

Competition Law and Policy in the Russian Federation

**What have been
the strengths
and weaknesses of Russian
competition policy to date?**

**What should be key
priorities in drafting
the new competition law?**

**What must be done
to make the new
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Introduction

When the Russian Federation began its transition toward a market-based economy, promoting competition and regulating anticompetitive behavior – issues never previously needing to be addressed – arose as new and unfamiliar subjects for state policymaking and law enforcement activities. In order to address these issues, the Russian Federation created a competition authority and basic law in 1991, quite early in its transition period. Support for competition was expressed in the 1993 Constitution, as well as in other fundamental legislation. As part of a larger study of regulatory reform, the OECD in 2003 undertook a detailed assessment of Russia's decade of experience with competition law and policy. The Report concludes that despite early legislation on the issue and strong expressions of support for competition in the laws, the creation and protection of competition on domestic markets has not been a policy priority. Emphasis on rapid privatization limited the scope of pre-privatization restructuring to promote competition and the competition authority has been expected to serve as a general regulator of behavior in markets, assigned to fill legislative gaps and to enforce against a variety of undesirable practices in markets. Overly broad responsibilities and a lack of credible sanctions have significantly limited the impact of the competition laws.

As Russia moves into a new phase of economic expansion, a strong and effective competition policy will be essential for meeting policy priorities, including the government's current goals of broadening economic growth to include more domestic industries and geographic areas, raising levels of living and creating new investment and new business opportunities. It is unlikely these goals can be achieved without removing state and private impediments to entry and to vigorous and fair competition in a transparent and open environment. The OECD's Report, however, concluded that serious structural and legal problems have interfered with the Russian competition authority's ability to effectively enforce the competition laws and to undertake focused competition advocacy. These problems include an overly broad mandate for the competition authority, inadequate investigative authority, a nearly complete absence of credible sanctions for violations, lack of clarity in legal standards and a lack of substantive economic analysis in enforcement decisions. Only a few weeks after the Report was issued, the Russian

Government undertook a fundamental restructuring of federal executive bodies that included the creation of a Federal Antimonopoly Service with a narrowed focus. The passage of a new competition law has been identified as a priority for the near future, and work on the law is proceeding. These circumstances present an excellent opportunity for the problems identified by the Report in both the institutional structure and the legal framework to be addressed, making the new competition authority better able to meet the challenges of reform and be a catalyst for economic growth. ■

What have been the strengths and weaknesses of Russian competition policy to date?

Despite some periods of instability, Russia has completed the transformation of a large number of basic economic and legal institutions within a period of little more than a decade, replacing many of them with completely new structures. The creation of a competition-based, market economy has been clearly articulated as a central goal of this transition process, with support for competition strongly expressed in the Constitution and Civil Code, as well as in the early creation of a competition law and competition authority. In practice, however, the competition authority has faced a shifting policy environment in which the creation of domestic competition and the direct enforcement of competition law have been secondary concerns, subordinated to other policy goals such as rapid privatization, crisis recovery and the creation of internationally competitive companies. Despite this, it has made contributions to the creation of the environment for competitive markets both through enforcement actions and through participation in policy formation and legislative drafting efforts. These include a substantial reduction of direct barriers to the movement of goods and services within the country and a leading role in the creation of the basic legislative frameworks for consumer protection, advertising regulation and other tasks that are necessary to allow markets to function in a reasonable manner. The competition authority has also played a central role in regulatory reform efforts directed at natural monopoly sectors. It led the initial drafting effort for the law on natural monopolies, creating a narrow definition, and as regulatory reforms have moved forward, the competition authority has continued to play an active role in the process – proposing models for the restructured industries and supervising the conduct of their

newly formed components to ensure non-discriminatory access for competitors.

With respect to the creation and protection of competition, however, some serious structural and legal problems have interfered with the ability of the Russian competition authority to be efficient in its enforcement efforts and to undertake focused competition advocacy. One of the chief structural problems has been the breadth of the competition authority's responsibilities. The initial conception of the competition authority as broadly responsible for civilizing markets and protecting public interests and weaker parties resulted in task overload, with assigned duties in the areas of consumer protection, advertising regulation, supervision of commodity exchanges, protection of small business and other areas that required different skill sets and procedures and scattered the resources and focus of the agency. This has been aggravated by the regular addition of enforcement responsibilities under the rubric of competition law. In 2002, new language added to the Law on Competition made the competition authority responsible for enforcing rules concerning competitive state purchasing. As part of the reform of the electricity industry, the competition authority has been assigned to supervise the dispatcher in the wholesale electricity market, and as of early 2004 rules were being developed requiring nondiscriminatory purchasing by natural monopolies that the competition authority would be assigned to enforce.

The substantive competition law, while relatively complete in terms of its areas of coverage, does not provide the competition authority with the tools needed to be effective. First, it does not contain credible sanctions. For even the most serious and damaging violations of the competition law, the consequences to a violator are minimal – usually limited to a cease and desist order. Substantive fines are so modest as to have little or no deterrent effect and are available only for a failure to observe an order or to file required information. While criminal sanctions are provided for by law, they have never been applied. Second, the law fails to provide the competition authority with sufficient investigative powers. Procedures for obtaining information are cumbersome and rely primarily on written requests. A minor administrative fine and a repeated request are the sole consequences of failure to comply with requests for information. The competition authority cannot compel testimony while searches of premises, are in theory possible with the cooperation of local law enforcement, but are in practice complicated and rarely occur.

Weaknesses in authority are compounded by an unrealistically large workload that is produced by a lack of discretion to refuse cases, broad wording of some provisions of the law, low merger control thresholds and incomplete regulation of the behaviour of monopolies. Many of the cases that the competition authority is required to address are repetitive, small in scope, and unlikely to have a significant effect on competition. Large amounts of resources have been devoted to the resolution, under formal investigation and case consideration procedures, of disputes between specific entrepreneurs and state bodies and between monopoly utility providers and specific customers – functions that do not appreciably increase levels of competition overall and that could more efficiently be performed by other bodies and/or under more streamlined procedural and substantive rules. Low merger control thresholds produced a caseload of over 25 000 merger control matters alone in 2002, making it impossible for staff to complete a serious analysis of most cases within the legally imposed time limits. The pressure of the enormous caseload, as well as difficulties in obtaining information and in attracting and retaining highly trained staff, have contributed to a marked lack of substantive economic analysis in decisions. This lack of analysis, in its turn, reduces confidence in the competition authority’s decisions and contributes to inconsistent results in appeals. In order for the new Federal Antimonopoly Service to respond effectively to the most serious competition problems and to meet the challenges of enforcement in newly deregulated sectors of the economy, these problems must be addressed in the design of the new body and in the provisions of the new competition law. ■

What should be key priorities in drafting the new competition law?

Provide credible sanctions against violators

The law must provide credible sanctions against violators in the form of substantial fines or other penalties that can be imposed directly upon a finding of a violation, rather than after failure to follow a cease and desist order. Fines must be high enough to provide a serious deterrence, which will require that they be adjusted to take the size and economic position of the violator into account (an example of this is the percentage of turnover measures in use in some jurisdictions). It would also be desirable to encourage private actions for damages as both a supplementary form of

sanction against violators and as a means to raise awareness of competition issues in the business community. The existence of criminal law penalties can provide clear evidence of the seriousness of commitment to competition as well as some additional deterrence and leverage that may be used in a leniency program. However, for criminal sanctions to have any real effect, at least some criminal prosecutions must be undertaken, and this will require the necessary changes in the laws and arrangements for cooperation with prosecutorial bodies. For a variety of reasons, however, including intent and proof standards under the criminal law and its application only to individuals, criminal sanctions cannot substitute for significant monetary sanctions imposed on enterprises through civil or administrative proceedings. Priority in the short term should be given to increasing civil and administrative penalties and enforcing them effectively.

Substantially reduce merger control submissions, strengthen economic analysis and structural remedies

The number of merger filings received per year under the current law exceeds 25 000 and is far too large to allow any real analysis. Very significant increases in the merger control thresholds will certainly be required to give competition authority staff the ability to do more than a brief review of submitted files for completeness. Strong consideration should also be given to the addition of criteria that would prevent companies whose own asset values meet the single, combined asset threshold from being required to notify (and FAS required to review) every transaction they conclude. A minimum value for the second company participating in the transaction could serve this purpose. As accounting practices move toward international standards and objective market valuations of transactions become more readily available, merger control rules should move away from the use of overall asset value criteria toward the use of transaction values and/or other measures that more accurately reflect the economic activity of the participants in the transaction (such as turnover).

Even with a vastly reduced burden, it may also be appropriate to provide for a two-tiered review system, allowing mergers unlikely to affect competition to be dealt with quickly and on the basis of limited information, while providing more generous time frames for the analysis of those that are of greatest concern and a greater ability to demand information. The law should provide specifically for the possibility of struc-

tural remedies. Increased use of such remedies should reduce the need for ongoing detailed supervision of the business activities of enterprises and help to allow FAS to accommodate mergers designed to increase international competitiveness without simultaneously permitting monopolization or inviting abuses on domestic markets. Parties to transactions should not be allowed to hide their true corporate structures and control relationships behind nominal holdings or offshore ownership and the law should make clear FAS' authority to require parties to provide all of the necessary information and to refuse consent or impose penalties when it is absent. Equally important, although not a matter of legal provisions, will be political support for a tough stance on such matters –the desire to facilitate inward investment should not result in pressure on FAS to approve transactions where parties have failed to provide adequate information on beneficial ownership and control.

Focus state action provisions on conduct that restricts competition

Until 2002, the provisions of the competition law on state actions appeared to make any action that violated the rights of an entrepreneur or enterprise a competition law violation, even if there was no effect on competition as a result of the violation. An amendment to the law in 2002 appeared to resolve this problem, making requirements for an infringement of rights and a restriction of competition cumulative. This did not, however, result in an immediate reduction in the number of state action cases. Provisions concerning anticompetitive actions of state bodies should be clearly focused on the protection of competition rather than individual competitors. Cases concerning individual license denials, lease renewals, zoning disputes, land rents and similar matters should be referred to courts or other dispute resolution facilities and resolved on the basis of standards for decision reflected in the relevant laws. FAS should not be responsible for reviewing such matters to determine whether a state body's decision is "groundless" and therefore an improper interference with an economic actor. For cases in which a state action or policy does affect competition, a more complex standard for evaluation needs to be developed that balances the effect on competition against the legitimate needs and responsibilities of the state actors. Achieving a clearer focus in this area will require the elimination of the current vague legislative prohibitions on "groundless" actions by state bodies and a clearer articulation of the elements of a violation.

Create clear legal standards for agreements and priority enforcement against restrictive agreements

Investigation and prosecution of anticompetitive agreements has been a particularly difficult area for the Russian competition authority. This is related in part to issues of investigative authority discussed above, but ambiguous legislation, unhelpful amendment and a lack of clarity concerning standards of proof for agreements have also played a significant role. Since its initial passage, the Law on Competition has contained provisions covering vertical agreements and also both horizontal agreements and coordinated actions or concerted practices. A definition of concerted practices has never been developed, however, and some courts have subjected agreements to extremely restrictive standards of proof. After amendments in 2002, the Law on Competition contains a confusing requirement that the participants in a vertical agreement collectively possess a 35% share of a market, and does not allow the competition authority to clear any horizontal agreement that does not restrict competition unless that agreement was voluntarily submitted for prior approval. Clear legal provisions applicable to both horizontal and vertical agreements should be a high priority in legislative drafting work. Specific description of adequate proof in varying cases cannot, however, be included directly in legislation and it will be necessary also to undertake work on guidelines for investigations and for the application of the law in markets characterized by oligopoly and high degrees of vertical integration. ■

What must be done to make the new Federal Antimonopoly Service effective?

Increase FAS's investigative powers

Although the Law on Competition includes a requirement that police and other bodies assist the competition authority in gaining access to premises and performing other investigative tasks, staff have reported that obtaining such cooperation can be difficult and result in significant delays. The law also requires businesses and other entities to provide information requested by the competition authority, but the process for enforcing this obligation is also time-consuming and the sanctions for failure to provide it are low. Under these circumstances, the competition authority loses efficiency and is unlikely ever to receive evidence of the most serious violations,

such as those that may result in criminal sanctions. In order for cartels and other serious competition violations to be discovered, FAS must be able to receive the kinds of evidence that is likely to be destroyed if prior warning is given and also the testimony of staff and other persons. If it is not considered to be desirable for FAS itself to possess the corresponding powers, more effective mechanisms for cooperation with the police, procuracy and other bodies must be found. In addition, more significant and immediate sanctions should be provided for failure to provide information in response to written requests, with a possibility for increasing penalties with increased delay. Deliberate provision of false information should be separated from failures or delays and should be subject to greater penalties.

Allow FAS to focus solely on competition issues

The competition authority's tasks have been too broad and too varied in their nature for any single body to be able to perform them well. The creation of the new Federal Antimonopoly Service has gone a considerable distance toward narrowing the authority's focus, having assigned duties related to consumer protection, regulation of commodity exchanges, promotion of small business and tariff setting functions to other bodies. Even with this reduced task list, however, care will need to be taken to ensure that FAS is able to concentrate on the most serious competition problems. In addition to the laws on competition, the new body retains responsibility for the enforcement of advertising laws and the law on natural monopolies, and there was some indication at the time of its formation that it would be assigned additional tasks and authorities related to the supervision of reforming natural monopoly sectors. While some of the tasks in these additional areas are closely related to competition concerns, others are not and it may be appropriate for additional enforcement authorities to be moved to other bodies. As an example, some violations of advertising law are clearly related to the unfair competition rules contained in the competition laws. But rules restricting the advertising of alcohol or tobacco or governing the use of images of children or restricting the placement and duration of advertisements in broadcast media are not primarily designed to protect or promote competition and their enforcement requires very different skills, information processing and work patterns. Consideration should be given to the assignment of those tasks to the federal

bodies more closely associated with broadcasting and publishing activities.

Relieve FAS of the burden of resolving disputes between regulated monopolies and consumers

The absence of comprehensive regulation of natural monopoly activity has left the Russian competition authority with a large burden of abuse of dominance cases that are in essence disputes between a regulated monopoly and a customer concerning service obligations, applicable tariffs or contract terms. To date it has been necessary to resolve these cases by applying quasi-judicial procedures requiring formal proof of the dominance of the entity and of the abuse and allowing a remedy that applies only to the specific situation considered. This is inefficient and leads to repetitive consideration of issues and lengthy court appeals challenging the dominance of regulated monopolies and the abusive nature of specific behaviour, with varying outcomes. A far more efficient resolution of this problem would involve more detailed and comprehensive regulation *ex ante* of permissible contract terms and service obligations. It would be preferable for this to be done by independent sectoral regulators, who could also possess the power to resolve complaints and disputes about such matters through simplified proceedings and to impose a solution that would bind the regulated entity in all similar situations. This would allow the regulator to make decisions on such matters as permissible types and levels of penalties that are consistent with the pricing models being used to set tariffs, and would avoid the repetition and inconsistencies inherent in the current system. FAS could continue to serve in a supervisory role, able to address undue restriction of competition by the regulator through its authority over anticompetitive actions and decisions of state bodies, but relieved of the burden of service as a forum for the resolution of thousands of specific complaints. Unfortunately, current plans do not appear to call for strong and independent sectoral regulators of the type under discussion here, and it may not be appropriate for dispute resolution tasks to be transferred to a unified tariff setting body. Under these circumstances, consideration should nevertheless be given to clearer and more comprehensive regulation of behavior in regulated sectors through regulations or model provisions and to the creation of a separate, more streamlined procedure for the consideration of disputes concerning violations by the competition authority.

Reduce or eliminate FAS responsibility for general oversight of state purchasing

The 2002 amendments to the Law on Competition added an article creating “antimonopoly requirements” for most state purchases and appear to make the competition authority responsible for supervising all such activity and seeking to void tenders where improper conduct or conditions were present. In the financial services sector, these responsibilities go further, with not only a general requirement that services for state bodies be obtained through tender, but also a requirement that the terms for tenders for all purchases of financial services with budgetary funds get prior approval. The volume of state purchasing is enormous, and these provisions may impose a nearly unlimited drain on FAS resources as it attempts to monitor state purchasing at all levels and is drawn into disputes concerning whether the specific requirements contained in a tender are appropriate or are designed to advantage a particular supplier. While a requirement that state bodies use competitive purchasing procedures may stimulate competition in a variety of markets, enforcement of that requirement should be entrusted to state financial and/or auditing bodies, backed up by a system for private complaint.

It also has been proposed that the competition authority take on similar supervisory responsibilities in relation to the purchasing activities of natural monopolies within newly formed regulatory structures, in order to ensure that these do not advantage related companies or otherwise restrict competition. Concern about such activities is appropriate in the Russian environment, where divestiture of non-core holdings by infrastructure monopolies is being conducted in some areas simultaneously with, rather than prior to, the first stages of other structural reform (e.g. railways). Detailed supervision of such purchasing activities, however, will entail many of the same problems as detailed control of state purchasing, requiring a detailed and ongoing involvement by FAS in the business activities of the relevant entities. This is a task more appropriate to sectoral regulators than to the competition authority.

Broaden responsibility for support of competition

Assigning all competition policy concerns only to the competition authority leads to an unrealistic multiplication of its tasks and responsibilities and may foster counterproductive attitudes and behaviour on the part of other bodies (branch ministries, privatization authorities, tariff regulators, and others) that are unaware of competition issues or view their primary responsibili-

ties as unrelated to competition concerns. While the specific investigation of violations and enforcement of the competition law may be a task exclusive to the competition authority, the general promotion and support of competition – as a core value expressed in the Constitution and a key element of the economic policy of the Government – should be the responsibility of all state bodies within the bounds of their authority. Inclusion of more specific responsibilities for promoting competition or eliminating competition restrictions in the mandates of ministries, regulators and other bodies would also broaden appreciation of the centrality of competition to a healthy economy. One area in which broader distribution of responsibility for competition could have a significant impact would be further reform in the areas of price regulation, licensing and other restrictions that continue to exist in many spheres and are administered by a variety of state bodies. Making the state bodies administering such restrictions responsible for reviewing them and removing (or proposing the removal of) as many as possible would require the bodies to explicitly consider the competition impacts of government regulation in their spheres and evaluate alternatives, creating a valuable skill as well as promoting further regulatory reform.

Improve the information gathering capabilities of the staff

Competition authority staff report that they do not have the time to undertake such standard tasks as carrying out telephone interviews of market participants or distributing questionnaires for the purpose of market definition, nor do they receive timely and accurate information. The reduction of enforcement burdens and increased investigatory powers recommended above may themselves lead to improved economic analysis by providing more opportunities for such work to be performed and better quality information. Information held by such bodies as the state statistics agency and branch ministries should be available to FAS when necessary for investigations and analyses. Receipt and circulation of firm-specific information by all state bodies is complicated by a lack of clear legal rules on confidential business information. Many state bodies and officials are subject to a general requirement to compensate damages caused by improper revelation of confidential information, and in the absence of specific rules on what is sufficient protection of such information, the liability provisions tend to discourage information sharing. While a recently passed law has made some progress on the definition of what information may be

considered to be confidential and what steps must be taken by companies to protect such information, the rules concerning sharing of such information by state bodies and the procedures that must be followed when using it remain to be defined.

Improve the economic analysis capabilities of the staff

Improvements in workloads and information flow are certainly necessary to allow high quality analysis, but they may not be sufficient to remedy the marked absence of in-depth economic analysis in the work of the authority. Data for 2003 showed that only half of the employees of the Ministry for Antimonopoly Policy had a higher education in an area generally related to its work (economics, law or management), and advanced degrees in economics were very rare. Turnover rates in the central body have been as high as 25% per year, reflecting in part the higher salaries available in the private sector. Under these circumstances, practical training of staff members in economic analysis and the attraction and retention of qualified staff will need to be a high priority for FAS. One possibility for consideration might be the creation within FAS of a specialized economic analysis department that would both assist other departments on economic issues and prepare training materials and guidelines to give staff members practical training on case investigation and analysis using realistically available information sources.

Improve transparency and increase public understanding of the benefits of competition

A first-order priority should be the preparation and dissemination of informational materials designed for the general public and for the business community explaining the benefits of competition and the provisions of the competition laws. Many sources suggest that public understanding of the meaning and benefits

of competition (as opposed to competitiveness or other concepts) is low and knowledge of competition law is limited. Without clear notice concerning the contents of the law, enforcement actions raise procedural fairness questions. And better appreciation of the benefits of competition and the provisions of the competition laws will allow the public and the business community to be active partners with FAS in the promotion of competition and the discovery of violations. Priority should also be given to improving access to the written decisions applying competition law and to ensuring that public notices and information contain not only the fact that specific actions or decisions have been taken, but also a clear statement about the reasoning behind them. This will allow those interested to develop an accurate understanding of the interpretation and enforcement of the law and allow them to conform their conduct appropriately. Such transparency will also help to reassure the public and the business community about the quality of the competition authority's analysis and the adequacy of its motivations. In its absence, decisions may seem random or suggestions of inappropriate motivations for particular actions may appear credible, leading to an atmosphere of insecurity and mistrust that are not conducive investment and growth. ■

For further information

For further information about the OECD's work on competition policy, please see our website at www.oecd.org/competition or contact us at daf-comp.contact@oecd.org.

For further information about this policy brief, please contact:

Sally Van Siclen, Tel.: +33 (0) 1 45 24 78 30

E-mail: sally.vansiclen@oecd.org. ■

For further reading

OECD Peer Reviews are available on our website at www.oecd.org/competition (see the "Country Reviews" section):

- Competition Law and Policy in Russia, OECD 2004
- Competition Law and Policy in Peru, OECD 2004
- Competition Law and Policy in Mexico, OECD 2004
- Competition Law and Policy in Chile, OECD 2004
- Competition Law and Policy in South Africa, OECD 2003

OECD Publications:

- OECD Economic Surveys: Russian Federation, OECD 2004, ISBN: 92-64-01634-1, € 35.00
- OECD Investment Policy Reviews Russian Federation, OECD 2004, ISBN: 92-64-01849-2, € 35.00
- OECD Journal of Competition Law and Policy, ISSN: 1560-7771, Subscription (3 issues per year) € 189

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Where to contact us?

FRANCE

OECD Headquarters
2, rue André-Pascal
75775 PARIS Cedex 16
Tel.: (33) 01 45 24 81 81
Fax: (33) 01 45 24 19 50
E-mail: sales@oecd.org
Internet: www.oecd.org

GERMANY

OECD BERLIN Centre
Schumannstrasse 10
D-10117 BERLIN
Tel.: (49-30) 288 8353
Fax: (49-30) 288 83545
E-mail:
berlin.contact@oecd.org
Internet:
www.oecd.org/deutschland

JAPAN

OECD TOKYO Centre
Nippon Press Center Bldg
2-2-1 Uchisaiwaicho,
Chiyoda-ku
TOKYO 100-0011
Tel.: (81-3) 5532 0021
Fax: (81-3) 5532 0036/0035
E-mail: center@oecdtokyo.org
Internet: www.oecdtokyo.org

MEXICO

OECD MEXICO Centre
Av. Presidente Mazaryk 526
Colonia: Polanco
C.P. 11560
MEXICO, D.F.
Tel.: (00.52.55) 52818 3810
Fax: (00.52.55) 5280 0480
E-mail:
mexico.contact@oecd.org
Internet:
www.ocdemexico.org.mx

UNITED STATES

OECD WASHINGTON Center
2001 L Street N.W.,
Suite 650
WASHINGTON D.C. 20036-4922
Tel.: (1-202) 785 6323
Fax: (1-202) 785 0350
E-mail:
washington.contact@oecd.org
Internet: www.oecdwash.org
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