ISBN 978-92-64-04597-2
OECD Investment Policy Review: Russian Federation

Executive Summary

The 2008 *Investment Policy Review of the Russian Federation* examines developments in the country's investment flows and policy since the last OECD Review published in 2006.* It also analyses Russia's energy investment policy against various aspects of the Policy Framework for Investment and considers corporate responsibility practices of large Russian companies.

In 2007 **Russia's international investment flows** reached the highest levels recorded so far. With USD 52 billion of foreign direct investment (FDI) inflows and USD 46 billion invested by Russian enterprises abroad, the country counts now among the world largest recipients and sources of FDI. Russia's FDI stock has considerably increased and the degree of FDI penetration has become comparable to other emerging market economies. Inward investment originates from a relatively few partner countries and is concentrated in the primary sector, manufacturing and traditional services such as trade. Russia's potential for attracting further foreign investments is significant giving its abundant natural resources and large and dynamic domestic market. The motivations of Russian enterprises investing abroad have considerably evolved in recent years. They now aim at internationalising their activities and controlling their value chains. This trend which concerns both state-controlled and large private enterprises is likely to continue in future.

A strengthening of state control has characterised Russia's recent economic development and has important implications for foreign investors. The new **law on strategic sectors** that entered into force in May 2008 defines 42 sectors in which the control by foreign investors will be subject to prior authorisation delivered by a special governmental commission. In replacing former *ad hoc* approval practices, the law is an important step in enhancing legal transparency and predictability. However, its sectoral coverage is broader and delays for notifications of governmental decisions longer than OECD recommended best practice which provide for investment restrictions narrowly focused on essential security and public order and a limited timeframe for completing reviews and notifying decisions. Another related phenomenon is the emergence of large state-controlled conglomerates which have often been

* OECD Investment Policy Review of the Russian Federation: "Enhancing Policy Transparency", Paris 2006.

established through consolidation of existing state-owned enterprises. These companies usually enjoy dominant market positions in their areas of activity. The scope and modalities of private sector participation, including by foreign investors, in these conglomerates are tightly controlled. An approach offering more opportunities for a positive contribution by the private sector and for beneficial competition would be better aligned with the government's declared strategy of modernising and enhancing the competitiveness of the Russian economy.

The overview of Russia's **energy investment policy** shows a significant heterogeneity in the policy approach adopted in the energy sector. While the state has strengthened its ownership and managerial control over oil and gas upstream activities and energy transport, the reform in the electricity sector has been actively pursued through the unbundling process associated with partial privatisation. Implementing a coherent energy investment policy framework is critical to cope with Russia's huge energy investment needs and sector-specific challenges, in particular volatility of world energy prices, significant sunk costs and usually long-term returns on investment. Several policies appear to be essential: continue the alignment of domestic energy prices with production costs, secure property rights, adapt the tax regime to differentiated production conditions and improve transparency of tax procedures, ensure effective competition policy and strengthen the independence of sectoral regulators. Maintaining the vital role of Russia's energy sector for the domestic economy and external economic relations thus depends not only on geological reserves and technological capacities but also on a sound energy investment policy framework enabling to attract adequate investment.

Responsible business practices have become an increasingly important element in evaluating countries' investment environment. As documented by OECD research, general awareness of international standards of corporate responsibility has been relatively low in Russia not only compared to OECD countries but also other emerging markets. The situation seems to be changing rapidly in conjunction with external exposure of large Russian enterprises. Recent studies indicate that large Russian enterprises have started to catch up with their counterparts in OECD and other emerging market economies. They now publish relatively detailed annual reports and provide information on their websites, including for instance on compliance with environmental standards. However, large Russian firms still give comparatively limited information on their adoption and observance of codes of conduct and management systems in place to promote business ethics. Dissemination of responsible business practices can boost Russia's creditworthiness and reliability as inward and outward investor.

The Annex summarises the findings of recent comparative **business surveys of the Russian investment climate**. Despite Russia's growing investment

 OECD INVESTMENT POLICY REVIEWS: RUSSIAN FEDERATION – ISBN 978-92-64-04597-2 – © OECD 2008

attractiveness evidenced by increased FDI inflows, many investors still perceive Russia's business climate uncertain and less favourable than in some other emerging markets. While expected high returns in the natural resources sector may make large foreign investors less sensitive to traditional investment barriers and explain a part of large FDI inflows recorded, the surveys report a number of factors which affect investors' perceptions, notably the persistence of regional disparities in business conditions and difficulties experienced by some categories of firms, especially small and medium-sized enterprises and exporters in obtaining information and in the face of regulatory uncertainty.