Foreword

The Review, a follow-up to the 2004 investment policy review of the Russian Federation, has been undertaken under the aegis of the OECD Investment Committee as a part of its co-operation programme with the Russian Federation. The European Commission has provided financial support for this work.

The Review benefited from close co-operation with the Russian authorities, especially Mr. Kirill Androsov, Deputy Minister, Ministry of Economic Development and Trade, and Mr. Andrei Kozlov, First Deputy Chairman of the Central Bank, who headed the high level delegation at the peer review by the Investment Committee held on 11 April 2006 in Paris.

*The business community and market practitioners also contributed to the preparations of the Review, in particular the Association of European Businesses (AEB), the OECD Business and Industry Advisory Committee (BIAC), the Association of Russian Banks, foreign-owned banks and securities firms and the Russian National Association of Securities Dealers. The analysis of regional aspects draws on discussions with Russian regional representatives and business associations in a workshop organised by the OECD in St. Petersburg in November 2005.**

The Review is based on a background report prepared by Blanka Kalinova, Senior Economist in the Investment Division of the OECD's Directorate for Financial and Enterprise Affairs, with input from consultants for the Division: Catriona Patterson and Eva Thiel who contributed chapter 5 and chapter 6 respectively, and James Beadle who undertook the OECD business survey in Russia. Celine Schwarz provided statistical support. Pamela Duffin is the Division's communication officer.

The Review is published under the responsibility of the OECD Investment Committee.

* The cut-off point for information in this report is 1 June 2006.

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Prefaces

This Review is part of long-standing co-operation between the OECD and the Russian Federation aimed at fostering mutually beneficial dialogue and supporting Russia's efforts to strengthen its policies in line with OECD best practices and instruments. In examining recent developments in Russia's regulatory environment, the Review highlights challenges and progress in investment policy and capital control liberalisation, with a focus on policy transparency. It encourages open and transparent implementation of recent initiatives such as the creation of special economic zones and upcoming legislation on the so-called strategic sectors. Enhancing the policy framework for investment will allow Russia to attract more and better international investment, stimulating sustainable growth and economic modernisation.

Throughout this Review, the OECD Investment Committee has sought to play an effective supporting role by offering a forum for sharing experiences among Russian and OECD government officials and engaging the business community and other stakeholders on the range of emerging investment policy issues. This interaction has also been conducive to closer compatibility between Russia's investment regulations and the standards embodied in the OECD Code of Liberalisation of Capital Movements and the Declaration on International Investment and Multinational Enterprises.

On behalf of the Investment Committee, I would like to thank the Government of the Russian Federation, especially the Ministry of Economic Development and Trade and the Central Bank of Russia for their active involvement in this work and distinctive contribution to the investment policy review of Russia by the Investment Committee in April 2006 in Paris on which this publication is based.

Manfred Schekulin
Chair, OECD Investment Committee

On behalf of the Ministry of Economic Development and Trade of the Russian Federation, I would like to express our appreciation of the fruitful collaboration with the Organisation for Economic Co-operation and Development on investment policy issues, which this Review further confirms and strengthens.

The Review recognises significant progress by the Russian Federation in improving the investment climate and attracting foreign investment and also points to remaining shortcomings and obstacles which still prevent our country from becoming a major recipient of international investment. By putting our achievements in an international perspective and comparing our investment policies with OECD countries' good practices in this area the Review and policy dialogue contribute to identifying main priorities and adopting adequate measures to enhance the role of foreign investment in Russia's economic development. As indicated by the Review several initiatives recently undertaken by the government have aimed to encourage the participation of domestic and foreign investors, in particular the creation of special economic zones and introduction of public-private partnership in infrastructures. We share the view that the success of these schemes as well as the role of the upcoming legislation on strategic sectors will greatly depend on the transparency of the relevant regulatory framework and its implementation.

I consider the Review of the Russian Investment Policy to be an important step in our co-operation with the Organisation and hope that it will be actively pursued, thereby reinforcing our partnership and participation within the international investment community.

Kirill Androsov
Deputy Minister
Ministry of Economic Development and Trade

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Russian Federation
Enhancing Policy Transparency

Overview and Recommendations

The 2006 Investment Policy Review examines developments in Russia's regulatory investment environment since the last OECD Review in 2004. It includes an analysis of capital control reform and a survey of Russia's approach to international investment agreements. In assessing these developments and offering options for further improvements, **policy transparency has been the focus of this Review**.

More international investment is needed to support Russia's economic development and diversification. Since 2003, Russia has attracted increased amounts of foreign direct investment (FDI), which reached record levels in 2004 and 2005. However, the share of FDI in domestic capital formation still remains low by international comparison. In 2005 the manufacturing sector attracted the largest FDI share and the energy sector absorbed one third of inflows, but Russia's service sectors have not yet benefited from significant FDI. Russia's international investment statistics provided by the Central Bank of Russia have been improved in line with OECD standards, but consistency problems between Russian different data sources persist.

Despite progress, the level of restrictions on foreign investment remains above the OECD average. Russia's formal barriers to FDI are high in insurance, electricity and transport, whereas some other sectors such as distribution and business services have been opened up. In addition to equity restrictions, foreign investors face impediments in licensing procedures and other business-related regulations concerning for example foreign personnel. These difficulties are often aggravated by corruption and the lack of predictability.

The OECD Review shows that insufficient policy transparency remains a serious obstacle to investment. Based on an OECD business survey carried out in 2005, foreign investors acknowledged improvements in information access and administrative simplification in a number of areas, such as foreign exchange regulations, but expressed concerns about non-transparent implementation in other fields, often under the responsibility of regional administrations, including land and property registration and work permits. The business community also finds prior consultation on regulatory changes insufficient. Improved policy transparency would naturally limit opportunities for corruption, which has been identified as a major impediment to investment in a number of other recent business surveys.

New laws on Special Economic Zones (SEZ) and Concessions can have a positive impact on investment. Costly investment promotion efforts and targeted investment incentives have not been effective in helping regions attract more foreign investment. The new laws could allow regions to exploit their potential comparative advantages better if they are implemented in a non-discriminatory and transparent manner, with a minimum of market distortion. A regulatory impact assessment of these programmes would be desirable, especially given the past experience with SEZ in Russia.

The forthcoming laws on "strategic sectors" and on subsoil will be a test of the government's commitment to transparency. Consistent with best practice under the OECD instruments, the Review recommends that the future strategic sector law narrowly defines the sectors concerned, limits the scope of restrictions to foreign control over domestic companies based on a strict interpretation of essential security interests, and clarifies the modalities of government review and permission procedures, in particular, by establishing specified time limits for notifications of government decisions to the applicants.

The Review welcomes the abolition of certain capital controls on 1 July 2006, in advance of the schedule of 1 January 2007 initially foreseen by the 2004 Foreign Exchange Law. Financial market participants have considered the system of capital controls too complex, insufficiently transparent, often ineffective and costly for both foreign and domestic investors. Consistent with the OECD instruments, the orderly removal of capital controls needs to be accompanied by supporting measures, including statistical reporting, appropriate tax control, anti-money laundering and non-discriminatory prudential safeguards. The Review encourages efforts to improve information sharing among the regulatory bodies of financial markets in Russia.

The Review invites continued efforts to enhance investment policy transparency. It welcomes the planned reduction of activities subject to mandatory licensing and the establishment of a Register of regional and municipal legislation. It encourages a speedy adoption of the new law on access to information submitted by the government in 2005. The Review recommends more effective and systematic consultations with interested parties, publishing and reviewing administrative decisions, and using electronic dissemination of investment regulations more extensively. It suggests the application and disclosure of regulatory impact assessments for special investment incentives regimes. The Review also encourages the inclusion of strong transparency disciplines in Russia's future international investment agreements.