

## Free Port of Vladivostok: Development Conditions, Prospects, Risks



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**Abstract.** One of the priority directions of Russia's state policy with regard to territories' development is the development of the Far Eastern region. The free port of Vladivostok is one of the key projects that are currently being implemented in the southern part of Primorsky Krai and they focus on boosting the socio-economic development of Vladivostok city, Primorsky Krai and the Far Eastern region as a whole. The goal of this research is to consider the conceptual issues of the free port of Vladivostok, to outline the conditions and prospects of its operation and identify risks associated with its future development. The article defines the modern concept of "free port", characterizes historical experience of the "free port" regime in Vladivostok in the end of the 19th century, substantiates the strategic importance of using the free port of Vladivostok as a tool of intensive growth of Russian Far Eastern territories. The article also discloses the essence of the free port of Vladivostok as a means to promote free entrepreneurship, which is used to increase freight traffic through the port of Vladivostok, increase foreign trade, attract new investments, create new industries and develop the port's infrastructure. The article provides a review of the main tax benefits and perspectives of the free port of Vladivostok in terms of the gross regional product formation.

Analyzing the mechanisms of effective functioning of the free port of Vladivostok, the authors identify the short-term (mid-term) and long-term priorities and operational risks for the free port of Vladivostok. The article also touches upon some issues concerning the response of some foreign countries to the creation of the free port of Vladivostok.

**Key words:** free port of Vladivostok; customs regime, port infrastructure, tax privileges, economy of Primorsky Krai, integration into the Asia-Pacific region, support for entrepreneurship, attraction of investments, gross regional product.

The law No. 212-FZ “On the Free Port of Vladivostok” came into force October 12, 2015 [11]. The main purpose of its realization is to accelerate socio-economic development of the Far Eastern region. Nowadays the functioning of the Free Port of Vladivostok (FPV) and areas of advanced development is a key vector of the regional socio-economic strategy. Geographical location, technical and economic infrastructure of the modern port Vladivostok are considered as the key element to fulfil the international transport and transit function of Primorsky Krai, and used as the basis for Russia’s inclusion into the international economic space of the Asia-Pacific region (APR). Vladivostok together with other seaside ports serves as Russia’s gateway to Asia, so it is no exaggeration to say that in the modern era of economic harmonization between countries and increased international integration Southern Primorye becomes a major center of Far Eastern territories development. Now and in the future Vladivostok is represented as a center of international economic, scientific-innovation and cultural cooperation, a focus of socio-economic activity, a growth point with huge potential for development, which implementation is largely promoted by the

regime of the Free Port. In this regard, there are particularly relevant issues, such as those related to the intensity and efficiency of ongoing economic integration of the Free Port of Vladivostok in the Asia-Pacific region, the development and improvement of mechanisms for the FPV effective functioning, as well as the main risks the Free Port residents face and will face.

The concept “free port” appeared due to the Italian term “porto-franco”, which has historically meant a harbor with the right of duty-free importation of foreign goods. This term has entered the economic lexicon due to the fact that the first free ports were opened in Italy in the 16th century. Being one of the types of free economic zones, available ports are areas with preferential tax, customs and currency regimes that stimulate the inflow of foreign capital and boost joint productions and export-import operations, etc. The ultimate goal of a free port is economic development of adjacent to territories through the realization of its dramatically increasing foreign trade and investment potentials.

Russia has certain experience in the establishment and operation of free port zones: in 1819–1859 the Porto-Franco regime was used in Odessa, 1828–1838 – in Kamchatka.

In 1856 the right of free trade was introduced in Nikolayevsk-on-Amur, later in Vladivostok, Posiet and other ports in the Primorskaya Oblast. In 1860–1862 there was duty-free bilateral trade of all goods, except tea and bread wine, through the land border with China. In fact, until the beginning of the 20th century the right of free trade, established on the entire territory of the Russian Far East, was abolished in 1909 after some hesitation [7, pp. 459-450].

The one-hundred history shows how the region has benefited due to the status of a free port, though its development occurred in conditions of isolation from the rest of the country, lack of capital, low quality of life, residential and administrative turmoil. According to experts, in the second half of the 19th century the Far East stimulated foreign trade. Only the volume of US export passing through the ports of the Pacific Ocean increased from 3.3% to 207.1 thousand dollars, or by 63 times in 1866–1881. In 1883–1899 the cargo turnover of Vladivostok grew from 47.8 thousand tons to the 333.3 thousand tons, or by 7 times. According to the Priamurye officials' reports, American agricultural equipment was sold to peasants on favorable terms, and many imported products were cheaper and of better quality than domestic produced locally or, for example, transbaikalian. According to contemporaries, "such trade and supply activity has brought undoubted benefit to the Far East" [4]. Then and now the Free Port of Vladivostok is a kind of window to Asia towards greater opportunities for the promotion of free

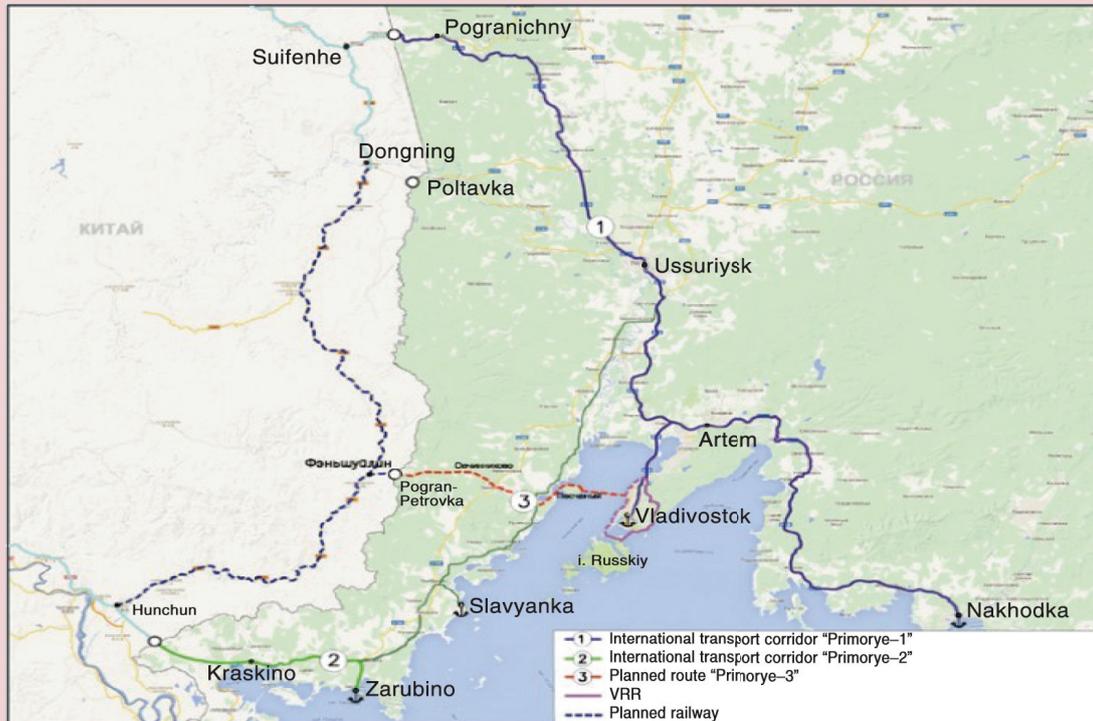
international trade. Suffice it to recall that the world major ports – Hong Kong, Singapore – have become such due to the duty-free regime of free trade and the world's best practices of port infrastructure development.

The Free Port of Vladivostok today is a territory with special status, which includes 15 municipalities of Southern Primorye along the border with China, North Korea and the coast of the Sea of Japan. The Free Port area comprises 28.4 thousand km<sup>2</sup>, its population is equal to 1.4 million people, accounting for more than 20% of the population in the Russian Far East.

Geographically the FPV territory is the center of the international transport corridors "Primorye–1" and "Primorye–2" and planned "Primorye–3", which connect the key points of Southern Primorye and near-border China (*fig. 1*), which provides Russia with obvious strategic advantages.

The area around Vladivostok separates a significant part of China – Heilongjiang, Jilin and Inner Mongolia (with the total population of 90 million people and the production volume of 750 billion U.S. dollars) from the sea. Nowadays the goods produced in these provinces are delivered to the ports of Dalian and Yingkou or loaded onto vessels at the distance of 1,100–2,300 km from the place of production. According to the Director of the Centre for Research of Postindustrial Society Vladislav Inozemtsev, the port in the southern part of Primorye together with Chinese railways and highways could become very attractive for Chinese companies. Shipping a product at the enterprise, one could deliver

Figure 1. Free Port of Vladivostok and main international transport corridors of Primorye



Source: photo from the presentation of the project of the international transport corridor "Primorye-3". Vladivostok Administration press-service. Available at: <http://primamedia.ru/news/economics/28.08.2015/458123/>.

it to the vessel for a few hours and export it without customs formalities. The demand for such transshipment would be 150–200 million tons per year, or a quarter of the total capacity of Russian ports. The expansion of the zone by means of industrial parks would lead to the localization of production and the creation of dozens of thousands of jobs [1]. Thus, transit handling of cargo from Northeastern China to Russia and from Russia to Northeast China via the port of Vladivostok is the first phase of the FPV functioning. The benefits will be vivid already in the short term in the form of increased turnover and expanded

activity of Russian transport companies. In the long term they will be manifested in the creation of the integrated macro-regional system of multimodal transportation based on a fundamentally new – global – level of development of port infrastructure, rail and road infrastructure in Primorye.

The promotion of the East China direction of goods transit through the FPV will encourage interaction between East China and Russia, East China and South China, East China and other Asian countries, particularly Japan and North Korea and South Korea. Though China has a branched network of rail-and

highways, Chinese goods can be conveniently, cheaply, and quickly transported by sea via the Sea of Japan and the East China sea – from Vladivostok to any Chinese port. In addition, the FPV development coincides with the development of the Northern Sea Route and in the future will naturally link the trade of Asia-Pacific countries and Europe. All this will significantly expand logistical capabilities of Southern Primorye. Today part of its territory, resembling an uneven triangle (see fig. 1), is one of the most promising international trade zone in Northeast Asia.

The Free Port of Vladivostok as a tool of effective territorial development is focused on establishing special measures of state support for entrepreneurial activities aimed at boosting export-import operations of foreign economic activity (FEA) subjects and extending commodity turnover through Russian Eastern ports. This will inevitably involve new investment on the part of both domestic and foreign economic activity subjects and integrated upgrade of port infrastructure: transport, energy, utilities, engineering, social, innovative, etc. In other words, the FPV is the base for attracting additional investment, working out and realizing new economic projects, and developing new industries. The financial burden on the creation of port infrastructure will be shared by budgetary and non-budgetary funds with the use of public-private partnership. Such a mechanism make the difference between the Free Port and other projects financed mainly by the federal budget, as it gives an opportunity to mitigate,

optimize the financial burden and better control the target use of allocated funds.

The special measures of state support are provided to the FPV residents – economic entities registered in the established order, setting up new productions or implementing new projects and willing to invest in production and upgrade of port infrastructure in the amount of not less than 5 million rubles for 3 years. It should be noted that the Pacific Investment Management Company is the first resident of the Free Port of Vladivostok. It plans to allocate about 5 billion rubles to construct a five-star hotel in the village of Slavyanka in Khasansky district, Primorye [14]. Today residents have tax privileges and preferences (*tab. 1*).

Tax policy of the state is one of the main factors that influence the formation of favorable business environment; therefore the reduced tax burden on residents of the Free Port of Vladivostok creates possibilities of obtaining additional revenue [3, p. 84]. So, the decreased tax burden on the wage fund and the creation of new jobs will contribute to the growth in the average wage and improve the overall welfare of citizens. Additional income tax receipts will increase revenues of the city and provincial budgets and help implement the projects related to development of the social sphere and socio-economic infrastructure of the city.

The entrepreneurs of the Free Port can use tangible tax benefits, advantages of a free customs zone, the absence of restrictions on foreign labor recruitment, and the number of industry preferences.

Table 1. Privileges and preferences for FPV residents

Privileges and preferences	State support measures
Corporate profit tax relief	Federal share: a zero rate for 5 years; regional share: the 5% rate for 5 years, next 5 years – not less than the 10% rate, federal share is not less than 2%, a simplified VAT refund – 10 days
Reduced rates of deductions to non-budgetary funds	For 10 years the total amount of contributions – 7.6%
Free customs zone	Duty-free and tax-free: - import, storage, consumption (utilization) of foreign goods; - import of goods (equipment); - import of foreign goods (equipment); - export of foreign goods (equipment)
Hire of foreign workers	Hiring foreign workers without quotas
Orderly state and municipal control (supervision)	Joint inspections, short time of control and supervisory inspections, coordination of inspections with the Ministry for Development of the Russian Far East
Simplification and acceleration of customs control	Single window for cross-border crossings, non-stop operation of checkpoints
Special rules for certain types of activities	- medical activity; - educational activity; - aquaculture (fish farming), fisheries and conservation of aquatic biological resources

Table 2. Tax burden of FPV residents, rubles per ruble of revenue

Index	2015	2016–2020	2021–2025	since 2026 et seq.
Corporate tax	0.05	0.02	0.03	0.05
VAT	0.13	0.13	0.13	0.13
Deductions to non-budgetary funds	0.07	0.02	0.02	0.07
Corporate property tax	0.01	0.00	0.00	0.00
Land tax	0.004	0.00	0.00	0.00
Total tax payments and payments to non-budgetary funds	0.26	0.16	0.17	0.24
Amount of tax burden reduction	-	0.10	0.09	0.02

Corporate profit tax relief and reduced rates of deductions to non-budgetary funds come into effect January 1, 2016. *Table 2* presents tax rates for FPV residents given the provided benefits in conventional calculation per 1 ruble of revenue. For 2015 there

are current payments, for the subsequent periods – calculations based on benefits and preferences. According to the table, in the first five years of the FPV functioning, tax savings will be 10 kopecks per ruble of revenue, in the next 5 years – 9 kopecks.

According to the developers of the law “On the Free Port of Vladivostok”, such as experts of the administrations of Vladivostok and Primorsky Krai, the Ministry for Development of the Russian Far East and business representatives, in 2021 gross regional product of Primorsky Krai will be equal to 1.106 trillion rubles (growth by 1.7 times to 2015), in 2025 – 1.402 trillion rubles (growth by 2.2 times to 2015), in 2034 – 2.157 trillion rubles (growth by 3.4 times to 2015). The number of created job places can reach to 84.7 thousand people in 2021, 108 thousand people in 2025, 468.5 thousand people in 2034. The growth in GRP of the Far Eastern Federal District will account to 1.97 trillion rubles in 2025 [8]. According to Mayor of Vladivostok I.S. Pushkarev, it is possible to expect tripling of GRP of Primorsky Krai for the next 10 years; it corresponds to a 34% increase on the scale of the Far Eastern Federal District [5]. It is expected that the production growth will be achieved by increasing the volume of transport and logistics operations, establishing processing, science-intensive industries, and raising the volumes of educational and health services.

Analyzing the law No. 212-FZ “On the Free Port of Vladivostok”, we can say that the economic content of the FPV goes beyond the classical definition of a free port and involves the formation of a special economic zone, characterized by complex development of region’s infrastructure and a high degree of international integration. The FPV objectives and targets correspond to the concept of

accelerated development of the Far Eastern region and strengthened economic and geopolitical positions of Russia in Asia and largely aligned with the guidelines of the Strategy of Development of Russian Sea Port Infrastructure up to 2030 [9], complementing and deepening the latter. To elaborate the mechanism of FPV effective functioning, it is useful to distinguish short-term (medium-term) and long-term targets of its activity. In particular, **the short-term and medium-term priorities** include *support of entrepreneurship and promotion of international trade*:

1. Increase in full capacity of the port of Vladivostok. Today the proportion of its uncommitted capacity is 44.4% [9]. The efficient operation of the port requires capacity equal to at least 80%.

2. Technical and technological upgrade of port facilities to increase their productivity, transfer capacity, and capacity of major transportation hubs of Southern Primorye [12, p. 434].

3. Deepening specialization of transportation hubs of the Primorsky port complex, development of container transportation as the most relevant, cost-effective and secure way of maritime transportation at the premises of the Vladivostok port. Thus, the share of container transportation in the total world turnover is more than 60%, and the containerization of general cargo in the world practice is practically 100%. The global annual growth in the amount of container shipping is about 10%, and this positive trend will only increase [9; 12, p. 435].

4. Encouragement of the interaction between the port and road and railway approaches, increasing the capacity of the latter. We should take into account that road transport is the main mode of transport, used to export goods from Russian ports (more than 60% of shipped goods), and Vladivostok are among the cities, along with Saint Petersburg and Novorossiysk, which have the problem of the interaction between seaports and approaches to them [9].

5. Ensuring tariff and tax attractiveness of the port of Vladivostok and, consequently, reducing the cost of transport and related transport services for economic entities – subjects of foreign economic activity.

6. Improving technological characteristics of port operations, particularly reducing vessel demurrage in the port, customs clearance, etc.

7. Simplification and acceleration of customs procedures, ensuring a single window for cross-border crossings, as well as liberalization of the visa regime for incoming individuals and, especially, entrepreneurs.

It is achievement of balance of growth rates of port capacities and volumes of cargo transportation. The enhancement of port infrastructure is to be accompanied with increasing turnover and it is, in fact, an adequate response to the increased demand for transportation services on the part of FEA subjects.

The FPV priority **in the long term** is to *increase competitiveness of the city of Vladivostok and the entire region through the development of the port zone of Southern Primorye*, particularly:

1) ensure the efficient development of port infrastructure of Southern Primorye, raise competitiveness of the port of Vladivostok to the level of other leading ports in the Asia-Pacific region;

2) enhance the role of the ports of Southern Primorye in the implementation of Russia's transit potential in the Asia-Pacific region, raise transit cargo traffic and, as a result, transfer part of foreign trade flows of the Asia-Pacific region to the seaside ports;

3) create new workplaces, increase incomes of foreign economic activity subjects and a level of wages;

4) raise opportunities to implement projects of accelerated development of Primorsky Krai and the Far Eastern region, in particular development of tourism, mining and manufacturing industries, hotel business, different services, etc. and, as a consequence, set up extended zones of innovative development – key growth points of long-term development [6];

5) use new organizational mechanisms of public administration of port infrastructure, including an institute for public-private partnership (IPPP), concessions, management companies, technology platforms and territorial clusters, etc.) thus, raise efficiency of the state management of port activity.

There are the following results of functioning of the Free Port of Vladivostok at the macroeconomic level, which will qualitatively improve the economic performance of Far Eastern territories:

1) creation of the modern international transport and logistics complex in Primorye at the premises of the Vladivostok port [12, p. 434];

2) establishment and development of modern high-tech industries to manufacture products that are competitive on the market of the APR countries both by quality and price in Southern Primorye;

3) provision of a steady flow of all types of revenue onto the territory of Vladivostok and Primorsky Krai as a whole;

4) acceleration of socio-economic development of Vladivostok and enhancement of standard of living of the population in Primorye, which, in turn, will contribute to stabilization of the resident population, growth of migration attractiveness, expansion of the Vladivostok agglomeration and improvement of the overall socio-demographic situation.

The mechanism to realize FPV priority development directions is the use of geo-

Figure 2. Geographical zones of the economic impact of the Free Port of Vladivostok



Source: the photo from the business weekly "Competitor". Available at: <http://konkurent.ru/ekonomika/690-sotvorenie-porta.html>.

graphical and economic advantages of Primorsky Krai for integration in the Asian economic space through the development of international trade with APR countries and the port's inclusion in the Asian market.

*Figure 2* shows that over 400 million people live at the distance of 1,000 km from Vladivostok, and the productive capacity of this territory is about 7 trillion U.S. dollars. Let us note that less than 100 million people live at the distance of 1,000 km from Moscow. At the distance of 2,000 km from Vladivostok 1.1 billion people live and the productive capacity is 14.3 trillion U.S. dollars. At the distance of 3,000 km the productive capacity reaches a value of 17.3 trillion U.S. dollars, which accounts for 16% of the global GDP in 2014. The geo-economic role of the port of Vladivostok is difficult to overestimate: the surrounding territory is a huge market for own products, there are great opportunities for the development of transport logistics facilities and complex innovative economy due to attracting domestic and foreign investment.

The benefits of economic development as well as the problems arising from the FPV operation, actively discussed in scientific and political communities at various levels, are today perhaps the most popular topic for consideration. The countries-neighbors of Russia in the Asia-Pacific region have already expressed their opinion about the Free Port in the South of the Russian Far East. Among the responses there are measures, aimed at increasing competition, and deep interest in the

development of partnership and cooperation. In particular, China's first retaliatory action was to introduce the simplified customs regime on the territories bordering with Russia, such as Harbin, Dalian, Shenyang, Changchun, Hohhot and Manzhouli, and grant additional rights to the companies engaged in foreign trade. Then China proposed to promote partnership within the Free Port, in particular form a logistics hub of online trade, construct a high-speed railway between Suifenhe and Vladivostok, create joint enterprises to process agricultural products, and develop innovative technologies, mining industry, medicine, tourism and some other areas. The Chinese government and business claim to continue the ongoing policy of entering the Russian market and searching new sources of scarce raw materials [13, p. 19].

The Republic of Korea and the Republic of Vietnam assessed the establishment of the Free Port of Vladivostok quite positively. The Korean side is ready to share the experience to form and develop free economic zones that exist in each of the eight Korean provinces with Russia. We can mention the first projects at the premises of the FPV, announced by the Korean side, such as the construction of a plant to process water biological resources with minimum investment in the amount of 10 million U.S. dollars and the opening of medical centers on the territory of Vladivostok to render high-tech medical services. Vladivostok Mayor I.S. Pushkarev mentioned in his interview about the social importance of the Russian-Korean medical project: "If we let high-quality

and ultra-modern technologies be introduced into Vladivostok, we will not only reduce the cost of these services (price of flights and accommodation in Korea) by half, but also will give our people a choice: be treated according to our standards or for another price according to Korean standards... This decision will not damage domestic medicine; on the contrary, we will create conditions for technology exchange, improvement of our doctors' skills" [5].

The Socialist Republic of Vietnam is a long-standing partner of Russia, particularly, of Primorsky Krai, in many sectors of economic activity. According to Deputy Consulate General of Vietnam on Economic Issues Mr. Trinh Xuan Hieu, the Vietnamese business and community is interested in the opportunities associated with the emergence of the Free Port of Vladivostok. The Vietnamese side believes that the adopted law on the FPV and the agreements on a free trade zone between Vietnam and the EEU member-states create favorable conditions for the development of relations between Vietnam and Russia, in general, and the Far East, in particular. The projected turnover in 2020 amounts to 10 billion US dollars, i.e. compared to 2014 and 2015 it is expected to grow by 2–2.5 times. The significant share of the increase in bilateral trade account for foreign trade projects within the Free Port. Power engineering, woodworking and textile industry are most promising sectors of the Russian-Vietnamese cooperation. Joint food production, construction and repair, real estate operations, and transport have also great potential [2].

If the benefits of the Free Port are obvious and connected with great hopes for long-term development of the city and the region, the project weaknesses is primarily associated with doubts about the realism of free trade in Russia. According to the results of the public opinion analysis, the weakest links in the chain of the FPV development are the following.

First, it is conservatism of state authorities, a red-tape management system, and administrative pressure on business, traditional in the Russian practice. The experience of the largest world ports shows that the main competitive advantage of any port is not so much the financial accessibility of its services as the organizational simplicity of customs procedures and operations, short downtime in the port, etc. It should be noted that the current Russian leadership makes ambitious economic decisions and has a strong political will; however, the mechanisms of these decisions realization are hampered by rigidity, slowness of the current administrative structure, inconsistency of views on those and other issues, and the system of prohibitions, barriers and Russian standards in international activities. To overcome the authorities' conservatism, it is necessary to develop fundamentally new approaches to management and ensure high dynamics of regulatory bodies' activities due to new personnel and training policies.

Second, it is inconsistency of current transport and logistics infrastructure of Vladivostok and Primorsky Krai with

requirements and requests of a free port, a lack of trained personnel. Indeed, despite its important geopolitical role, Vladivostok and other Russian ports lag far behind other Asian ports by level of economic and port infrastructure development. To attract new investment and form advanced economic infrastructure as a locomotive of the territory's further development are objectives of the Free Port. Usually when a free port is established, the increase in the volume of transport operations is accompanied by the enhancement of port infrastructure. In this case we can expect gradual but steady development due to the Free Port functioning.

Third, it is corruption and criminal risks. Unfortunately, Primorye has a very disappointing statistics by level of crime in the economic sphere. Thus, in 2014 the number of corruption offences in the economy grew by 34.4%, compared to 2013; of them the largest share of violations is observed in public procurement, state control implementation, state (municipal) property use, land and budgetary legislation. The 2015 data also indicate the increased number of offences relating to bribery, graft and official forgery, including in the field of customs and foreign trade. According to experts, developing the Free Port, the authorities of all levels should consolidate efforts to minimize criminal corruption risks, which can reduce macroeconomic effect of the FPV [10, pp. 84-85].

Fourth, it is a threat of uncontrolled export of resources from Russia. Working out legislative and institutional mechanisms of the Free Port functioning, the government should consider not only the development of export-oriented commodity activities, but also the conditions and opportunities for establishing processing facilities that manufacture products of high readiness, including knowledge-intensive.

Thus, the Free Port, which is nowadays the main factor to increase competitiveness of the southern Far-Eastern territories and attract new investment, is affected by purely Russian problems. To successfully implement the law "On the Free Port of Vladivostok", it is necessary to improve the Russian normative-legal base in the sphere of customs, tax, fiscal, pricing, tariff policy, enhance and simplify the organizational mechanism of collaboration with residents and foreign partners and, importantly, extend experience and hone daily practices of the port in a new environment. The time of doubt and promises has passed. It is high time for the city and Primorsky Krai to act on the basis of a constructive dialogue of government, business and society. The most urgent tasks in the short term are the following: quality and detailed monitoring of economic processes on the territory of the Free Port of Vladivostok, consideration and adoption of the measures coordinating the work of all FPV participants in order to make the Free Port of Vladivostok a successful socio-economic project unprecedented in the country's history in a relatively short time.

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