



OECD-RUSSIA EXPERT MEETING ON RUSSIA'S INVESTMENT POLICY: RECENT TRENDS AND SPOTLIGHT ON ENERGY

(Moscow, 9 April 2008)

SUMMARY OF DISCUSSIONS

Organised jointly by the OECD and the Russian Ministry of Economic Development and Trade with the financial support of the Ministry for Foreign Affairs of Finland, the meeting has provided an opportunity to Russian and OECD officials and experts to review and contribute to comment the draft OECD Investment Policy Review of Russia to be published in summer 2008. Discussions focused on recent developments in Russia's investment policy, notably the recently adopted law on 'strategic sectors' and its implications for foreign direct investment, in particular in the energy sector. Seventy participants attended the meeting, including representatives of 12 OECD countries and the EC, Russian government officials from several ministries and governmental agencies as well as business representatives and Russian and OECD experts (see the list of participants).

Making FDI growth sustainable

Although available Russian FDI statistics have to be interpreted with caution, Russian authorities see the remarkable growth of FDI flows to Russia in 2007 as a confirmation of the country's economic dynamism which contradicts the negative perception of Russia's investment climate noted in some business surveys summarised in the draft OECD Review. Whereas large firms and the energy sector are strongly represented in Russia's FDI, other sectors, such as food processing and financial services, have also attracted significant foreign investment and small and medium-sized enterprises start showing interest in investing in Russia. EU countries remain the major foreign investors in Russia (80% of FDI inward stock) as well as the main destination of Russia's FDI outflows (nearly 2/3 of the total in 2007), but firms from other countries, in particular Japan and Korea are now also looking for investment opportunities in Russia. To assess FDI developments in Russia and evaluate their impact on domestic economy, more reliable and detailed data would be useful, especially concerning the importance of round-tripping flows and the respective shares of greenfield investment versus mergers and acquisitions within international investment in Russia. The main challenge for Russia is to maintain recent dynamic trends and further diversify geographical and sectoral structures of FDI flows.

Investment climate: is the glass half full or half empty?

In the opinion of the Russian business community, the improved investment environment is mainly a result of the country's favourable macroeconomic situation and dynamic domestic market which allow incumbent firms generate high profits and encourage them to reinvest in Russia. Several other elements contribute to the country's attractiveness, notably the availability of energy and natural resources, skilled labour and still relatively low wage levels. However, many shortcomings persist and dissuade potential investors among both Russian and foreign firms, especially corruption, high taxation and outdated infrastructure. The Russian business community considers the existing legal and regulatory framework at

the federal level generally adequate but its implementation especially at regional and local levels and in some specific areas such as intellectual property rights less satisfactory. Foreign investors can rely on protection offered by bilateral investment treaties which however do not provide sufficient guarantees in all relevant areas. Achievements of the economic liberalisation process still have to be consolidated in WTO and OECD international commitments. The main policy challenge remains to ensure the level playing field for all categories of firms whether domestic or foreign, large or small.

Russia's Chamber of Commerce and the Russian Union of Industrialists and Entrepreneurs (RSPP in Russian) actively support enterprise development in particular through their involvement in preparation of new legislative acts and international cooperation. Recently for example, the RSPP participated in the development of the law on strategic sectors. It argued for and obtained further simplification of the authorisation procedures. A commission bringing together representatives of foreign and domestic firms operating in Russia has been recently established with the objective to present to the Russian government a common view of the business community on possible actions to deal with the administrative burden. International cooperation within the framework of inter-governmental agreements and joint activities with other business associations also contribute to enhance the business climate in Russia.

On the behalf of the OECD business community, the BIAC representative expressed concerns regarding remaining formal and informal barriers to foreign investment in Russia and the increasing economic role of the state. As a result, the country's considerable business and investment potential is not yet fully exploited. Whereas the investment dialogue at the governmental level and within the business community may help resolve many operational issues, Russia has to adhere to international disciplines embodied in particular in the Energy Charter, GATS and OECD investment instruments and adopt good international practices in the areas such as combating corruption, regulatory reform and corporate governance.

Spotlight on energy

In the coming years, the Russian energy sector will require considerable investment. Although some energy investment will be financed from internal sources generated in particular by gas and oil export earnings, Russia has to secure additional resources, including through FDI. As emphasised in the chapter on energy investment policy included in the draft OECD Investment Policy Review, the reform process has considerably advanced in the electricity generation and distribution open to privatisation and foreign investment, whereas the state ownership and oversight have been strengthened in the oil and gas sectors, most recently also through provisions of the law on strategic sectors.

This new law was adopted by the Duma and the Federal Council in March 2008 and is expected to be signed by President Putin before the end of his mandate. It specifies 42 sectors in which the control by foreign investors will be subject to the government's approval. In addition to the defence-related activities, the sectors concerned include nuclear installations, aerospace equipment and technology, natural monopolies, fixed telephone communications, television and radio broadcasting and publishing. The screening process will be applied to FDI projects resulting in the acquisition by foreign investors over 50% of shares in strategic enterprises and to transactions concerning over 10% of shares acquired by foreign investors in companies involved in exploration and exploitation of subsoil plots of federal importance. Foreign state-owned companies have to obtain the prior approval if their involvement reaches over 25% of shares in strategic entities and over 5% in subsoil prospection and extraction activities.

In replacing former case-by-case approval practices, the law on strategic sectors will enhance legal transparency and predictability. Foreign investors also appreciate that the law will not be applied retroactively. However, several aspects of the law are questioned by foreign investors, in particular its broad sectoral coverage and the fact that the law does not apply to majority state-owned enterprises. Low thresholds applied on foreign participation in oil and gas prospection and extraction risk aggravate the

situation in these sectors facing increasingly difficult exploitation conditions and struggling to cope with growing domestic and international demand pressures. As documented during the meeting, the experience of other oil producing countries shows that energy investment requires high transparency and predictability in public decision-making, protected property rights and sufficient flexibility of taxation.

Fully aware of the essential role of competition policy in the energy sector, the Russian Federal Anti-monopoly Service (FAS) seeks not only to promote competition but takes various legislative initiatives and is actively involved in the regulatory process. Current efforts focus on transparency in energy pricing as a pre-condition for adequate investment and effective functioning of the sector. Another FAS' priority is to improve the situation in the energy transport, in particular to facilitate the access of independent companies to the transportation network.

In sum, energy investment, though subject to some specific economic constraints and strategic and political considerations requires the similar general conditions as investment in other sectors, notably transparent and predictable business environment and policy setting. The draft Investment Policy Review and discussions at the expert meeting showed that Russia-OECD policy dialogue in this area is useful to draw attention to the need for policy coherence and identify energy investment policy options and priorities.