

INSTITUTE OF CURRENT WORLD AFFAIRS



Elena Agarkova will be studying management of natural resources and the relationship between Siberia's natural riches and its people. Previously, Elena was a Legal Fellow at the University of Washington's School of Law, at the Berman Environmental Law Clinic. She has clerked for Honorable Cynthia M. Rufe of the federal district court in Philadelphia, and has practiced commercial litigation at the New York office of Milbank, Tweed, Hadley & McCloy LLP. Elena was born in Moscow, Russia, and has volunteered for environmental non-profits in the Lake Baikal region of Siberia. She graduated from Georgetown University Law Center in 2001, and has received a bachelor's degree in political science from Barnard College.

Institute of Current World Affairs

The Crane-Rogers Foundation
4545 42nd St. NW, Ste 311
Washington, D.C. 20016

Tel: 202-364-4068
Fax: 202-364-0498
E-mail: icwa@icwa.org
Web: www.icwa.org

The Information contained in this publication may not be reprinted or republished without the express written consent of the Institute of Current World Affairs.

Special Economic Zones and The Future of Tourism on Baikal

By Elena Agarkova

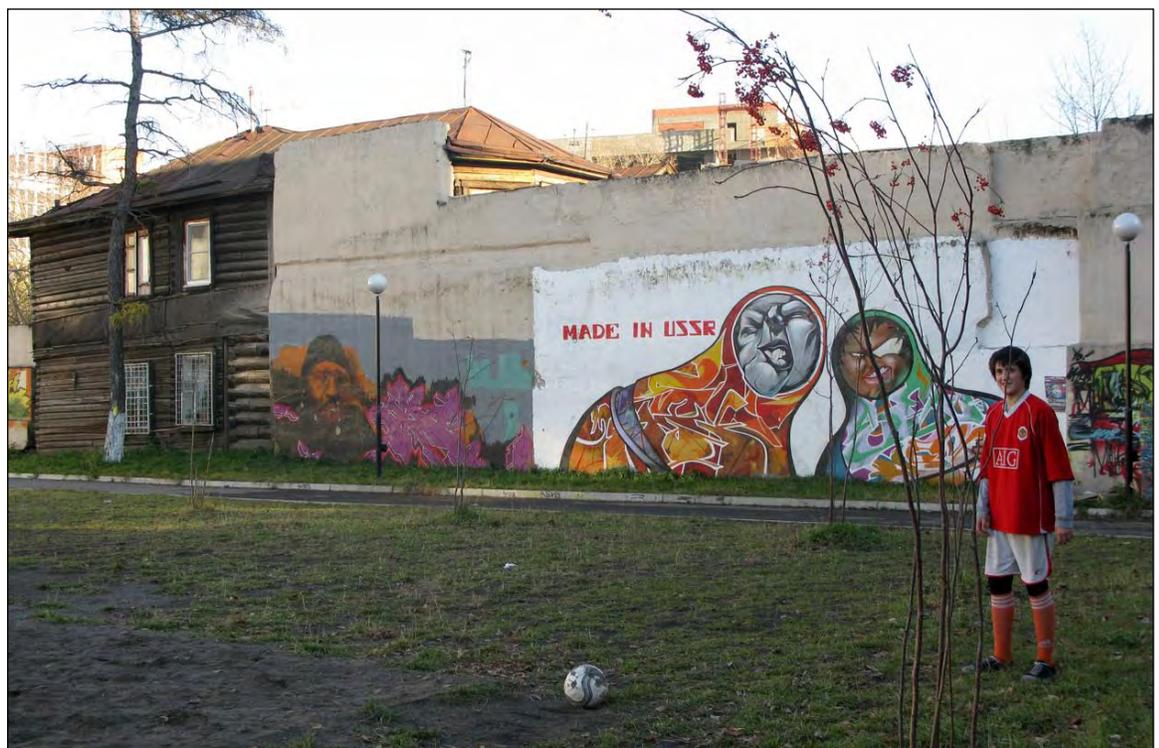
LAKE BAIKAL—In the weeks prior to the fifth Baikal Economic Forum (BEF), construction crews dug up the main streets of Irkutsk. They laid down new asphalt for cars that would carry VIP attendees from the airport to their hotels and BEF events. Drivers, stuck in new traffic jams, cursed the administration. By the end of the first week of September, when the Forum began, the newly asphalted streets opened up, but official cavalcades created more traffic problems.

Even though Irkutsk drivers waited for the BEF to be over, many locals hoped that the speeches and deals made during the Forum would have a positive impact on the local economy. BEF's theme this year was "Siberia, the Land of Opportunities." One of the most important

local issues discussed at BEF concerned plans to build two "special economic zones" on Baikal to spur development of tourism in the region. The tourist zone proposals, one from the Irkutsk region and one from Buryatia, have gone through a number of unexpected changes in the past two years, and even today their future remains unclear. One of the crucial questions is whether these proposals will truly balance economic development and environmental protection. For now local administrations appear convinced that one must be sacrificed for the other.

Russian SEZ - History and Goals

In 2005 German Gref, the then-Russian minister of economics, championed the idea of creat-



Graffiti in front of a local high-school soccer field in Irkutsk.



The billboard on the left is an advertisement for a magazine titled "Rich Man" or, alternatively, "Get Richer." The ad on the right is by United Russia, Putin's party: "Putin is our leader!"

ing special economic zones (SEZ), geographical areas which have more liberal economic laws than the rest of the country, in Russia. Gref's goal was to use SEZ to diversify Russia's economy, stimulate the processing industry, and attract new investments, especially into depressed economic regions. In support of his proposal the minister relied on the successful examples of similar zones around the world. There are more than 1200 such economic zones globally, from the so-called "techno-parks" (California's Silicon Valley is one example), to off-shore investment zones in developing countries. Whereas different types of economic zones offer different packages of financial incentives, as a norm those include certain tax benefits and exemptions for investors.

President Putin supported Gref's initiative, helping to overcome skepticism of the more conservative members of the Russian cabinet. In January of this year the Russian vice-premier, Sergey Ivanov, reiterated the idea that SEZ will help Russia escape "the oil curse."

Initially the Russian SEZ law, which took effect in January 2006, provided for two types of zones: "industrial production," or processing industry zones, and "technical innovation," i.e. "hi-tech economy" ones. Even though the law aims to attract capital by liberalizing conditions for investment and for conducting business, its provisions could be more favorable.

On its face the law creates some

significant hurdles for investors. For example, to become a resident of an industrial production SEZ a company must invest at least 10 million euros into the project. Out of the total sum, one million euros must be invested during the first year of the investment. Also, the SEZ (and the profits therefrom) will expire. They will be in existence for a period of 20 years, without a possibility of extension.

One benefit of investing in a Russian SEZ is that its residents don't pay property and land taxes for a period of five years. The SEZ law also exempts foreign goods

imported to a SEZ from customs duties. Another perk is the principle of "one administrative window," or reduced bureaucratic procedures for registering a business or investing in the SEZ.

There are two models of special economic zones in the world: those created "from the top" and "from the bottom." In the first case the state creates an SEZ pursuant to a government program, primarily using funds from the state budget. As part of its management strategy the state



A backyard across from the "Get Richer" billboard in Irkutsk, with a broken-down car covered in plastic.

usually forms an agency charged with administration of the SEZs, including licensing of potential investors. This is the model that China used to create its special economic zones starting in late 1970s.¹

In the “from the bottom” model, which is much more widespread today, a separate legal entity—a private developer or a joint public-private venture—is responsible for managing the SEZ. This entity builds relationships with the investors on a contractual basis, allowing investments in a freer fashion than the state-approved licensing procedure.

Russia chose to follow China’s model, creating state-managed SEZs on state-owned land, with the necessary infrastructure funded mainly by monies from the state budget. The Russian SEZ law did not allow “from the bottom” SEZ projects, the ones primarily financed by private capital. Some Russian analysts criticized this approach from the beginning, arguing that it runs contrary to global trends and ignores the current financial situation in Russia, i.e. already strained state resources.²

Pursuant to the federal SEZ law, the Russian Ministry of Economics created a special agency responsible for SEZs management, licensing, control and oversight. The agency doesn’t participate in the coordination and implementation of business activity in the SEZ. The agency holds competitions for creation of SEZ in different regions. The applications have to come from local governments. Winning proposals receive federal financial support, including dedicated federal investment into an SEZ’s infrastructure.

To date the agency has approved four “technical innovation” zones (two out of four are located nearby Moscow and St. Petersburg), and only two “industrial production” SEZ. The agency has received more than 70 applications, from half of the constituent entities of the Russian Federation.³ The minister of economics justified their selection of



only six proposals by describing SEZ as a new tool that needs tweaking: “At first we would like to go through the entire process with these six SEZ, work out the legal basis for them, and then go forward [with additional zones].”

Tourist SEZ and Baikal

In July 2006, six months after passing the federal SEZ law, the Russian government expanded its vision of SEZs. It amended the original law to provide for creation of “tourist-recreational” zones.⁴ The stated goal of tourist SEZs is to stimulate tourism and development of resorts, spas and other “therapeutic facilities” across Russia. General goals include, as with other types of SEZs, attracting direct

1 There are some such zones in South Korea as well.

2 Depending on how the world’s financial markets perform in the next couple of years, it’s possible that the Russian/Chinese desire to micromanage private investment may yet win additional supporters.

3 Russia is a federation which today has 83 “constituent entities.” These entities range from republics (21 total) to “federal status” cities (Moscow and St. Petersburg). All 83 have equal federal rights, meaning that they have equal representation (two delegates each) in Russia’s Federation Council, the upper house of the Russian Federal Assembly.

4 The law defines permitted “tourist-recreational activity” as construction, restoration, and operation of tourist facilities; facilities utilized for medical treatment, after-care and recreation; as well as development and exploitation of mineral waters, therapeutic muds, and other natural resources; provision of spa-type and disease prevention services, medical after-care, recreational services, and commercial bottling of mineral water.



Irkutsk is one of the oldest Russian cities, with some beautiful traditional architecture.

Russian and foreign investment, creating additional work places and testing of new methods of management and labor efficiency.

Tourist SEZ are different from the other two types of SEZ in that they can be located on private as well as state land, and even on parts of protected natural areas' territories. The law does not limit the potential territory of tourist SEZ. In contrast, technical innovation zones cannot be larger than two square kilometers, and industrial production zones are limited to 20 square kilometers.

In February 2007 the SEZs agency approved creation of seven tourist SEZs. Both administrative regions ("constituent entities") that share Lake Baikal's watershed, the Irkutsk region and the republic of Buryatia, participated in the federal competition. From the beginning both regions felt that they were competing with each other. One of the SEZs agency vice-directors told me that they initially opposed creating two different zones on the opposite shores of Baikal. The agency did not think it made sense to divide the potential tourist stream between two areas, and instead wanted to concentrate on "getting it right" in one place at a time.

Both Irkutsk and Buryatia view tourism revenue as an important part of their respective budgets. The beauty of Lake Baikal, the world's largest source of fresh water, draws tourists from all over the world despite its remote location and lack of infrastructure. A large portion of Baikal's shoreline is on protected territories of nature reserves and national parks. Here, the nature is still truly wild and tourists are hard pressed to find anything that resembles a modern toilet. Tourist infrastructure in non-protected areas of Baikal

is rudimentary as well. There are no five- (or even four-) star hotels in the non-urban areas, transportation options are limited, and it's not easy to find English speakers. All of these act as natural limiting factors, curbing the number and the types of people who stay on Baikal each year.

Local administrations feel that they are not fully using Baikal's potential as a tourist mecca. But keeping the number of tourists low may have environmental pluses. At the present moment local authorities lack the means to enforce existing environmental regulations. Illegal construction and logging are rampant. Ships routinely dump diesel and wastes into the waters of the world's deepest lake. At the end of each summer season garbage piles up along Baikal's shores; empty vodka bottles are a common find even on the pristine beaches of Baikal's national parks.⁵

The administrations of Irkutsk and Buryatia saw the federal tourist SEZs competition as an opportunity to get federal financing for much-needed improvements to their transportation infrastructure, along with other potential economic benefits. Ironically, in choosing between the Irkutsk and Buryatia proposals the SEZ agency initially leaned towards selecting the Irkutsk project because Irkutsk has better infrastructure, including a bigger, newer airport, better roads, and a source of cheap electricity, the Angara dam.

Irkutsk's original proposal involved development of year-round tourism in a small valley nearby Listvyanka, an already popular tourist destination on the shore of Baikal, about 45 minutes away from Irkutsk. The region's SEZ project called for construction of several world-class ski

⁵ The new president of Buryatia made headlines soon after Putin appointed him to the post, when he said that one way to solve the garbage problem is to sell all of Baikal's shoreline into private hands.

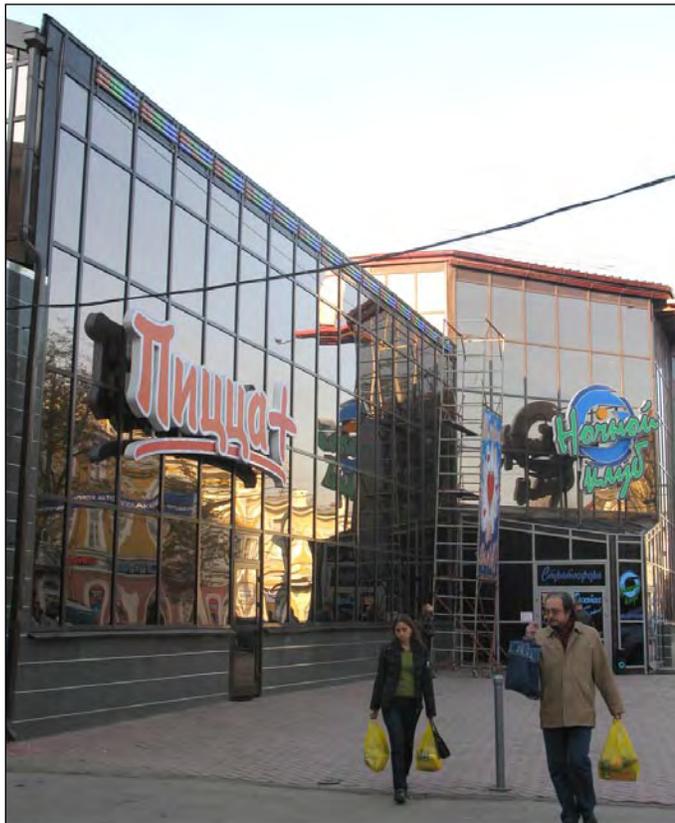
⁶ Ethno, or ethnic, hotels usually utilize aspects of local indigenous or traditional culture, to various degrees. Buryatia's proposal calls for building several traditional-style structures (yurts, see FN8 below) instead of regular hotel buildings.

lifts, “ethno-hotels,”⁶ spas, and an aqua-park, with a total projection of a million tourists annually.

Buryatia proposed an SEZ zone of 700-square-kilometers, with several ski resorts, three-, four-, and five-star hotels, golf clubs,⁷ a yacht club, modern spa and therapy centers, entertainment complexes, a “traditional-style” yurt hotel⁸ on the shore of Baikal, and a center of Tibetan medicine. The planners expected the SEZ to attract almost two million tourists a year.

Burytia is an economically depressed region and, in contrast to Irkutsk, receives federal subsidies. Its SEZ proposal, more ambitious geographically than the smaller zone proposed by Irkutsk, would require a larger contribution from the federal government. The airport in Ulan-Ude, the capital of Buryatia, needs reconstruction. The main road that goes north from Ulan-Ude to tourist destinations along the shore of Baikal — small villages, sandy beaches and hot springs resorts — is a jumble of potholes. The paved pieces are few and far in between, even though road crews have been working here for several years.

Buryatia’s senator is a dedicated lobbyist of his republic’s interests and has high-placed connections in the Russian Ministry of Economics. In 2006 he took German Gref, who was the minister of economics at the time, on a VIP tour



Sushi bars, pizza, and a bowling club on one of the main street of Irkutsk.

of Buryatia’s attractions. Despite the SEZ agency’s initial resistance to creating a tourist SEZ in Buryatia, both Irkutsk and Buryatia won in the final round of the competition.

Since then both projects have gone through significant changes, and the process does not appear to be over yet.

Last October the federal agency announced a decision to move the Irkutsk SEZ to the village of Bolshoye Goloustnoye, located 50 kilometers north of the original SEZ site, Listvyanka. The estimate of potential SEZ visitors has gone down to 93,000 tourists annually (at a 50 percent occupation rate) from the original 1 million.

In March of this year the federal authorities arrested Tatyana Kazakova, the mayor of Listvyanka and president of “Baikal Visa,” one of the biggest tourism firms in the region. Kazakova lobbied for the tourist SEZ in Listvyanka. Charges against Kazakova include abuse of office, unlawful participation in entrepreneurial activity, fraud committed by an organized criminal group, and impeding voters’ rights or work of voting commissions. The regional court just extended her initial two-month arrest by another four months.

At this point the federal government supports Bolshoye Goloustnoye as the SEZ location. Land prices have gone up almost two-fold since the SEZ agency announced its choice of the future construction site.

The SEZ agency changed Buryatia’s project as well. Instead of creating a 700-square-kilometer zone, as the republic proposed originally, the current plan calls for construction of tourist resorts in five separate, smaller geographical areas. Two of those will be developed during the first phase of SEZ construction, with the remaining three to be developed during the second phase.

The Baikal Economic Forum & the Future of SEZ

The first Baikal Economic Forum (BEF) took place in 2000, and reoccurred every two years since. Its organizers meant BEF to become a logical continuation of the Economic Forum for Countries of the Commonwealth of Independent States (the Commonwealth consists of several former Soviet Union republics), which takes place in St. Petersburg since 1996. One of the main goals of the St. Petersburg forum is to form economic and political ties between participant countries. BEF has traditionally concentrated on issues of development of Siberia and the Russian Far East, investment in Siberian industry, infrastructure, and communications, and on Russia’s interaction with neighboring Pacific Rim countries.

This year the list of BEF attendees included representatives of Russian federal ministries, regional administrations,

⁷ The golfing season on Baikal can last three to four months at the most.

⁸ A traditional yurt is a tent-shaped movable structure of wooden beams and felt covering. Different Asian cultures, including Buryat nomads, have their own variations of the yurt (called ger in Mongolia).

Russian and foreign businessmen, local NGOs and the press. Many of them came to the BEF roundtable on tourist SEZs in the Baikal region to participate in the discussion of current issues facing Irkutsk and Buryatia as they struggle to create these special economic zones. The roundtable presented a discouraging snapshot of a flawed administrative process, with disjointed stakeholders who are not communicating effectively with one another, and who appear to be intent on pushing their own agendas at the expense of other interests.

The vice-director of the federal SEZ agency used some of his speech time to encourage local medium and small businesses to invest in the Irkutsk SEZ. At the time of the roundtable Buryatia had two potential investors in its SEZ, while Irkutsk had none.⁹ However, interviews with local Irkutsk companies that I read in local media seem to reveal that the companies are weary of continuing changes in the SEZ proposal, and do not want to commit to any investments until they feel that the zones have been finalized.

Despite the fact that local businesses are in no rush to invest in the proposed SEZ, and the region is already behind the development and construction timetable, the vice-governor of the Irkutsk region used his time to urge the federal government to expand the zone to two more areas. One of these is the island of Olkhon, the biggest island on Baikal and a place considered sacred by many locals. Buryat shamans still bury their dead in a remote grove on the island, in the tops of ancient trees (a local rarity given the rocky soil of the island, exposed to 360 degree winds). Olkhon did not have electricity until two years ago. About 1,500 people live there year-round, with the vast majority concentrated in the main village Khuzhir. When I visited Olkhon four

years ago, I walked on the one and only unpaved road for miles without running into a soul.

This August I got a view of the modernized Olkhon when I took a high-speed boat from Irkutsk to Severobaikalsk. Dozens of new homes have already sprouted on the barren, erosion-prone slopes of the island. The vice-governor of Irkutsk proposes to build an “active tourism resort” on Olkhon, with a carrying capacity of 220,000 people. According to the administration’s economic calculations, simultaneous development of tourist bases in several locations will be “ten times more effective” than creation of the Bolshoye Goloustnoye resort alone. It’s possible that Irkutsk is trying, belatedly, to replicate Buryatia’s SEZ proposal, which now calls for development of five separate SEZ areas.

Some of the local discontent also came through in the speeches of Siberian scientists, who criticized the proposed tourism SEZs for their disregard of existing local research and recommendations concerning proper zoning of the Baikal watershed. The criticism is on point insofar as the federal SEZ agency and local administrations hired German and Austrian consulting firms to develop SEZ proposals. It’s doubtful that these experts had access to decades of local materials and data, which exists primarily in Russian.

One after another the scientists repeated that before building an SEZ, the government should solve existing environmental and legal problems on Baikal. These include lack of proper sewage facilities in practically all of the existing settlements, illegal occupation of land, unsanctioned construction of tourist resorts and private homes on the shore, lack of garbage collecting and disposal facilities, and pollution from small ships. This criticism makes sense (why create

additional pollution problems on top of existing ones), but the local administrations see themselves in a catch-22 situation. Local enforcement capabilities are limited by constant lack of finances. In order to deal with environmental problems on Baikal, local administrations need money. Instead of searching for local solutions to local problems, administration officials in the Baikal region look to outside entities for help. The reasons are many, including the fact that most administration officials lack relevant economic experience — or initiative.

This mentality came through in the speech by the representative of Buryatia’s Ministry of Natural Resources. From the ministry’s point of view, the region is a “hostage” of the “Baikal factor,” and



One of the new developments on the island.

9 As of the middle of October, Irkutsk press reported that no local companies had applied for the SEZ resident status.



A street nearby Irkutsk's central food market.

cash-strapped Buryatia has to expend additional financial resources on environmental compliance. "When UNESCO established Baikal as a World Heritage Site, they said that this designation will bring about 70 million euros into the region. We don't see this money in Buryatia. The world community should pay the costs associated with the World Heritage Site designation." The ministry representative said that alternatively, Buryatia should be allowed to develop its mineral resources without compliance with existing environmental regulations protecting the Baikal watershed.

The stark scenario presented by Buryatia has only two visions of Baikal's future. In one, the nature wins at the expense of human population. Environmental laws are strictly enforced, Baikal is protected, but the people are suffering. In another, industrial development is allowed even in the environmentally sensitive zones. These extremes ignore other possible avenues of development, ones that would take the "limiting" environmental factors and transform them into positive economic stimuli.

The Baikal region is one of the rare remaining places on Earth where natural ecosystems exist in their pristine, "wild" state. The percentage of such undisturbed territories is much higher here than in the European part of Russia. The indigenous people of Baikal have retained their cultural traditions, more kindred to the ethics of sustainable development rather than the philosophy of a consumerist industrial society. The Baikal region could become a model, or a platform area, for implementation of innovative, environmentally-friendly technologies. Local populations should receive financial help and guidance to determine how they can capitalize on the region's environmental resources without sacrificing environmental protection. For example, the Russian federal government could invest its funds and attract international investment into alternative sources of energy, including solar (Buryatia has a very high number of sunny days annually) and geothermal (there

are a number of active hot springs around Baikal). Another option is to assist locals in development and certification of organic agriculture. Such agriculture may be more profitable economically in an under-populated area like Buryatia than it is in Europe, where the demand for environmentally clean products remains high.

These are just some of the options. Local and foreign experts have suggested other potential development options that take the region's ecological significance into consideration. It is imperative to keep in mind that this lake has twenty percent of the world's fresh water. In a world where millions of people already don't have access to clean drinking water, it is impossible to overestimate the value of clean Baikal as a resource. However, economists are creating ways of measuring ecosystem value, including in dollar terms. As imperfect as such valuations may be, they offer a starting point for understanding

benefits that a particular ecosystem provides. Any discussion of economic development on Baikal should weigh the economic benefits of any proposed activity versus potential harm to the economic value of Baikal's water.

Unfortunately, the business community appears to share the stark vision that Buryatia's administration presented. The president of Metropol, one of Russia's largest financial investment companies, who spoke at the SEZ roundtable, said that "a hungry man cannot think about protecting nature." He was confident that the notion of Buryatia as a "Baikal reservation" is a path that must be avoided: "We need to have rational use of resources. Buryatia's main wealth is in its raw minerals. If Buryatia develops as a "reservation," it will exist only on federal subsidies, which will create parasite-like dependency [on the federal government]."

Metropol made news recently because it sponsored an entire year of scientific underwater exploration and monitoring of Lake Baikal. The expedition, with participants from the Russian Academy of Sciences, scientists from Irkutsk, Buryatia, and Japan, is using two deep-sea diving apparatuses to explore the Lake.

The president of Metropol has a Ph.D. in geography and has stated in interviews that he takes environmental compliance seriously. Metropol says that its motives in sponsoring the expedition are purely philanthropic. One of the stated goals of the expedition is "to study Baikal's hydrocarbons, determine the extent of such reserves, and their background level in order to assess the level of water pollution." The most recent articles about Metropol reveal that one of its subsidiary companies won a bid to develop Buryatia's mineral resources not too long ago.

There is oil and gas in Baikal. In some spots at the bot-

tom of the Lake black oil bubbles leak into the water. Local scientists knew this for quite some time but chose to keep quiet. The Baikal region is a highly seismic zone, which makes any commercial exploitation of oil and gas deposits here an extremely complicated endeavor. Drilling for oil more than 5,000 feet below the surface of the Lake does not seem to be the most environmentally-friendly of ideas.

Ultimately, Metropol's position on "rational use of resources" echoed that of the Russian minister of natural resources, who, according to the local press, became the first person to use the term "sustainable development" in all of ten years of the Forum's existence. The minister did not mean the energy-saving or environmentally clean technologies. He referred to "the balance between field development and replenishment of mineral resources," meaning the need to look for new sources of mineral resources even as the companies develop existing fields. His proposed solution is to boost geological exploration.

The Future of SEZ

Most of the BEF visitors have left town but the questions of how a tourism SEZ would function on Baikal are still relevant. In addition to existing economic and environmental controversies surrounding SEZ plans, it remains to be seen whether the current financial crisis and investors' flight from Russia will affect development of SEZs, tourism, and resource exploitation in the Baikal region. The latest statistics on tourism in the region show that because of the global increase in food and gas prices, the average cost of a vacation has increased by 20 to 40 percent. Even though there

are no exact numbers, local tour operators say that both foreign and Russian tourists preferred to stay closer to home this summer.

There are other difficulties as well. This September the Russian federal prosecutor's office published the results of its investigation into SEZ's compliance with the law. The prosecutor concluded that the federal SEZ agency used allocated budget funds ineffectively, and the process of creating the zones is too slow. The first criticism was that the agency lost potential revenue by investing allocated funds into low-yield financial instruments (with annual returns of 3.5 to 5.5 percent), instead of available higher-yield options. The prosecutor's second criticism concerned bureaucratic hassles in the creation of an SEZ and the low number of registered private investors. For example, five out of seven tourist SEZs do not have any residents yet, there have been no private investments in them, and no new work places were created on their territories.

The prosecutor's office concluded that due to the SEZ agency's failure to properly exercise its responsibilities in managing SEZs, and the "passivity of the local administrations," the SEZ projects are "developing poorly," and have a low socio-economic effect. As another example, only eleven businesses invested funds into a technical innovation SEZ in Moscow during the two years of its existence. Out of these eleven, only one actually does business on the territory of the SEZ. All the others operate elsewhere. Despite this, the federal SEZ agency used combined results of the business activity of all eleven businesses as a measure of the SEZ's economic success. The same distortion of economic effects of an SEZ happened with regards to the other technical innovation zone.

This is a story that has repeated itself in Russian history time and time again, beginning with Potemkin villages. During the Soviet Union days cameramen filmed corn stalks from the ground up, to make them appear bigger on state-run TV, and reports of non-existent farm yields became rosier as they made their way up to the top levels of state management. Today it appears that when the state exerts pressure to perform on its subordinate agencies, by creating positive economic trends, they respond the same way their predecessors did—by falsifying the results. □



United Russia's contribution to the Baikal Day celebrations in September, dressing up in polar bear costumes.

Since 1925 the Institute of Current World Affairs (the Crane-Rogers Foundation) has provided long-term fellowships to enable outstanding young women and men to live outside the United States and write about international areas and issues. An exempt operating foundation endowed by the late Charles R. Crane, the Institute is also supported by contributions from like-minded individuals and foundations.

ICWA Letters (ISSN 1083-4273) are published by the Institute of Current World Affairs Inc., a 501(c)(3) exempt operating foundation incorporated in New York State with offices located at 4545 42nd Street NW, Suite 311, Washington, D.C. 20016. The letters are provided free of charge to members of ICWA and are available to libraries and professional researchers on our web site.

CONTACT:

Phone: (202) 364-4068
 Fax: (202) 364-0498
 E-mail: icwa@icwa.org
 Website: www.icwa.org

STAFF:

Executive Director:
 Steven Butler

Program Assistant/
 Publications Manager:
 Ellen Kozak

Administrative Assistant/
 Bookkeeper: Meera Shah