tatarstan. An overview of the Republic of Tatarstan and the Russian economy is also provided.

This document is intended as an aid to investment for organisations seeking to expand operations in Russia and forms part of a series focusing on the competitive advantages offered by different Russian regions.

This guide has been prepared in collaboration with SEZ Alabuga and draws extensively on material supplied by its administration.

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Partner  
PricewaterhouseCoopers in Russia

# Special economic zones

## History

Since 1998 the Russian economy has experienced strong and stable growth. The population's increasing purchasing power provides a strong foundation for further economic development.

The economy, however, is currently heavily dependent on natural resource exports, and it is the Russian government's stated aim to diversify into high technology industrial production and innovation. To facilitate this diversification several special economic zones have been set up, the main objective of which is to create favourable business conditions for investors.

In 2005 the Federal Agency for the Management of Special Economic Zones was created under the Ministry of Economic Development and Trade as the main body

responsible for establishing, developing and operating SEZ. Since then various Russian regions have competed to have an SEZ located on their territory.

## Types of zones

Four types of SEZ have been created. These have been strategically placed across Russia.

- Industrial (two locations);
- Research & development (four locations);
- Tourism & recreation (seven locations);
- Ports (competition between regions on-going at time of writing).



# SEZ Alabuga

The name “Alabuga” derives from the Tatar language name for the nearby town, known in Russian as Elabuga.

SEZ Alabuga is an industrial zone that is planned to include at least the following types of production facilities: automotive, chemicals, pharmaceuticals, aeronautics, building materials, waste treatment, machine-tools, and fibre optics, among others.

## Why Tatarstan?

The Republic of Tatarstan successfully competed for an SEZ as a result of a number of natural advantages.

### Industrial clusters

Tatarstan is considered one of three main automotive

production regions in Russia. Large automotive OEMs such as KAMAZ and Severstal-Auto are located in Tatarstan and are actively expanding production, both organically and through a series of joint-ventures with foreign-owned partners. The existence of large-scale OEMs provides significant opportunities for auto component and other supply companies to invest in the region.

Tatarstan is also considered part of a strategically important petrochemical production cluster. Large refineries in Kazan and Nizhnekamsk within Tatarstan, as well as at Ufa, Salavat and Sterlitamak in neighbouring republics, provide local access to a full range of polymers necessary for manufacturing in a number of different industries.



## Logistics

Tatarstan's transportation and logistics advantages:

- Access to trans-continental railway to eastern and western destinations;
- North-south railroad connecting the largest Volga-region industrial cities;
- Access to European Russia's main rivers: the Volga, Kama, Belaya and Vyatka. These rivers connect north-western, southern and north-eastern Russia as well as the Urals;
- Access to federal highways in three directions: 'west-east', 'west-southeast' and 'northwest-south';
- Three airports serving international and domestic destinations.

## Population

Tatarstan is within the belt of the most populated areas of Russia. An estimated 46% of the Russian population resides within 1,000 kilometres of SEZ Alabuga. This allows direct delivery access to Russian consumers with rapidly increasing spending power.

## Education and labour

There are more than 90 institutes of higher education in Tatarstan, including the following reputable establishments:

- Kazan State Finance & Economics Institute;
- Kazan State University;
- Kazan State Technical University (A. N. Tupolev);
- Kazan State Technological University;
- Elabuga State Pedagogical University;
- Kama State Engineering and Economic Academy;
- Naberezhnie Chelny State Trade and Technology Institute.

Graduates from these schools are employed in all spheres of the local economy. Several institutes provide professional training and job placement programmes in collaboration with the region's major enterprises. There are also approximately 200 secondary technical schools and colleges in Tatarstan.

## Industrial heritage

Tatarstan has a long history of large-scale industrial production tracing back to the second world war, when a significant proportion of military production was relocated there. Consequently, the region has long been associated with aircraft, military and automotive production.

## Raw materials

Tatarstan is also geographically well placed to have access to Russia's wealth of natural resources. The region itself has large deposits of crude oil and bitumen, as well as transport links to the Urals and Siberia. One of the largest Russian oil companies Tatneft is based in the region at Almetyevsk.

## SEZ Alabuga resident-status benefits

Residents of SEZ Alabuga have competitive advantages in the spheres of tax, customs, and industrial and business infrastructure.

Alabuga residents are entitled to:

- Tax benefits;
- Free customs zones treatment.

Other state support to SEZ Alabuga residents includes:

- Financing from federal, regional and municipal budgets, as well as support in the engineering, transport, social and innovative spheres;
- "Single window" approach for registration;
- Preparation of invitations for foreigners arriving in Russia to work;
- Obligation to conclude land-plot lease agreements (land plots may be subsequently purchased by SEZ residents upon construction and ownership of immovable property);
- Assistance in obtaining construction permits.

Regional tax benefits:

- A reduced regional profits tax rate of 13.5% as opposed to standard 17.5% (i.e. total profits tax rate of 20% instead of 24%);

- Transport tax exemption for ten years from the vehicle registration date;
- Property tax exemption for ten years from the date of recording the property on the balance sheet;
- Land tax exemption for ten years for land plots located on SEZ territory;
- A higher depreciation rate for tax purposes may be used (i.e., the standard depreciation rate may be multiplied by a coefficient not more than 2);
- Expenses incurred on research and development projects (even if unsuccessful) can be deducted in full for profits tax purposes when they are incurred.

Additional incentives and guarantees may be granted to investors according to a Cabinet of Ministers of the Republic of Tatarstan degree of 7 May 1999 (e.g., investment of regional budget funds in residents, provision of tax credits, etc.). Depending on the circumstances, the incentives can total up to 15-20%.

SEZ Alabuga provides free customs zone services with the following benefits:

- Exemption from import customs duty and VAT for equipment and property imported to construct production facilities.
- Foreign goods delivered to and used within the SEZ are free from import customs duties and VAT. But when foreign goods are released into free circulation to the rest of Russia, import customs duties and VAT will be due for these goods and/or products of their processing. (This provides a cash flow advantage since customs duty and VAT will be due not when raw materials are imported, but when the finished goods are released into free circulation to the rest of Russia).
- Possibility of choosing the import customs duty rate on processed goods (i.e., either the rate applicable for raw materials or the rate applicable for finished goods). Independent of the customs duty rate chosen, the customs value for determination of the customs duty should be taken as the value of raw materials.

Please note that if the finished goods are not sold in Russia, but rather exported, they will be subject to export duties (if any).

“One stop shop”:

The objective of “One stop shop” is to facilitate the investment process by providing investors with a single point of contact for all dealings with the government. One-stop-shop provides a single window access to all government services and information.

16 governmental agencies reside under one roof at SEZ “Alabuga”. These are:

- The Regional Administration of the Federal Agency for the Management of Special Economic Zones in the Republic of Tatarstan;
- The Ministry of Ecology and Natural Resources;
- The Ministry of Labor and Social Security;
- The Service of Environmental, Technological and Nuclear Oversight;
- The Federal Real Estate Cadastre Agency;
- The Social Insurance Fund;
- The Fund of Obligatory Medical Insurance;
- The Inspection of State Architectural Building Supervision;
- The Registration Service;
- The Chamber of Commerce and Industry;
- The Tax Service;
- The Customs Service;
- The Migration Service;
- The Pension Fund;
- The Certification Test Center;
- The Technical Inventory Bureau.

Other benefits:

The 20 sq km site dedicated to the SEZ has been constructed at the expense of the federal and regional budgets. The complex includes all the necessary industrial infrastructure, such as power and heating, a gas pipeline, a modern telecommunications system, a customs post and a bonded warehouse. This infrastructure will shorten the time and expense required for processing imported and exported commodities.

# The Republic of Tatarstan

The Republic of Tatarstan is situated in the European part of the Russian Federation at the confluence of the Volga and the Kama rivers. The republic extends some 460 kilometres west to east and 290 kilometres north to south. It has an area of 67,836 sq km, which is approximately equal to that of Belgium and the Netherlands together. Tatarstan borders on eight other Russian regions.

## People

At the start of 2007, Tatarstan's population was 3,760,500 and included a diverse range of ethnic groups and over 115 different nationalities. The three largest groups are Tatars, Russians and Chuvashes. There are more than two million Tatars in the republic, or 52.9% of its total population. Russians account for a further 1.5 million, or 39.5%, and Chuvashes a further 126,500, or 3.4%.

## Economy

Tatarstan is one of the wealthiest regions in Russia outside of the major centres of Moscow and St Petersburg. The region derives most of its wealth from oil, but it also has large and well-developed manufacturing and petrochemical industries. Tatarstan is also considered a centre of science and innovation.

## Towns and cities

Several well-known towns and cities are located in Tatarstan, including:

### Kazan:

Kazan is the capital of Tatarstan. With a history stretching back over 1,000 years, Kazan has been





an important cultural and trade centre throughout its existence. The city has undergone extensive redevelopment in recent years and has been host to a number of high-profile conferences and exhibitions. It is also home to the nearest PricewaterhouseCoopers office in Russia. Kazan is served by a modern international airport.

**Naberezhnye Chelny:**

Naberezhnye Chelny is the second-largest city in Tatarstan. Located 250 kilometres east of Kazan, it forms part of the industrial region and is home to OEMs like KAMAZ and Severstal Auto, among others.

**Elabuga:**

As the town closest to SEZ Alabuga, a “Work, Live and Play” principle has been adopted to attract residents. This includes constructing new housing and several projects in the social sphere.

**Almetyevsk:**

This city is home to Tatneft, the largest oil extraction company in Tatarstan and a significant player in the Russian oil industry. It is served by the domestic Bugulma Airport.

**Nizhnekamsk:**

This city is home to one of the largest petrochemical plants in the region, Nizhnekamskneftikhim. It is served by the international Begishevo Airport.

# Tatarstan as a part of the Russian Federation

## Russian federal structure

The Russian Federation is divided into 83 federal subjects (constituent units), 21 of which are republics. These republics represent areas of non-Russian ethnicity; the Republic of Tatarstan is the second-largest of these after the Republic of Bashkortostan. The indigenous ethnic group that gives rise to a republic's name is known as the "titular nationality". Due to a long history of internal migration in Russia, the indigenous ethnic group does not necessarily form the majority of a republic's population.

## People and culture

Russia's well-educated workforce is an important asset for long-term growth. Its relatively low-cost and generally highly skilled workers are one of the main attractions for investors. Russia's population is approximately 142.1 million, of which 64% are of working age; 16% are below it, and 20% are above it. Approximately 55% of the population is female and 45% male.

Statistics show that Russia's population is steadily declining, but the government is trying to reverse this trend through immigration policies and federal programmes to stimulate birth rates and reduce mortality.

Russia is home to 160 ethnic groups. According to the latest census, the largest are Russian (79.8%), Tatar (3.8%) and Ukrainian (2%).

## Economy

### Overview:

From the end of the USSR in 1991 until 1998, Russia's GDP significantly declined. After the economic crisis in 1998, the economy began to recover, with annual GDP growth at around 7% from 1999 to 2007. Driving this recovery are the sharp increase in prices for Russia's main exports (oil, petroleum products, gas, metals), the import substitution effect caused by rouble devaluation in 1998, tax reform, a tightening of fiscal policy, and greater social and political stability.



Nevertheless, much of the total output is produced by large industrial enterprises; small- and medium-sized businesses' share in the total GDP is very small. Services accounted for 56% of the GDP in 2006; industry accounted for 39% and agriculture, 5%.

### **Stabilisation Fund and National Wealth Fund:**

Russia's Stabilisation Fund was set up on 1 January 2004 as part of the federal budget to provide budget deficit financing as needed. The fund may be used for this and other purposes if its balance exceeds 500 billion roubles (approximately USD 19.5 billion). Amounts spent depend on the federal budget law for the corresponding fiscal year. The fund accumulates revenues from oil exports and, as of July 2007, its aggregate amount exceeds USD 120 billion. The fund's assets are invested in US dollars (45%), euros (45%) and pounds sterling (10%).

### **Leading sectors:**

#### **Energy, utilities & mining**

Russia's energy industry comprises oil, gas, coal, shale and turf production, electricity generation, oil refining, centralised heating supply systems and power transmission networks.

Currently, Russia's energy, utilities, and mining sectors (especially in electricity and gas) are facing major reforms to encourage continued domestic and foreign investment and to solve challenges like high energy demand and export restraints.

Russia is an important player in international energy trade. Russia's energy reserves are among the world's largest; a country with less than 3% of the world's population, it controls around 7% of the globe's proven oil reserves, 26% of its natural gas, 17% of its coal, and 14% of its uranium.

Oil and gas production remains the Russian economy's principal sector, accounting for 22% of the GDP. It plays a leading role in generating state budget revenues and secures a positive trade balance. Some 66.2% of the country's exports are oil, petroleum products and gas.

#### **Metals**

Along with oil and gas production, metallurgy is another of the Russian economy's key industries. Russia ranks first in the world in nickel production, second in aluminium production and export after the US, and fourth in steel production after China, Japan and the US.

According to official statistics, in 2006 the metal industry accounted for over 16% of Russia's total industrial production and around 10% of total foreign investment.

#### **Retail & consumer**

The increasing purchasing power of the population is the main driver behind the recent dynamic growth of Russia's retail and consumer sector. It is one of the fastest-growing markets in Russia and attracts 24% of all foreign investment.

The retail industry's turnover in 2006 was around USD 317.4 billion. Russia is the fastest-growing retail food sales market in the world, with the potential to double in size by 2008. In 2006, Russia was ranked the second most attractive retail market in the Global Retail Development Index. Major international chains are expanding their presence in the non-food market (IKEA, OBI, Leroy Merlin, Castorama) and food market (Auchan, Carrefour, Metro, Rewe and Ramstore), but Russian retail giants like the X5 Retail Group, Magnit, Sedmoi Continent and the Kopeika chains continue to make up a significant share of the market. And despite the extensive growth of modern retail chains (both Russian and international), street markets and kiosks still account for almost two-thirds of Russia's retail turnover. This share of the market, however, is steadily declining.

#### **Communications and IT**

The Russian communications and information technology sectors are developing rapidly and represent 4.5% of the country's GDP. According to the Ministry for Information Technology and Communications, the industry's revenues grew by 19% to reach USD 27.6 billion in 2006.

By the end of 2006, mobile telephone penetration by SIM cards exceeded 100%, while objective penetration came to around 80%. In 2006, Russia had 150 million mobile subscribers. Mobile penetration is growing

particularly fast in the regions, stimulated by sharp competition among the three major national operators (Mobile TeleSystems, VimpelCom, and MegaFon).

These three operators are vying to buy up regional operators, developing new networks across the country and actively expanding in the CIS and Europe.

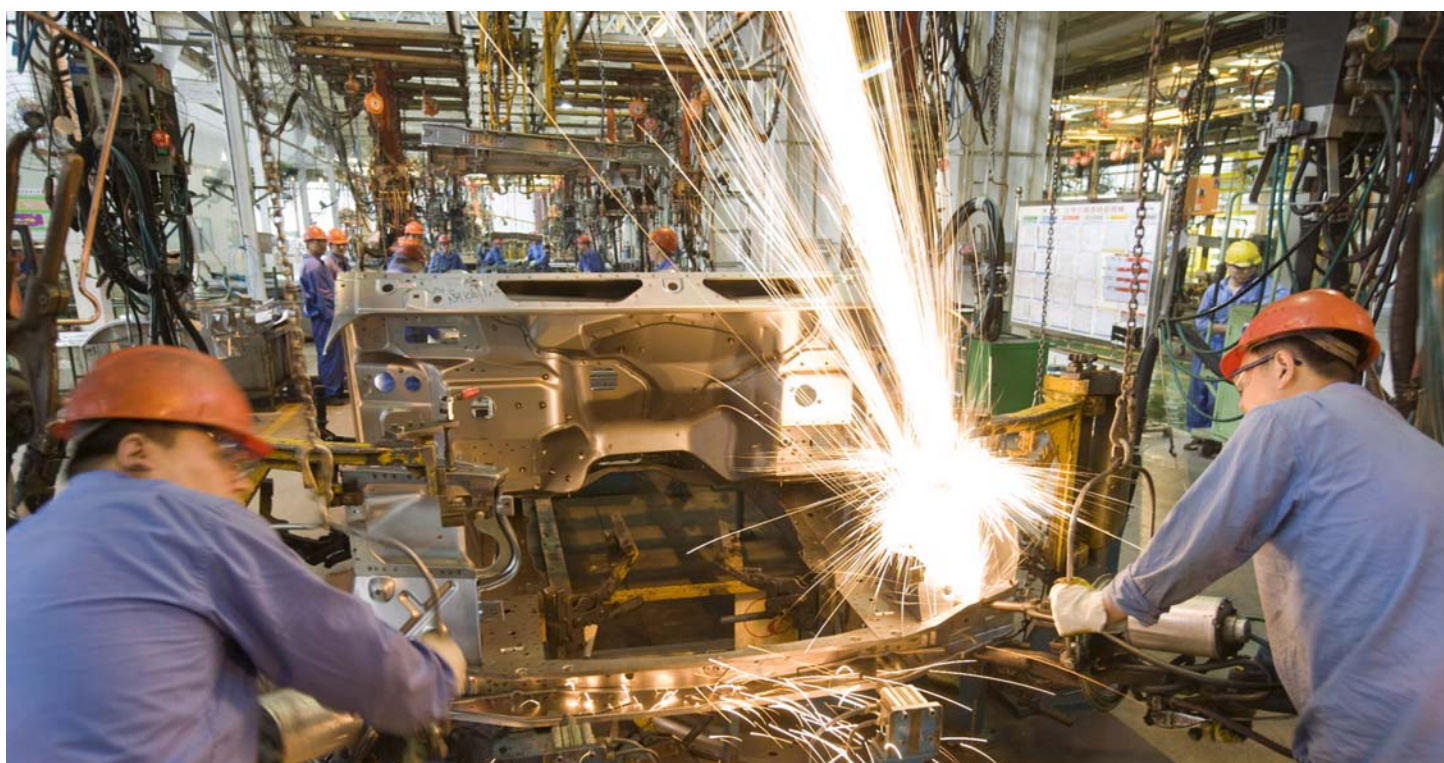
### **Automotive**

In 2007, sales in the Russian automotive market rose 35% in unit terms on the previous year to 2.8 million cars. This was the fifth-highest sales volume in Europe, after Germany, France, the UK and Italy. Over the past five years, the demand for cars has increased 5 fold in money terms, from \$10 billion in 2002 to more than \$53 billion in 2007. The main reasons for such rapid growth are the steady increase in personal disposable income, better access to car loans and expansion of sales outlet and dealership chains all over the country. Industry

experts anticipate further market growth and predict that in several years, the Russian automotive market could become the largest in Europe.

Russian car manufacturers are losing their market share to foreign brands that are either imported or have assembly plants in the country. New foreign brands account for 78% of the market in money terms.

The Russian government has offered tax breaks to companies that start major assembly lines in Russia. Ford, Renault, GM, Toyota, Volkswagen, KIA, Great Wall, Hyundai, Fiat, SsangYong, and Isuzu are already being assembled in Russia. Suzuki, Nissan, Peugeot/Citroen, Mitsubishi and others are constructing factories or have announced plans to set up assembly plants. An influx of foreign car component manufacturers in the next few years is expected. Similar tax remissions are on offer to large-scale car component producers.



## Conclusion



As a result of structural changes and high commodity prices, the Russian economy is experiencing a sustained period of strong growth.

It is widely acknowledged that diversifying the economy beyond natural raw materials is crucial to its continued long-term success. For this reason, a series of special economic zones have been created.

The Republic of Tatarstan is home to industrial SEZ Alabuga. Tatarstan was chosen as the location for one of two industrial SEZ in Russia because of a number of natural advantages. For example, its location in automotive and petrochemical clusters creates significant opportunities for supply chain investment. Other strengths include access to a strong logistics network, an educated and experienced workforce and proximity to a significant portion of the Russian consumer population and raw material sources.

Further information and assistance can be obtained via the contact details provided in Appendix.

## Appendix: Contact information

The regional administration of the Federal Agency for the Management of the Special Economic Zones in the Republic of Tatarstan

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