



***INVEST IN***

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**REGIONAL ASPECTS OF  
ENABLING ENVIRONMENT  
FOR FOREIGN INVESTMENT**

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***AGENCY FOR DEVELOPMENT  
AND INVESTMENT PROMOTION***

***АРПИИ  
ADIP***

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# INTRODUCTION

**Background.** Improvement in the enabling environment for investment became one of the main topics of the latest discussions. The fact is easily explained by the significance of the foreign capital and direct investment inflows for the development (and even mere existence) of Russian economy. But to attract investment the government should provide the investors with enabling business environment and guarantees against the risk to lose their property.

All of the above had been declared many times. Some individuals and groups of experts do not simply state the fact but describe certain measures to improve the enabling environment for business. But despite the fact, the formal investment response has been disappointing. Russia is gradually coming to the bottom of the list of the countries with favorable investment climate (but could be the top among the most risky for business) though to change the situation a miracle is not required, it is necessary to show political will and follow consistent investment policy.

Present situation provides all necessary conditions to create favorable investment climate at sub-federal level and even can offer examples of positive effect of the regional<sup>1</sup> governments' efforts. The objective of the present document is to study and analyze the regional experience in order to improve enabling business environment in the country in general.

**Scope of the document** – to describe the abilities of the regional government to influence an investment climate in their regions, problems faced in that process and to give several examples of such regions. Obviously, not all the opportunities arising in the regions could be transferred to the federal level, though in general the methods of improving enabling business environment and creation of positive image of the territory are more or less the same.

Besides, the study shall enable foreign investors to avoid problems and hidden rocks they would inevitably face while investing in Russia.

**Structure of the document.** The document contains three chapters. The first chapter describes the abilities of the regional governments to influence the investment climate and unavoidable problems faced while improving business environment. The second chapter offers methods for analysis of investment opportunities at the sub-federal level, and finally, the third chapter contains the examples of several regions.

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<sup>1</sup> Hereinafter "region" is referred to as sub-national jurisdiction.

# 1. METHODS FOR IMPROVEMENT OF THE INVESTMENT CLIMATE AT SUB-FEDERAL LEVEL

## 1.1. Ability of the Regional Government to Influence the Enabling Environment for Investment at Sub-Federal Level in the Russian Federation.

It has been a traditionally accepted concept, that investment climate in the region can not be more favorable than the investment climate in the country in general. Another widely noted view is that opportunities for the regions to improve enabling business environment are restricted and limited to the standard set of tax incentives. But in our opinion, both approaches require additional comments.

Russia is a Federal state and although its legislation framework is far from perfection, its Constitution clearly states major principals of the public law (it is a separate issue that not all of them are implemented if we take the cases of discrimination between different agents of the Federation).

Division of authorities between the Federal and Sub-Federal levels of the Government is regulated and based foremost on the Constitution of the RF (Article 3 “Federal Structure”) and other regulations and legislative acts. But due to rather declarative structure of the Federal legislation the division of authority is not clearly determined which causes major problems. It resulted in “sovereignty’s parade” in 1991 – 1993 when many regions (mainly national republics) concluded with the Federal Government agreements on the division of the subjects of labor which resulted in rather unequal rights for different regions.

Uncertainty in their authority makes the region pass the laws which are rather contradictory to the Federal regulations (an example relevant to the land and real estate issues will be given later) on the one hand, and on the other hand “freeze” the regulations so not to conflict with the Federal law.

Non the less, the principal of the government cognizance is recognized and the regions are given the practical opportunities to influence their investment climate. We can list the following opportunities of the kind:

***Sub-National and Regional Regulation.*** It is generally known that there are areas where the sub-national jurisdictions can create their own policy. That could be both interpretations and implementations of Federal laws as well as internal regulations on the issues regulated at sub-federal level. Sub-national administrations often have significant influence in this respect which practical aspect will be analyzed henceforward. The system of regional regulations shall be characterized as follows:

- a. ***Straightforward and Complete.*** Legislative framework should be absolutely clear and complete. Regulations on the issues solved at sub-federal level should not give chances for different interpretations. Existing "white spots" in regulations can give rise to different interpretations (which is possible considering general character of the Federal legislation). Any legislative act should not only describe the regulations but guarantee the mechanisms for its enforcement.
- b. ***Stability.*** Regional legislation should be guaranteed from rapid changes. Introduction of new regulations or amendments and changes in the existing one should be strictly regulated and stipulate a time-gap between the issuing of the possible amendments and/or changes and its coming into effect. The possibility to introduce undated changes in the laws should be eliminated.

- c. Coherence at macro and micro levels . Federal legislation should not be violated by the regulations of the regional government. Special attention should be given to the principal issues relating to acquisition of land and real estate, tax incentives, registration and licensing. Otherwise, regional regulations can not be exercised without been persecuted by the Federal authorities.
- d. Available and transparent . Regional regulations should be available to any interested parties, developed with maximum transparency and, whenever possible, with participation of the non-government organizations and public institutions.
- e. Consistent . Regulations should be consistent and nether get in contradiction with each other.
- f. Simple direct regulations. It is of the special importance in relation with the investment activity for today most of Federal and Sub-Federal investment regulations require from investor a great number of unavoidable additional agreements and negotiations on certain matters with Government authorities (for instance if we take the Federal Law "On Agreements on product distribution"). This should be as much as possible avoided at the regional level through introduction of direct regulations..

**Government Policy.** There is not a single region in Russia where the Government is not aware of the significance of investments in the development of the economy. More that that, the Governors of the regions declare their pro-business orientation and eagerness to create favorable investment environment, but unfortunately hardly succeed in encouraging new investments. In our opinion, sub-federal policy shall comply with the following principles:

- a. Complex approach. There is a strong belief that Sub-federal governments' investment policy implies only passing the Law "On investment activities" and granting tax incentives, but that is a serious mistake. It is IMPOSSIBLE to improve investment environment without solving a whole series of problems. Some of them will be described further. The complete list of tasks and main trends in complex approach to development of enabling environment at sub-federal level is given see the picture 1.
- b. Coordination and partnership . Regional Government Policy shall be closely coordinated within itself and with the local governments. There are examples when the regional Duma is in conflict with the Governor who is in his turn is at odds with the Mayor. The fact which if fatal for favorable investment climate. Pro-business oriented policy can be developed and implemented only when considering mutual interests and having the same mission.
- c. Stability. Policy of the regional Government shall be consistent and predictable. It gives investors the possibility to plan their activities and the guaranties for the future..
- d. Orientation for mutual results. The regional government faces a whole series of problems which require financial income (tax revenue). But it is impossible to receive more tax without increase in the taxable property which in its turn requires favorable climate for its growth. Sub-federal government should not yield to the temptation to solve its problems at the expense of a couple of investors imposing several additional taxes for development and maintenance of the infrastructure (technical and social) which leads to nowhere, but to understand the investor who is interested in profit which is of the only importance to him. The ability of the regional government to assist the investor with getting the maximum profit possible naturally result in solving some of the problems of the region (through the increase in the tax revenue).

**Picture 1. Main Trends in Complex Approach to Development of Enabling Environment for Investment at Sub-Federal Level.**

<p><b>Small and medium-sized enterprise sector policy</b></p> <ul style="list-style-type: none"> <li>• development of infrastructure supporting SME;</li> <li>• legislation supportive of SME;</li> <li>• incentives to the institutions and NGOs supporting SME;</li> <li>• direct support of SME through crediting or placing regional orders;</li> <li>• participation of SME associations in development of regional policy;</li> </ul>	<p><b>Infrastructure policy:</b></p> <ul style="list-style-type: none"> <li>• development of infrastructure through direct investments and rating policy;</li> <li>• development of "industrial zones" - green sites with engineering infrastructure;</li> <li>• development of high-tech infrastructure - communications, etc.</li> </ul>	<p><b>Educational policy:</b></p> <ul style="list-style-type: none"> <li>• development of multi-level educational system;</li> <li>• introduction of market economy adaptation programs.</li> </ul>	
<p><b>COMPLEX APPROACH TO DEVELOPMENT OF ENABLING ENVIRONMENT FOR INVESTMENTS AT SUB-FEDERAL LEVEL</b></p>			<p><b>Public institutions policy:</b></p> <ul style="list-style-type: none"> <li>• development of the local self-governance;</li> <li>• development of neighborhood associations ;</li> <li>• development of non-profit NGOs through placement regional orders.</li> </ul>
<p><b>Foreign investment policy:</b></p> <ul style="list-style-type: none"> <li>• development of investment legislative framework ;</li> <li>• regional promotional programs;</li> <li>• system allowing to deal with the administrative barriers.</li> </ul>	<p><b>Land ownership policy:</b></p> <ul style="list-style-type: none"> <li>• regulations on land ownership issues within the regional government jurisdiction;</li> <li>• automatic cadaster systems (GIS);</li> <li>• selling the bankrupt companies' fixed assets as industrial sites to the investors;</li> <li>• real estate auctions;</li> <li>• real estate tax.</li> </ul>	<p><b>Public utilities policy :</b></p> <ul style="list-style-type: none"> <li>• public utilities reform aiming to reduce the costs of services;</li> <li>• suspension of budgetary subsidies for the facilities with simultaneous introduction of resources-economy technologies and precise calculation of costs ;</li> <li>• competition between the suppliers of public utilities .</li> </ul>	



It is essential to understand the difference between **the policy of the Sub-Federal Governments in the regions of the RF aiming to reduce the risks and expenses for the investor in a legal way** and the **actions to improve their positive image through solving certain “hot” investor’s problems by any means**.

To explain this difference it is necessary to illustrate the possible measures of Sub-Federal government in such situation when the Federal legislation is changed in unfavorable for the investors manner.

In 1997 Federal Government unexpectedly increased the amount of the tax paid to the Federal road-fund. Investors who already started to implement their projects in Russia had to recalculate their business-plans. Novgorod Region Government established open and legal procedure of return to the investors from the regional budget the money paid in order to solve this problem. Thereby the investors operating in Novgorod region has been reimbursed their losses and neither Law has been violated.

On the first of January 2000 the Amendments to the first part of the Tax Code has come into force which deprived the regions (as well as the cities) the right to grant incentives on the profit tax. Non the less, some regions kept this incentive at their territory for it gave them certain advantages over other regions in investors’ opinion. It is possible, that the regional government using their authority can block the activities of the Federal tax office regarding this tax at their territory. But it should be taken into account that the tax offence do not have statute of limitation and one day investor can receive large-scale bill for applying this incentive.

So the investor should clearly understand, that not everything offered by the Sub-Federal Governments is legal and advantageous. In our opinion, the best decision for such situation is to apply to local consultants, such as International Foundation for Strategic Initiatives.

***Incentives and Guarantees.*** It is obvious that incentives is not the only mechanism to improve business environment. But the importance of that factor should not be underestimated. Experts as well as the businessmen list excessive tax burden among the major negative factors influencing business development. In this respect, incentives and guarantees should be based on the following fundamentals:

- a. *Incentives should be granted on any of the development project without exceptions* Incentives regarding direct tax (payable to the regional and local budgets) for such projects should be 100% for the complete pay-back period.
- b. *Mechanisms of granting tax incentives should be stipulated by the direct regulations (where possible).* Otherwise the procedure should be simple and clear.
- c. *Methods for calculations of the project pay-back period* shall be easily understood by the investors and simple in use.

It is also possible to provide the return of the part of the tax payable to the federal budget (federal part of the profit tax), payments to the federal road-users tax, and the payments which are out of the sub-federal jurisdiction (part of the profit tax and VAT entered in the regional and local budget accounts). It is also quite reasonable to grant incentives to the organizations dealing with the development of the business enabling infrastructure and business monitoring.

Competently and effectively exercising the rights for incentives the venture can avoid paying of 2/3 of the total amount of the taxes due during the period of the project implementation. The example with the company "Dandy"<sup>2</sup> implementing investment projects in Novgorod re-

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<sup>2</sup> Company from Denmark, trademarks " Stimorol", "Dirol", "v6"

gion shows, that the total cost of the project was reduced down to 40% and the pay-back period to 1/3 of the estimated. (See the picture 2.)

Guarantees also constitute an important mechanism encouraging new investments. Speaking about guarantees we should mention not only direct financial guarantees of the regional government (which are usually hardly liquid and strictly limited) but the following guarantees:

- Guarantee of unchangeable regional regulations relevant to the project implementation existing at the date of the beginning of the project implementation; which means that if the changes or amendments influencing the investment climate for worse are introduced in the regional legislative framework, they are not applied to the project until its paid-back date and two years after complete return of the investment;
- Guarantees, allowing to balance possible toughening of the Federal legislative framework. Those guarantees are usually not stated in the regulations but reflected in the regional Government policy. Compensation to the investors, paid by the Government of the Novgorod region from the regional road fund when the amount of the Federal road tax has been increased can be an illustrative example of such guarantee..

**Land and Real Estate. Land ownership is one of the "hottest" issue of the existing legislation.** The common approach is that the issue is of the extreme importance to the inflow of the foreign investments to the Russian economy, but we don't share this opinion. The problem is not either to allow or not the land ownership (especially considering certain steps to bypass the blockage of this issue). The question for the moment is WHAT and HOW to sell.

To begin with, it seems necessary to point out, that regulation of the land ownership issue at sub-federal and local level is limited by one essential condition – neither the subjects of the RF nor the local government own any land. In fact, all the land belongs to the Federal government (State) and only insignificant plots – to the private persons (houses, country cabins, garages, etc) and certain privatized ventures.

The problem is complicated by the Federal Government which occasionally passes regulations on land ownership issues in order to organize it but in fact only making the whole situation even more confused. For instance, according to the President's of the RF Decree <sup>1</sup> 1263 of 26.11.97 and . the Government of the RF Decree <sup>1</sup> 2 <sup>2</sup> 05.01.1998 it became possible to sell and lease the spare plots in the city for the long-term rent through the auctions. The mentioned above documents provide detailed description of the auction procedure. But it will become possible to use it in practice not earlier then the regions and local governments has the property-right for the land.

In addition to that, to transfer the land ownership to the Sub-Federal and Local Government is not as easy as it seems to be. To pass the Land code is only the minor part of the task for it requires long detailed work on description of the plots and establishing of the appraisal methods.

**Picture 2. Possibilities to Apply Tax Incentives at Sub-Federal and Local Levels (Example of Novgorod Region and the City of Veliky Novgorod)**

*Tax incentives .*

<b>Tax - exemptions granted at the regional level</b>	<b>Tax - exemptions granted at the city level</b>
1. Property tax. 40% of calculated property tax	1. Property tax. 60% of calculated property tax
2. VAT. 13.5% of calculated tax payment for newly established entities	2. VAT. 1.5% of the calculated payment
3. Tax for purchase of transport vehicles. Entirely tax-exempt	3. Social/cultural objects and housing maintenance tax. Entirely tax-exempt
4. Tax for owners of transport vehicles. Entirely tax-exempt	4. Rent payments. 70%
5. Tax for road users. 1,75% of 2,5% of sales value	5. Land tax. 50% of calculated payments
	6. Public security and education needs fee (regional). Entirely tax-exempt
	7. Advertisement tax. Entirely tax-exempt

*Approximate calculation of the pay-back period for the venture*

<b>Project parameter</b>	<b>Values (mln. rubles)</b>		
	<i>Ordinary terms</i>	<i>Including tax exemption (prior 01.01.2000)</i>	<i>Including tax exemption (after 01.01.2000)</i>
1. Investments	100	100	100
2. Annual sales (exl. VAT)	200	200	200
3. Costs of goods sold	135	135	135
4. Gross margin	65	65	65
5. Salary and wages (400 people * 18 000 rubles)	7.2	7.2	7.2
6. Depreciation	5	5	5
7. Taxes and duties	12.860	4.293	4.293
8. Profit	39.940	48.507	48.507
9. Profit tax	11.982	5.336	14.552
10. Profit after tax	27.958	43.171	33.955
11. Vat part compensation	-	1.950	1.950
12. Net profit	27.958	45.121	35.905
13. Cash flow	32.958	50.121	40.905
<b>14. Payback period (months)</b>	<b>37</b>	<b>24</b>	<b>31</b>

<i>Budgetary payments</i>				
<b>Tax/Duty</b>	<b>Taxable base, tax-rate</b>	<b>Total payments due, rubles</b>	<b>Tax exemptions</b>	
			<b>Regional budget, inclusively rubles</b>	<b>City budget, inclusively rubles</b>
1. Property tax	2% of Assets Value	2000	800	1200
2. Social/cultural objects & housing maintenance tax	1.5% of sales	3000		3000
3. Land rent	Size \$ location of land size	70		70
4. Public security/education needs duty (Regional level)	3% of annual payroll fund based on minimum salary	18		18
5. Advertisement tax	5% of advertisement price			Tax-exempt
<b>Total budgetary payments</b>		<b>5088</b>	<b>800</b>	<b>4267</b>
<b>Tax-exemption</b>				<b>5067</b>
<i>Non-Budgetary Taxes/Funds</i>				
<b>1. Road funds</b>				
1.1. Motor users tax (for enterprise only).	2,5% of sales	5000		3500
1.2. Transport vehicle purchase tax	Actual sales price, differential rates			Tax-exempt
1.3. Tax for transport vehicles owners	Engine power & type, differential rates			Tax-exempt
<b>Total (road funds)</b>		<b>5000</b>		<b>3500</b>
<b>Total budgetary payments and road funds</b>		<b>10088</b>		
<b>Tax exemption</b>				<b>8567</b>
<b>2. Insurance fees calculated on basis of payroll fund (extra-budgetary funds)</b>	38,5% of payroll fund	2772		
<b>Total taxes &amp; duties</b>		<b>12860</b>		
<b>Tax-exemption</b>				<b>8567</b>

Considering all of the above, it seems necessary to warn the investor against the state of euphoria relevant to the possibility to apply to the land ownership legislation existing in Samara and Saratov regions. In fact, both regions has passed thoughtless regulations in order to improve their investment image, but both do not possess the land which is the subject of this regulation which is so any deal executed in accordance with such laws **COULD BE DECLARED INVALID ANY MOMENT**.

Here we would like to mention the necessity of detailed methods for description of plots and appraisal of land and mechanism regulating the procedure of sale. In fact, regional and local governments should develop geo-information systems containing all information relevant to the plots, land cadastres, entrails cadastres, water cadastres, real estate register, city construction regulations. It is necessary to subdivide the territory of the region into legislation zones allowing to verify the tax and payments rates and prices for plots. The region Governments should be more persistent introducing the real estate tax in their jurisdiction. Introduction of this tax shall exclude technological equipment from the taxable property of the venture and stimulate modernization and development of production facilities (Novgorod and Tver regions are making significant efforts to impose real estate tax).

As a result of the crisis, every region has a great number of vacant industrial sites which could be offered to the investors to place their projects.<sup>3</sup> To be able offer it to the investors, regional Governments must submit all necessary relevant information in the appropriate form.

Such system is a practical tool to develop land and real estate market , determine the prices and to monitor and regulate the situation there. It is another efficient step on the way to satisfy the investors on the land ownership issue.

***Administrative Procedures and Projects Monitoring.*** We would like to emphasize the fact, that while incentives, including tax incentives, can impact favorably on the company's profit, they are not the sole determining factor for the companies when choosing an investment location. More important is the overall business climate, the level of so-operation with the local administration, committees and facilities. Investors are less concerned with the existing tax systems, but the administrative procedures and steps required to complete the investment approval and business establishment process. Most of them agree to pay taxes according to the existing rates but you can hardly find one who is ready to undergo equipment import procedure ever again.

There is no doubt, that the existence of the majority of the administrative barriers is caused by inconsistent implementation and interpretation of Federal law, but pro-business oriented sub-federal Governments can have significant influence on the interpretation of Federal level policies and thus reduce the existing barriers.

For instance, in Novgorod region every investment project is given a governor deputy- supervisor to monitor the project at all the stages. This supervisor is authorized to call for a "round-table" meeting of the investor with the representatives of local administration, committees and facilities in order to clarify all difficult issues and guarantee mutual interests of the parties.

Besides, analysis of government requirements relevant to licensing and business establishment procedures shows that most regulation of investment activity is carried out by sub-federal or local offices. Detailed regulations on such issues allow to reduce administrative barriers arising here.

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<sup>3</sup> The experience of the Foundation and the Agency shows that it is not the best practice for the price for the adaptation of the Russian production facilities to the western technologies is much higher than for the construction of a new plant at the "green site" . Existing facilities, after been reconstructed (which require additional investments) could operate as incubators or techno- parks for small businesses.

For the future, it seems reasonable to introduce "one window shopping" modality for project implementation, when the investor has to apply to only one institution or non-government organization with any problem arising no matter if it is officially solved at Federal, sub-national or local level.<sup>4</sup>

**Region Promotion Program.** Providing enabling business environment is not enough to stimulate significant inflow of investment capital. It is necessary to disseminate sufficient information on it.

It is not enough to implement some of the recommendations stated above and to announce the region as "providing favorable investment climate" without having firm evidence to it. Of course, the best prove is the increase in the investment inflow, but to come to the region investors should be sure that it can really satisfy their requirements.

That makes it necessary to develop and implement the region promotion program informing potential investors at most on the business environment in the region. Here one have always to follow the fundamental rule: **EVERYTHING EVER PROMISED TO THE INVESTOR SHOULD BE ALWAYS DONE NO MATTER IF THE REGION HAS TO SUFFER CERTAIN LOSS TO FULFIL ITS COMMITMENTS**. Otherwise the image of the region is practically ruined. If we recall the example with the Government of Krasnodarsky Kraj and "Knauf" concern we understand that no matter that the Government do in the future to attract investors, it is almost impossible to regain investor confidence.

The company "Knauf" purchased the major share in the company "Kubansky gips" in Krasnodarsky Kaji, reconstructed production facilities and installed new equipment. After that the company's management increased the company's stock so "Knauf" lost control over it. Sub-Federal Government and Regional Court of Justice (influenced by Sub-Federal Government) supported the measures of the company's management (though against the law).

## **2.2. Limitations and Bans Set for Development of Investment Enabling Environment at Sub-Federal Level.**

As it has already been stated, sub-national administrations have significant influence on the improvement of investment environment. But the steps they can take to improve business climate are possible only to the maximum extent allowed within the legal framework of the Russian Federation and often limited by a number of factors. Structuring those factors we can see the following:

**Internal factors:** (factors existing in the region itself). Region creating opportunities for investors inevitably faces lack of resources, such as:

- financial (we already mentioned the vital necessity of finance for solving a whole number of problems including improvement of enabling environment for investment);
- human resources (here we speak about professional staff for today many investors has to operate training centers for their employees despite of general excess of human resources);
- information;
- infrastructure (undeveloped technical infrastructure, business enabling environment, engineering networks, etc.) ;

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<sup>4</sup> This is how the Foundation and the Agency operate.

- time allowed.

**External factors** (circumstances out of the control of sub-national jurisdictions) It seems necessary to describe the following external factors:

Legislative collisions:

- insufficient Federal legal framework, poor enforcement of rights and obligations resulting in existence of "white spots". For instance, Federal Law "On Foreign Investments in the Russian Federation" stipulates registration of the companies with foreign capital by the state justice authorities in accordance with the Law "On State registration of the legal entities". However the mentioned above Law has not yet been passed by the Government so the companies with the charter capital less than 100 000 roubles are registered in accordance with the previously existing order which has been abrogated so we can say that the sub-federal governments registering the companies practically violate the Law.;
- the problem of inconsistent implementation and interpretation of federal laws and regulations is also a recurring theme. For instance, change in the first part of the "Tax Code" and the Law "On profit ..." caused confusion. Practically, changes disabled sub-federal governments of the right to provide profit tax relief on the share paid to the local budget though it has never been stated directly and some of the regional administrations continue granting this exemption. But one should remember that Federal offices (including Tax Ministry) consider this relief illegal and the investors, not the regions who exercise this exemption could suffer.;
- finally, some of the regions pass special laws on the issues omitted on the Federal level trying to bypass the blockage of such issues. Such an example give laws regarding land ownership in Samara and Samara region. Today many companies purchase land on terms stipulated by these regulations, but in the nearest future all those deals could be cancelled in accordance with the introduced into practice "Land Code".

Unfavorable macro economy and political situation in the country in general

Current political situation in the country does not contribute to the success of the regions in improving their investment climate. In fact, all positive results the regions accomplished in encouraging new investments are not stimulated by the Federal policy, but done despite of it.

**1.3. Summary.**

Investment climate is influenced by a whole series of factors. All those factors will be described in details in the next chapter. Some of them are permanent (or almost invariable). But despite the existence of such factors, sub-federal governments often have significant influence to create favorable investment climate.

On his side the investor should be very careful evaluating investment environment in the region where he is going to implement his investment project. It seems reasonable to contact experts who have experience of working in Russia for that purpose..

Among such companies we can mention International Foundation For Strategic initiatives who organize the business of foreign companies in Russia on "one-window" bases. In other words, the Foundation organizes the activities of his clients' at all the stages of the project implementation following all the requirements of the existing legislation. Practically, the Foundation reduces the risks and business costs in Russia for its clients.

When evaluating investment environment himself, the investor should pay special attention to the following:

- existence in the regional legislation of the acts conflicting with the Federal regulations;
- good-will of the regional Government to develop enabling investment environment (and not to increase their own political capital);
- property disputes and conflicts relevant to infringe upon shareholders' rights in the region;
- positive experience in attracting foreign investments

## **2. METHODS FOR ANALYSIS OF INVESTMENT CLIMATE AT SUB-FEDERAL LEVEL**

It is necessary to point out that the further described methods are developed only for the purpose of the present analysis. It, probably, would not provide complex description of the region investment potential but will signify the most prominent characteristics of the investment climate at sub-federal level.

### **2.1. Factors, Effecting Investment Climate at Sub-Federal Level**

As it has already been stated, investment climate is influence by a whole series of factors. All of those factors are considered by investor when choosing investment location. (Appendix 2).

Considering the possibility to influence such factors they could be subdivided as follows::

#### ***Permanent factors :***

- geographical location (position of the region related to the main markets and resources);
- natural resources.

#### ***Gradually changing factors :***

- ecological environment in the region;
- availability of qualified human resources ;
- availability and development of transport infrastructure (railway, highways, ports, airports);
- availability and development of engineering infrastructure (facilities, gas, electric power);
- economic situation in the region;
- availability and development of communication lines.

#### ***Rapidly changing factors:***

- regional legislative framework (general situation, incentives and guarantees, enforcement );
- policy of sub-federal government towards investors ;
- administrative barriers ;
- technical infrastructure and enabling environment.

Study and analysis of these factors can monitor investment climate in the region in general. Here the special attention should be given to rapidly changing factors, for influencing them one can receive almost immediate outcome which inevitably results in gradual change of other factors.



## **Criteria for Ranking the Regions According to their Investment Climate**

### **LOCATION AND AVAILABILITY**

- ◆ distance to the major markets ;
- ◆ availability of raw materials and human resources;
- ◆ development of transport infrastructure (highways, preferably international, and railways) ;
- ◆ easy access to main ports, terminals, airports.

### **TRANSPORT AND ENGINEERING INFRASTRUCTURE**

- ◆ availability of international airport, port;
- ◆ developed transportation networks;
- ◆ companies, providing transport services;
- ◆ "green-sites" with developed engineering infrastructure;
- ◆ facilities, gas and electric power nets ;
- ◆ developed communications system (information and communication networks, fiber optic lines, satellite communications)

### **BUSINESS ENABLING ENVIRONEMNT**

- ◆ special institutions and NGOs providing information support and project monitoring;
- ◆ availability of customs services in the region;
- ◆ SME supportive infrastructure.

### **SOCIAL, POLITICAL AND ECOLOGICAL ENVIRONMENT**

- ◆ Political stability in the region ;
- ◆ Qualified human resources;
- ◆ Favorable ecological environment.

### **LEGISLATION**

- ◆ Stability in the regulations (legislative framework for the investment process);
- ◆ Guarantees against worsening of the conditions for business of operating companies;
- ◆ Land ownership right guaranteed by the Law;
- ◆ Tax regime stimulating investments (tax incentives);
- ◆ "transparency" and availability of the legislation .

## 2.2. Methods for Evaluation of Separate Factors Affecting Investment Climate.

Thus, we pay special attention to the analysis of rapidly changing factors. Here we would like to point out legal framework and policy of sub-national government as primary factors, for others to a certain extent are derived from those two.

Methods developed by International Foundation for Strategic Initiatives has been applied for the analysis of Sub-Federal legislation in different regions. Experts' evaluations of the listed below criteria has constructed the core of the analysis:

- Coherence of regulations with the main concepts of legislation implying supreme power of Constitution, federalism, territorial division, equal rights, etc. (**Coherence criterion**).
- Consistency and systematic character This criterion characterizes consistency of the legislation and existence of the "white spots" in the regional investment. (**Consistency criterion**)
- Availability This criterion describes the possibility to access the information on regulations, number of information sources, etc. (**Availability criterion**).
- Correspondence with the mission and scope, of the regulations. The mission of the legal framework is to improve investment climate and provide business enabling environment (**Scope criterion**).
- Enforcement Existence within the legislative framework procedures and methods relevant to its enforcement. (**Enforcement criterion**).
- Systematic character. This criterion characterizes systematic character in practical application of regulations. (**Currency criterion**)
- Efficiency of the incentives offered. Quantity and quality of the incentives and relieves offered to the investors and its duration. (**Efficiency criterion**).
- Existence of guarantees for regulations enforcement. Existence in legislative system of the guarantees for enforcement of its regulations and procedures for adaptation of those guarantees. (**Guarantees criterion**).
- Liability for violation of regulations. Existence in legislative system penalties for violation of legislative acts. (**Liability criterion**).
- Duration. Time-period, stipulated for the validity of regulation. (**Duration criterion**).

This document contains only general results and conclusions of this analysis. For additional information on the analysis and its methods you can contact IFSI representatives.

Consistence in the policy of the regional government is to be taken into account speaking about the political aspect of the investment climate. We also advise to analyze "Government policy" and "Administrative barriers" in close coherence and consider influence produced by such policy on those barriers.

## 2.3. Summary. Scheduler for the Analysis of Investment Climate at Sub-Federal Level.

Investment climate of several regions will be analyzed according to the following scheduler::

**General information.**

**Appraisal of certain factors affecting investment climate:**

- permanent factors ;
- slowly changing factors ;
- rapidly changing factors .

**Summary.**

Recommendations to the investors and regional government will be given as the result of the study for every separate every region as well as non-formal investment climate rating.

### 3. ANALYSIS OF INVESTMENT CLIMATE IN SEVERAL REGIONS OF RUSSIA

#### 3.1. Background of the Region Selection

Four regions have been selected for the investment climate analysis. The main choice principle, we tried to adhere to whenever possible, was the identity (or maximum proximity) of invariable factors in all the selected regions. Choice results are submitted in the table below:

Region	Choice principle
Leningrad region	These regions were selected due to their success in attracting investments.
Novgorod region	
Pskov region	This region is known for its hostile attitude (though in lesser degree than in Krasnodar region) towards investors.
Komi republic	This region was chosen due to the existing need to analyze the investment climate of the territory rich in natural resources..

#### 3.2. Analysis of the Investment Climate in Leningrad Region.

**General information.** Leningrad region is located to the North-West of the Russian Federation. It has the area of 85,9 thousand km<sup>2</sup>, population – around 1600 thousand people. The administrative center – the city of Saint Petersburg – is not included in the region. The region borders on Finland, Estonia, Karelia, Pskv region, Novgorod and Vologda regions.

#### *Appraisal of the factors affecting investment climate.*

##### Permanent factors:

<ul style="list-style-type: none"> <li>geographical location, (location of the region related to the main markets and resources);</li> </ul>	<p>Leningrad region location has considerable advantages. Main Russian markets (Moscow, Saint Petersburg) and Western markets (Finland, EC) are located in direct proximity.</p> <p>This factor can be listed among favorable conditions for creating auspicious investment climate. (Appendix 1b).</p>
<ul style="list-style-type: none"> <li>natural resources.</li> </ul>	<p>The region is not rich in natural resources. There are peat, bauxite and mineral fuel deposits. It has large timber resources.</p> <p>The effect of this factor can be characterized as neutral.</p>

##### Gradually changing factors:

<ul style="list-style-type: none"> <li>ecological environment</li> </ul>	<p>Ecological environment pollution is caused by the existence of large petrochemical companies, pulp and paper industry, nuclear power plant and the proximity of Saint Petersburg. However, ecological environment in many parts of the region can be described as propi-</p>
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	<p>tious.</p> <p>The effect of this factor can be characterized as neutral.</p>
<ul style="list-style-type: none"> <li>• availability of human resources;</li> </ul>	<p>There are human resources in the region in adequate number. The problem is the lack of qualification and low mobility of human resources (human resources are located in several administrative centers of the region). However, human resources of Saint Petersburg (top management particularly) can be used.</p> <p>The effect of this factor can be characterized as neutral.</p>
<ul style="list-style-type: none"> <li>• availability of transport (railway lines, highways, ports, airports);</li> </ul>	<p>There is a developed network of railway lines and highways and the infrastructure of Saint Petersburg port to be used.</p> <p>The effect of this factor can be characterized as favorable.</p>

Rapidly changing factors:

<ul style="list-style-type: none"> <li>• regional regulations (general situation, incentives and guarantees, enforcement procedures);</li> </ul>	<p>According to the experts' analysis (Appendix 1à) Leningrad region investment regulations framework can be characterized as enabling. System of incentives and guarantees is favorable for investors. There are only two negative factors that should be pointed out:</p> <ul style="list-style-type: none"> <li>▪ guarantees are in direct dependence on investment amount;</li> <li>▪ granting the profit tax incentive is in direct conflict with the act of federal law.</li> </ul> <p>The overall effect of this factor can be characterized as favorable.</p>
<ul style="list-style-type: none"> <li>• local administration investment policy (existence and degree of administrative barriers to investment)</li> </ul>	<p>Majority of investors find the policy of regional administration successful in attracting investments. The mission of this policy is to solve the problems and reduce the administrative barriers the investor faces (investment projects monitoring by the regional administration is widely used). Apart from this, Leningrad region administration proved that their investment policy is continuous and is not influenced by the change of the governor, which produced a favorable effect on the region image.</p> <p>The effect of this factor can be characterized as highly favorable.</p>
<ul style="list-style-type: none"> <li>• technical infrastructure and enabling environment.</li> </ul>	<p>Leningrad region utilizes Saint Petersburg technical infrastructure and enabling environment.</p> <p>The effect of this factor can be characterized as favorable..</p>

*Summary.*

Thus, investment climate in Leningrad region can be evaluated as **favorable**. This fact is illustrated by the statistics on the increase in the investments inflow (Appendix 1c).

**Investor** should pay attention to the existence in the regional legislation of the regulations conflicting with the Federal legislative act, especially the ones relevant to the profit taxation. OECD would advise the investors to avoid applying those incentives till the issue is passed at the Federal level. Non he less, Sub-Federal Government proves being very open and understanding towards the investors. Several property disputes relevant to the ownership rights (Lomonosov china factory, Viborg pulp and paper factory) has been resolved in a civilized manner.

In this connection, the region could be advised to eliminate in the Sub-Federal legislation the inconsistency with the Federal legislation.

### 3.3. Analysis of the Investment Climate in the Novgorod Region.

**General facts.** Novgorod region is located to the North-West of the Russian Federation, at the crossroad between Moscow and Saint Petersburg. It has the area of 55,3 thousand km<sup>2</sup>, population – around 753 thousand people. The administrative center – the city of Novgorod Velikii (240 thousand people). The region borders on Leningrad, Tver, Pskov, Vologda regions.

#### *Appraisal of the factors affecting investment climate.*

##### Permanent factors:

<ul style="list-style-type: none"> <li>geographical location, (location of the region related to the main markets and resources);</li> </ul>	<p>Novgorod region location has considerable advantages. Main Russian markets (Moscow, Saint Petersburg) are located in direct proximity.</p> <p>This factor can be listed among favorable for creating auspicious investment climate. (Appendix 2b).</p>
<ul style="list-style-type: none"> <li>natural resources.</li> </ul>	<p>The region is not rich in natural resources. There are peat, quartz sand and clay deposits. It has large timber resources.</p> <p>The effect of this factor can be characterized as less favorable.</p>

##### Gradually changing factors:

<ul style="list-style-type: none"> <li>ecological environment</li> </ul>	<p>Ecological environment of the whole region can be described as favorable (in several parts of the region ecological environment provides for the development of recreation and tourism facilities).</p> <p>On the whole the effect of this factor can be characterized as neutral.</p>
<ul style="list-style-type: none"> <li>availability of human resources;</li> </ul>	<p>There are human resources in the region in adequate number. They are mainly located in the major cities. The level of professional skill is not very high (fifteen years ago 70 per cent of industrial enterprises in Novgorod Velikiy (“Novgorod” back then) were radio-electronic companies. If you chose a random per-</p>

	<p>son in the street back then and ask about the different in various radio-electronic transmission signals you would be given an expert opinion. These people never left Novorod. But when the company “Dansk Tyggegummi Fabrik” (Dirol and Stimorol brand) started the plant construction in Novgorod it had to open the training center.</p> <p>The effect of this factor can be characterized as neutral.</p>
<ul style="list-style-type: none"> <li>• availability of the transport (railway lines, highways, ports, airports);</li> </ul>	<p>The region is connected with Moscow and Saint Petersburg by railway lines and highways, the infrastructure of Saint Petersburg port can be used. In summer Novgorod can be reached by water (by sea and river ships with displacement tonnage up to 2000 tons).</p> <p>The effect of this factor can be characterized as very favorable.</p>

Rapidly changing factors:

<ul style="list-style-type: none"> <li>• regional regulations (general situation, incentives and guarantees, enforcement procedures);</li> </ul>	<p>Novgorod region investment regulations framework can be characterized as enabling and can be applied as a model for investment regulations development in other regions. System of incentives and guarantees is favorable for investors. Novgorod legislation is highly efficient.</p> <p>The Federal Law “On experimental real estate taxation...” exercised in Novgorod region is a unique example for Russian Legislation.</p> <p>The effect of this factor can be characterized as very favorable</p>
<ul style="list-style-type: none"> <li>• regional administration investment policy (existence and degree of administrative barriers to investments) ;</li> </ul>	<p>Novgorod administration investment policy is complex and well balanced. Legislative and executive authorities investment policies as well as the investment policies of regional and city administrations are closely coordinated.</p> <p>Investment project monitoring with the purpose of removing administrative barriers as well as meetings of the investors with the representatives of all the administrative bodies related to investment issues settlement is employed.</p> <p>Regional Administration is engaged in development of geo-information systems and data bases meant to provide relevant information to the investors.</p> <p>The effect of this factor can be estimated as encouraging business development.</p>
<ul style="list-style-type: none"> <li>• technical infrastructure and enabling environment;</li> </ul>	<p>The technical infrastructure and enabling environment are being constantly developed (special attention being paid to the support of small and medium enterprises).</p>

	<p>In view of the considerable amount of work which was carried out in Novgorod region and the city of Novgorod Velikij and implying all the experience gained there the Agency for Development and Investments Promotion was founded.</p> <p>The effect of this factor can be characterized as favorable.</p>
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**Summary.**

Investment climate in Novgorod region can be evaluated as **rather favorable**. Many investors share this opinion (Appendix 2ñ).

The region is convenient for the **investors**. Regional authorities in all possible ways support the growth of investment activity in the region.

**Regional government** could be recommended to consider return of the part of the profit tax paid to the regional budget (similarly to the return of the part of the VAT).

**3.4. Analysis of the Investment Climate in the Pskov Region.**

**General facts.** Pskov region is located to the North-West of the Russian Federation, at the Western border. It has the area of 55,3 thousand km<sup>2</sup>, population – around 847 thousand people. The administrative center – the city of Pskov (250 thousand people). The region borders on Estonia, Latvia, Byelorussia and Leningrad, Tver, Vologda regions.

**Appraisal of the factors affecting investment climate.**

Permanent factors:

<ul style="list-style-type: none"> <li>geographical location, (location of the region related to the main markets and resources);</li> </ul>	<p>The region location has considerable advantages. Foreign markets and Saint Petersburg market are located in direct proximity.</p> <p>This factor can be listed among the favorable for creating auspicious investment climate. (Appendix 3b).</p>
<ul style="list-style-type: none"> <li>natural resources</li> </ul>	<p>The region is not rich in natural resources. It has peat deposits and timber resources of high quality. The effect of this factor can be described as less favorable.</p>

Gradually changing factors:

<ul style="list-style-type: none"> <li>ecological environment</li> </ul>	<p>Ecological environment can be described as stable (in several parts of the region ecological environment provides for the development of recreation and travel facilities). In general the effect of this factor can be characterized as neutral.</p>
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<ul style="list-style-type: none"> <li>human resources ;</li> </ul>	<p>Human resources are located in the main administrative centers of the region. Qualification and mobility can be characterized as moderate.</p> <p>The effect of this factor in general can be characterized as unfavorable.</p>
<ul style="list-style-type: none"> <li>availability of transport (railways, highways, ports, airports);</li> </ul>	<p>The region is connected to Moscow, Kiev, Minsk, Riga and Saint Petersburg with railway lines and highways. Saint Petersburg port infrastructure can be used.</p> <p>The effect of this factor can be characterized as favorable.</p>

Rapidly changing factors:

<ul style="list-style-type: none"> <li>regional regulations (general situation, incentives and guarantees, enforcement procedures);</li> </ul>	<p>According to expert opinion investment regulations of Pskov region can be evaluated as not very favorable</p> <p>general is limited to profit tax incentive, granting of which is in conflict with Federal Legislation. Incentives and guarantees are time limited.</p> <p>The effect of this factor can be characterized as unfavorable.</p>
<ul style="list-style-type: none"> <li>regional administration investment policy (existence and degree of administrative barriers to investments) ;</li> </ul>	<p>Regional administration investment policy can be characterized as low efficient and targeted to enroll profitable enterprises into regional property (liqueur manufacture, timber industry, etc.). It is known that all the investors are given the choice to either create a joint venture or forget about the project.</p> <p>The fact that the Governor is a member of the Liberal Democratic Party of Russia does not enhance the image of regional administration.</p> <p>The effect of this factor can be estimated as very unfavorable.</p>
<ul style="list-style-type: none"> <li>Technical infrastructure and enabling environment</li> </ul>	<p>Technical infrastructure and enabling environment can be characterized as undeveloped.</p> <p>The effect of this factor can be estimated as unfavorable.</p>

**Summary.**

The rating of the investment climate in Pskov region varies between **very unfavorable** and **unfavorable**.

**Investor** should avoid implementing projects in this region at least till the next Governor's elections (it is expected that the Government in the region should change). At the same time, the region has rather remarkable potential to establish enabling business environment.

**Regional Government** (after elections) should pay attention to positive experience of its neighbors' - Leningrad and Novgorod regions. Pskov region can rapidly significantly increase its investment climate if start making certain steps in this direction.

### 3.5. Analysis of the Investment Climate in Komi Republic.

**General facts.** Komi republic is located to the North of the Russian Federation. Area 415,9 thousand km<sup>2</sup>, population – around 1400 thousand people. The city of Syktivkar being administrative center (233 thousand people). Republic borders Archangelsk, Tymen, Sverdlovsk, Kirovsk regions.

#### *Appraisal of the factors affecting investment climate.*

##### Permanent Factors:

<ul style="list-style-type: none"> <li>geographical location, (location of the region related to the main markets and resources);</li> </ul>	<p>Geographical location can be characterized as unfavorable, republic does not have direct access to the markets. (Appendix 4b).</p> <p>The effect of this particular factor can be characterized as unfavorable.</p>
<ul style="list-style-type: none"> <li>natural resources;</li> </ul>	<p>Republic has oil, gas, coal, gold deposit, the area is rich in timber.</p> <p>The effect of this particular factor can be characterized as favorable.</p>

##### Gradually changing factors:

<ul style="list-style-type: none"> <li>ecological environment</li> </ul>	<p>Ecological environment can be characterized as unfavorable, oil and coal mining and timber processing cause pollution.</p> <p>The overall effect of this particular factor can be characterized as unfavorable.</p>
<ul style="list-style-type: none"> <li>human resources;</li> </ul>	<p>Republic has human resources in adequate numbers, some of these became unemployed in the cause of the number of mining (coal mining companies in particular) companies going down. Human resources qualification and mobility are moderate.</p> <p>The effect of this particular factor can be characterized as neutral.</p>
<ul style="list-style-type: none"> <li>availability of transport (railway lines, highways, ports, airports);</li> </ul>	<p>The region is connected to Moscow and Archangelsk with lengthy railway lines and highways. There is not many highways and railways in the republic itself.</p> <p>The effect of this particular factor can be characterized as unfavorable.</p>

##### Rapidly changing factors:

<ul style="list-style-type: none"> <li>regional regulations (general situation, incentives and guarantees, enforcement procedures);</li> </ul>	<p>According to expert opinion investment regulations of Komi republic can be evaluated as not very favorable</p> <p>general is limited to profit tax incentive, granting of which is in conflict with Federal Legislation. Incentives and guarantees are time limited.</p>
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	The effect of this particular factor can be characterized as unfavorable.
<ul style="list-style-type: none"> <li>regional administration investment policy (existence and degree of administrative barriers to investors) ;</li> </ul>	<p>Republic administration investment policy is not very clear:</p> <ul style="list-style-type: none"> <li>- Republic was granted credit from The Lion Credit Bank; Bank Board rates Komi republic administration policy highly and managed to avoid credit default after August Crisis in Russia;</li> <li>- But there are cases when investors being made to fulfill supplementary conditions related to social problems solving (like supply of the school equipment, etc.);</li> </ul> <p>The effect of this particular factor can be characterized as unfavorable.</p>
<ul style="list-style-type: none"> <li>technical infrastructure and enabling environment;</li> </ul>	<p>Technical infrastructure is at the stage of initial development, its major element being companies dealing in barter payments.</p> <p>The effect of this particular factor can be characterized as unfavorable.</p>

**Summary.**

Investment climate in Komi republic can be evaluated as **neutral**. On the one hand the Republic, in fact, has not developed enabling environment for business, but on the other this fact is balanced by rich natural resources. Generally it is proved by very prudent investment inflow. (Appendix 4ñ).

**Investor** should identify his priorities and decide how important for him is the lack of incentives considering the rich natural recourses. In such a case the investor should be ready to face the fact, that the regional authorities will try to exploit him in order to solve some of their internal problems (there are examples when the investors were forced to sponsor schools).

**Region** has rich potential to attract investments. The Government should take certain practical measures in this respect.

## **SUMMARY.**

From all of the above it is obvious that the opportunities given to sub-federal government when properly applied have significant influence on the investment climate in the region. Reluctance of sub-federal government towards these opportunities seriously damages business enabling environment. Comparing Novgorod and Pskov region is perfectly demonstrative of that. Being characterized practically by the same permanent factors, those two regions provide absolutely different investment environment, the fact which emphasize the importance of proper application of legal mechanisms and possibilities within sub-federal jurisdiction.

However the efforts of sub-national governments to improve investment climate in the region are not sufficient, national leaders must take the initiative in the reform process, otherwise the results would be disappointing.

## **APPENDIX.**

## **Appendix 1. Informational Materials for the Analysis of the Investment Climate in Leningrad Region**

### **Appendix 1à. Analysis of the Investment Legislation in Leningrad Region**

#### ***1. List of reference.***

The following legislative acts were used as the source of the analysis :

Leningrad Regional Law dated 15<sup>th</sup> of July 1994 ref. "Tax incentives for the companies located in Leningrad region"

Regional Law "Investment activities in Leningrad region", passed by the Leningrad region Legislative Assembly on the 8<sup>th</sup> of July 1997.

Leningrad Region Administration decree ref. 11, dated the 30<sup>th</sup> of March "Establishment of investment pay-back term and actual investment pay-back period calculation technique for Leningrad region tax incentives policy realization"

#### ***2. Information collected.***

Information collected in the cause of studying investment legislation:

a) Major regulation of investment legislation is the "Investment activities in Leningrad region" passed on the 8<sup>th</sup> of July 1997. The Law defines basic concepts, system of guarantees and tax incentives to the investors.

b) According to Leningrad region legislation companies implementing investment projects are granted tax incentives on the following taxes (for the share paid to the regional budget):

- property tax (on property purchased or constructed for the investment project);
- profit tax (on profit received in the course of investment project implementation);
- road tax.

On those taxes are given complete 100% relieves during the investment pay-back period. Apart from these, there are incentives for the period of two years from the date of investment pay back period completion:

Property tax - 100%;

Profit tax:

- for 30% - investment amount from 6 to 60 mlrd. rub.
- for 50% - investment amount over 60 up to 300 mlrd. rub.
- for 100% - investment amount over 300 mlrd.rub. (non-denominated rubles).

There is a complete list of the documents required for granting incentives and a document that defines incentive granting procedure.

Profit tax incentives are also granted to institutions, crediting investment projects.

c) Calculation of investment projects full pay-back period is done according to calculation technique, developed by the regional administration.

d) Investors are given major guarantees, including guarantees specifying that deterioration of investment regulations imposed by federal (!) and regional administration shall be prevented. This regulation is valid for the pay back period of the investment projects starting with 6 bln.rub.

e) Investment projects auditing is done by the companies authorized by regional administration. Selection of the auditing companies is done through tender.

f) The investor is to return the full amount of the tax relief to the regional budget if the investment project is suspended prior to the completion of pay back period, or the company implementing investment project is closed down up or re-registered in another region.

### **3. Summary.**

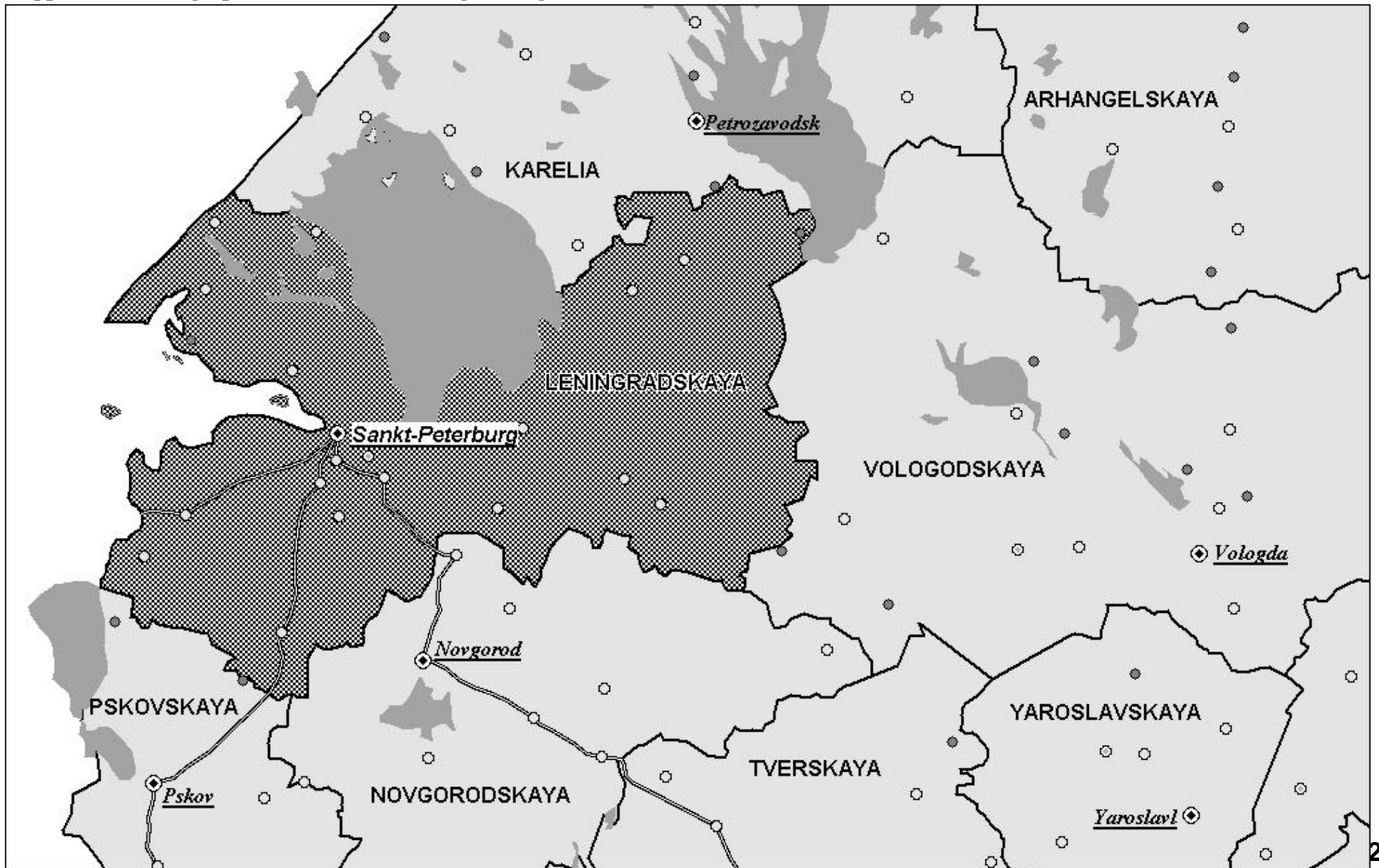
Leningrad region investment legislation can be characterized as attractive for investments.

The following factors can be characterized as favorable:

- incentives granted to the investor after the completion of the project pay-back period;
- simplicity of project pay-back period calculation technique.

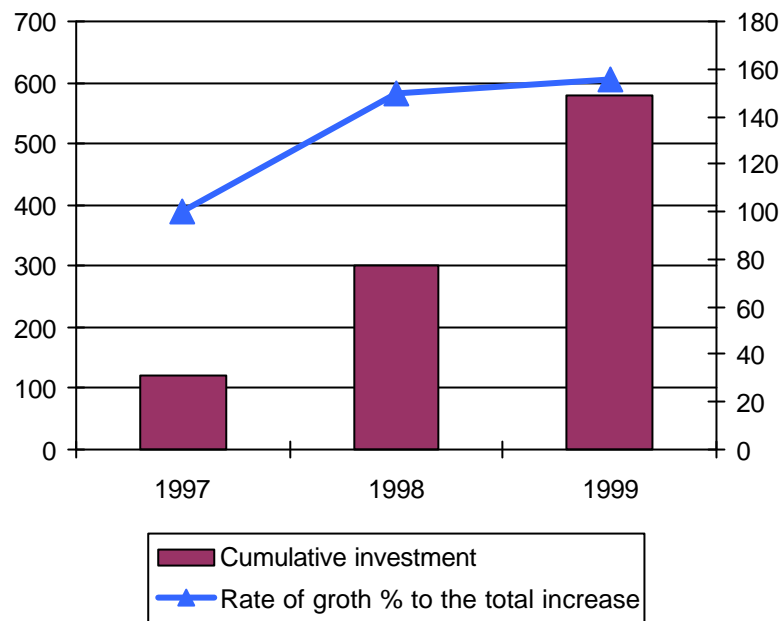
Limited guarantees providing stability of investment environment can be described as negative.

Appendix 1b. Geographical Location of Leningrad Region.





### Appendix 1c. Statistics on Foreign Investment in the Economy of Leningrad Region .<sup>5</sup>



<sup>5</sup> Expert – North-West #1 (8) 2000ã.

## **Appendix 2. Information Materials for the Analysis of the Investment Climate in Novgorod Region**

### ***1. List of reference***

The following legislative acts were used as the source for analysis:

Regional Law "Investment activities in Novgorod region"

Regional Law "Tax incentives for individuals and legal entities located in Novgorod region, for the year 2000"

Regional Law "Annual regional budget for the year 2000" (Article 24)

Oblast Duma Decree "Establishment of investment pay-back period calculation regulations and other incentives granting conditions for the investors in Novgorod region" (with the Regulations)

Oblast Duma Decree "Rate of the road tax payable into the account of the local road fund"

Oblast Duma Decree "Procedure of VAT return to the newly-established companies (for the share paid to the regional budget)" (with the Regulations)

Oblast Duma Decree "Favorable taxation regions" (with the Regulations on favorable taxation regions)

### ***2. Information collected.***

Information collected in the cause of studying investment legislation:

**a)** Novgorod region investment legislation is based on two major regulations: "Investment activities in Novgorod region" and "Tax incentives for individuals and legal entities located in Novgorod region, for the year 2000". The first one defines general guidelines and system of investment guarantees, both regulations embrace taxation schemes for investors.

**b)** According to the Novgorod region investment legislation, companies, implementing investment projects are granted 100% tax incentives (for the share paid to the regional budget):

- property tax;
- road tax (for the share paid to the local road fund).

Incentives for the above mentioned taxes are granted for the investment project pay-back period. Apart from this, value added tax return for the share paid to the regional budget is granted to the newly-established companies (founded for investment project implementation).

**c)** Four zones with favorable taxation have been established in Novgorod region. All the enterprises (but trade companies) located in the region are relieved from all taxes paid to regional and city budgets, regional and city administrations are entitled to grant incentives on. Apart from this, part of VAT paid to regional and city budget and complete amount of profit tax are reimbursed to these companies from the regional budget. .

**d)** Investment pay-back period calculation is based on the "Arthur Anderson" company calculation technique.

**e)** Investors are given basic guarantees, including guarantees against worsening of investment regulations within sub-federal jurisdiction during the investment project pay-back period..

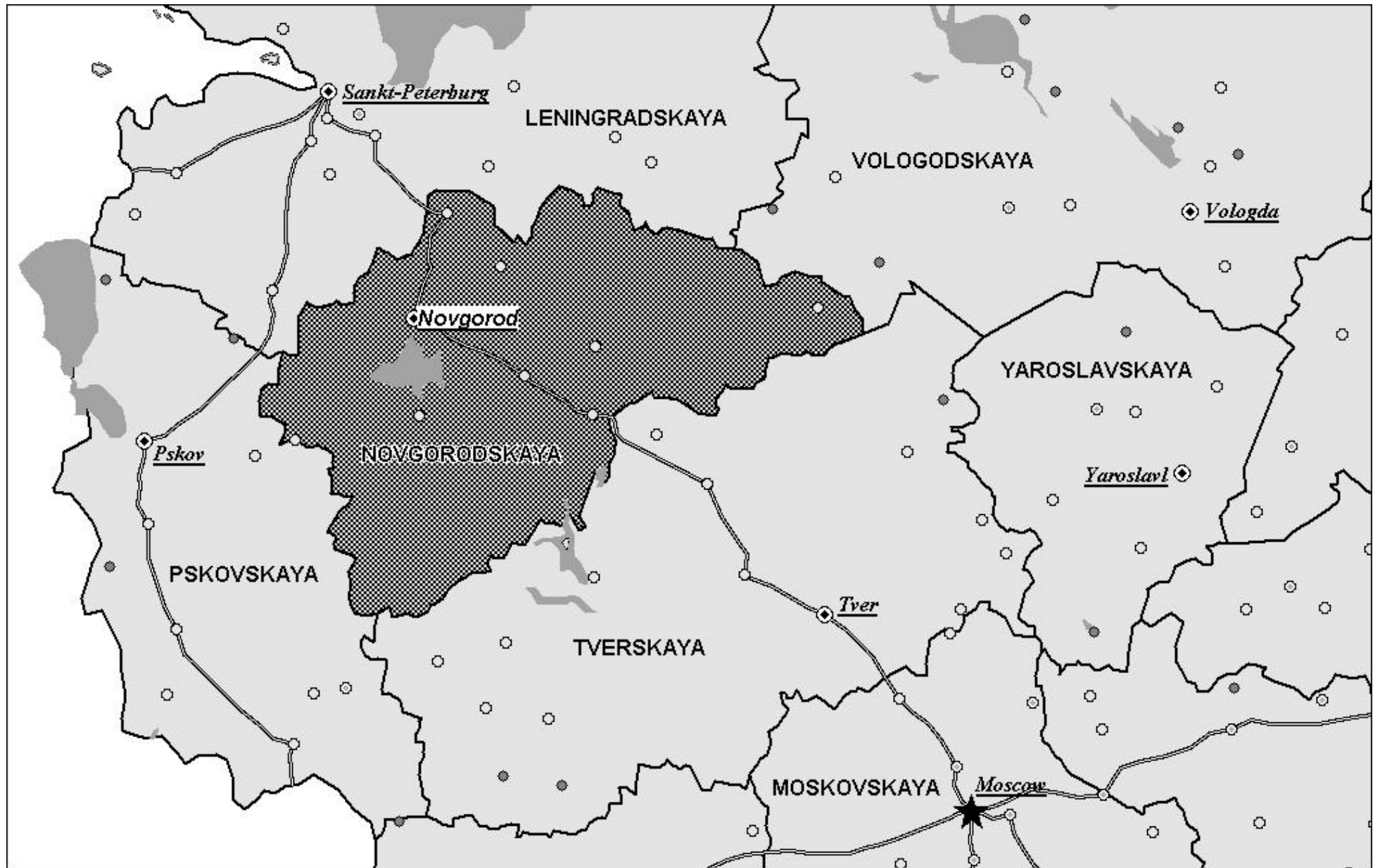
### **3. Summary**

Novgorod region investment legislation can be characterized as attractive for investments.

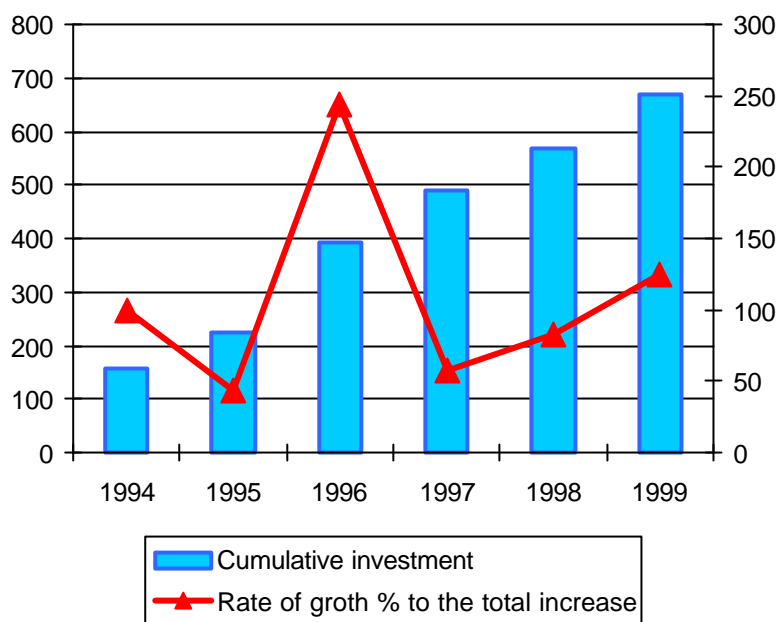
The following factors can be characterized as favorable:

- existent system of paid tax return on some taxes;
- project pay-back period calculation technique was developed by a world-known auditing and consulting company .

Appendix 2b. Geographical Location of Novgorod Region



## Appendix 2c. Statistics on Foreign Investment in the Economy of Novgorod Region<sup>6</sup>



<sup>6</sup> According to the information supplied by Novgorod Region Economical Committee



- f) The investor is to return the full amount of the tax relief to the regional budget if it (he) fails to fulfil the requirements and/or investment project implementation conditions.
- g) Registration procedure for the company with foreign capital is thoroughly defined in the investment legislation.

### **3. Summary**

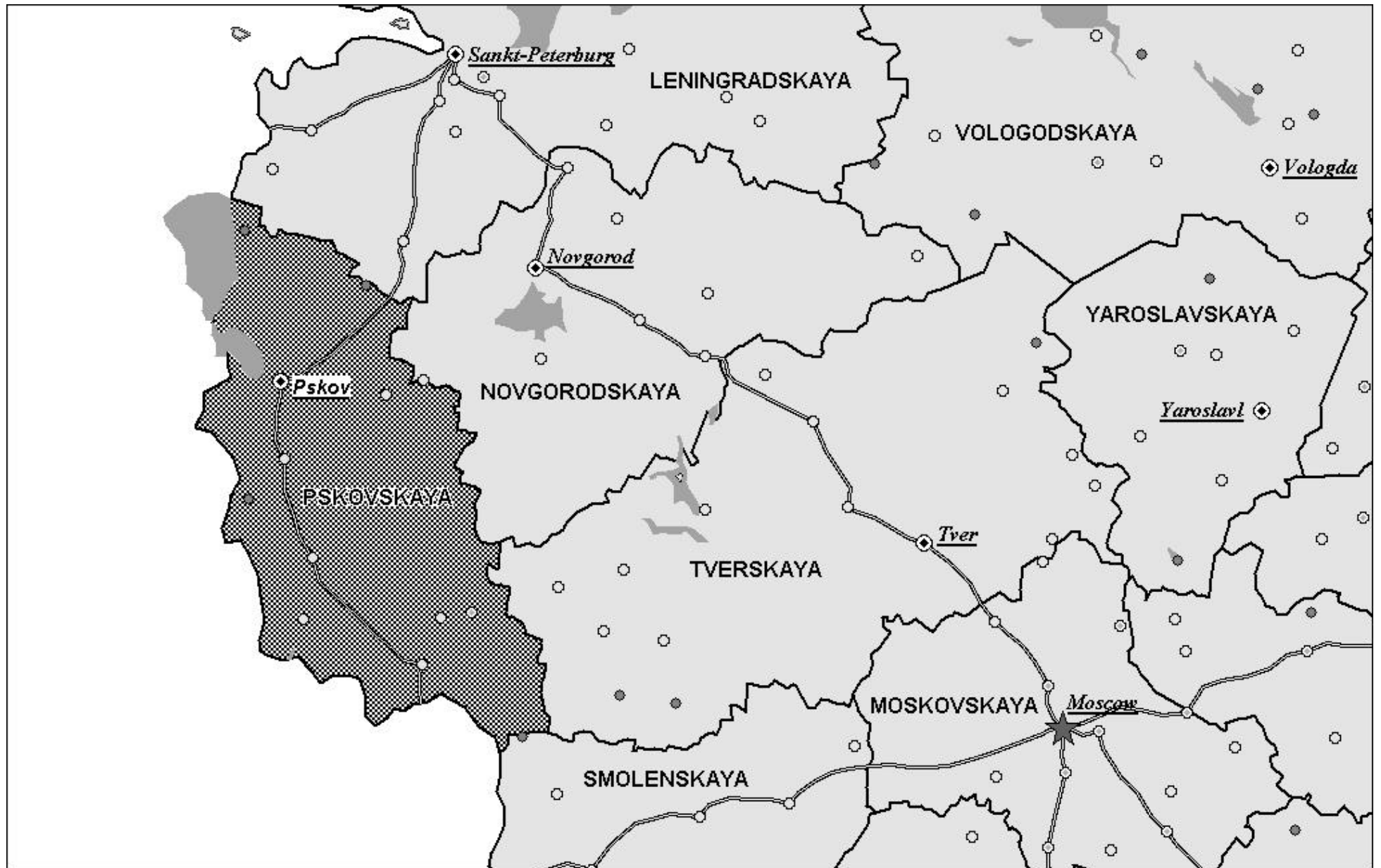
Pskov region investment legislation can be characterized as unattractive for investments.

The following factors can be characterized as negative:

- insignificant incentives amounts;
- incentive granting for a period of 3 years at the most.
- Guarantees against worsening of investment environment are limited to 3 years period

Thoroughly developed incentive granting procedures and registration procedures for companies with foreign capital can be characterized as favorable factors.

Appendix 3b. Geographical Location of Pskov Region





economy of Komi republic"

Komi Republic Decree dated July 15<sup>th</sup> 1996 with ref. 190 «Establishment of investment tax incentives regulations» (with Regulations).

Komi Republic Decree dated September 12<sup>th</sup> 1996 with ref. 242 «Establishment of regulations on state guarantees granting to the investors implementing projects in Komi republic» (with Regulations).

## **2. Information collected.**

Information collected in the cause of studying regional investment legislation:

à) Major regulation of investment legislation is the "On attracting investments into the Komi republic economy". The Law defines basic concepts, procedure for registration of the companies with foreign capital, system of guarantees. Tax incentives to the investors are defined in Regulation on tax incentives granting for investors implementing projects in Komi republic.

b) According to Komi republic legislation there are following taxation schemes:

for legal entities engaged in establishment of new production companies and/or modernization diversification) of existing production companies:

- for the investment project pay-back period (3 years at the most) the profit tax rate (for the share paid to regional and city budgets) is reduced to 50 per cent;
- for the investment project pay-back period property tax rate is 0,01 per cent;
- for the legal entities engaged in investment project implementation with the export share over 50% of the product manufactured (for processing industry) and for the companies manufacturing substitutes for the imported goods, profit tax (for the share paid to the republic budget) is reduced to 50 per cent;
- for leasing companies, if the profit from leasing transaction conducted in Komi republic amounts to 80 per cent of the total company profit, the profit tax rate is reduced to 10 per cent for the period of 2 years from the date of company registration and to 50 per cent for the following two years;
- for insurance companies, registered in the region, engaged in investment insurance and reinsurance the profit tax of the profit from the above mentioned transaction is 15 per cent reduced;
- for the banks (for the amounts crediting investment programs projects on the territory of the republic) profit tax rate is 25 per cent reduced;

c) Granting of state guarantees for investors engaged in particular projects and programs on the territory of Komi republic is provided for and clearly defined.

d) Investors are given basic guarantees, including guarantees against worsening of investment regulations within sub-federal jurisdiction during the investment project pay-back period but not more than 3 years.

e) Registration procedure for the company with foreign capital is thoroughly defined in the investment legislation.

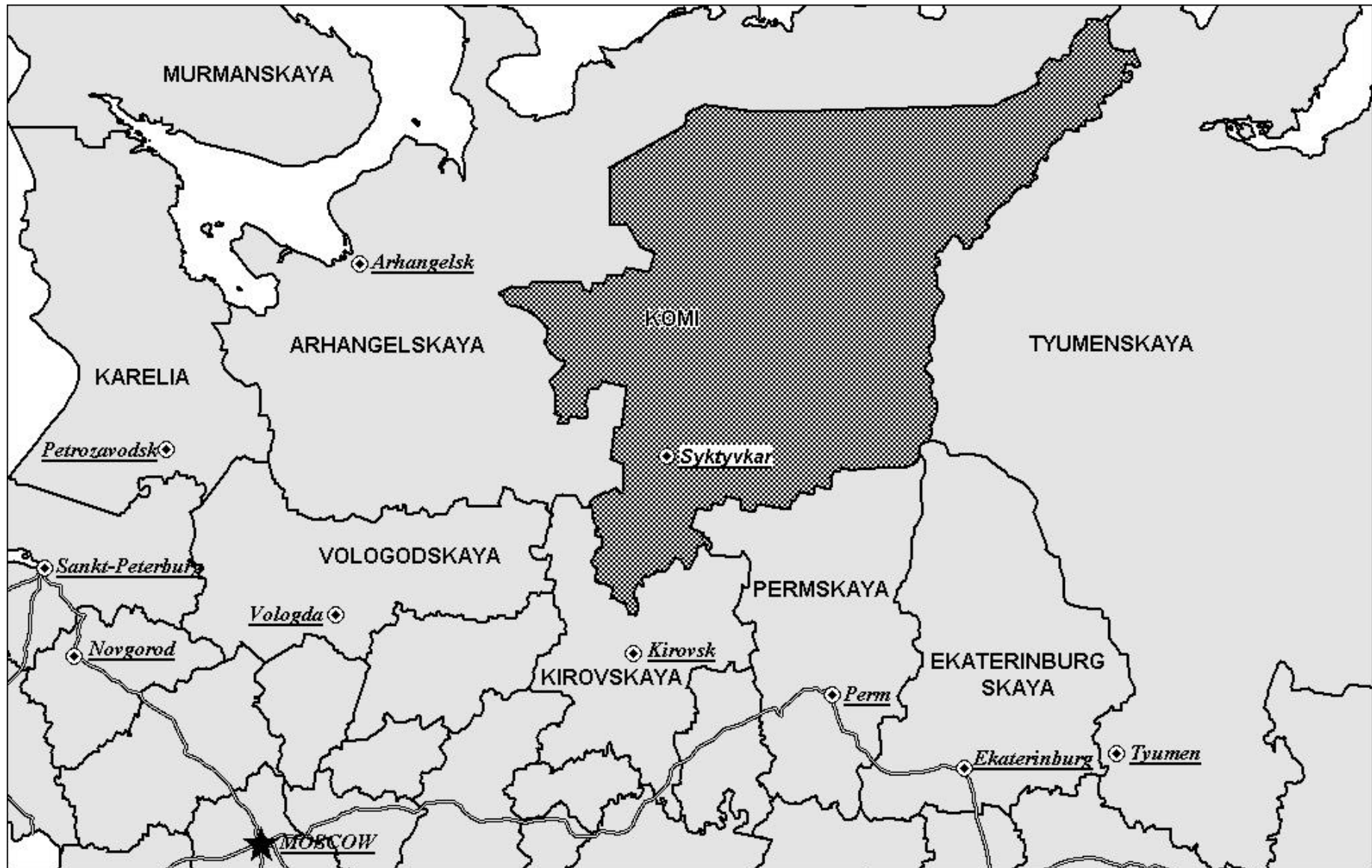
### **3. Summary**

Komi republic investment legislation can be characterized as unattractive for investments.

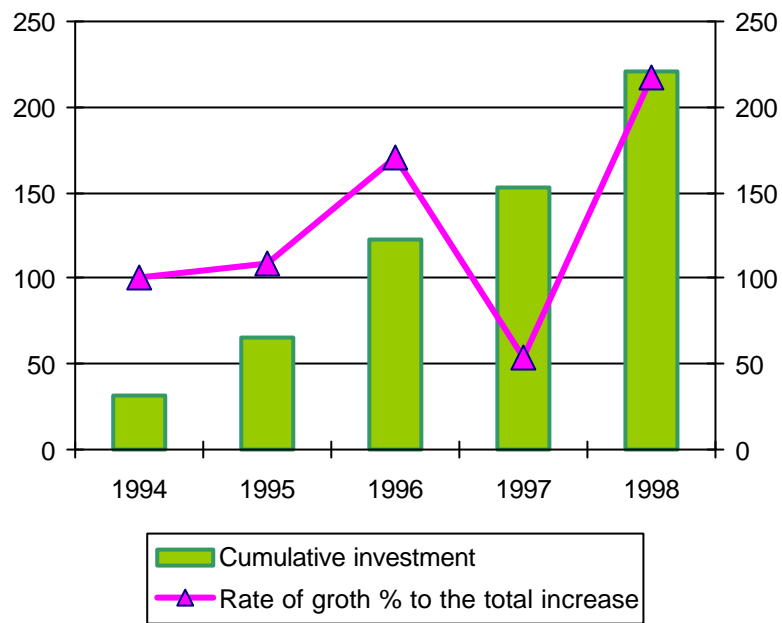
The following factors can be characterized as negative:

- insignificant incentives amounts;
- incentive granting for a period of 3 years at the most.

Appendix 4b. Geographical Location of Komi Republic



## Appendix 4b. Statistics on Foreign Investment in the Economy of Komi Republic<sup>7</sup>



<sup>7</sup> Komi Republic State Statistics Committee