OECD ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

SEMINAR ON RECENT DEVELOPMENTS IN RUSSIA'S INVESTMENT ENVIRONMENT AND POLICY

Helsinki, 21 - 22 May 2007

Summary of Discussions by the Secretariat

Organised with the support of the Finnish authorities, the objective of this OECD Seminar[1] was to mobilise business experience and available expertise in preparation for work on the next OECD Investment Policy Review of Russia to be completed in 2008. Discussions amongst the 70 participants[2] addressed recent trends in the country's investment policy openness and transparency, its growing involvement in international investment inflows and outflows, especially in the energy sector, and promotion of responsible business practices by Russian firms. The seminar also provided useful insights to discussions on Russia's investment attractiveness at the International Economic Forum taking place on 8-10 June in St. Petersburg.

Dealing with policy uncertainty

As emphasised in the introduction by the Russian representative, Russia's rich natural resources, robust economic growth and dynamic domestic market have made it increasingly attractive for international investment. However the country's investment needs and absorption potential are far from being fully exploited. Despite the recent upsurge, inward foreign direct investment (FDI)[3] remains relatively modest as a share of GDP and total investment and their geographical and sectoral structures are not sufficiently diversified.

Business representatives and practitioners of major law and consulting firms operating in Russia considered that by and large the basic legal framework for foreign investors' activities is now in place and could be assessed as relatively open overall. Regulatory implementation has also significantly improved in many areas, for example, with regard to the promptness of judicial procedures. However, investors continue to confront a number of longstanding problems such as corruption and lack of predictability. Other bottlenecks, such as an unclear land ownership status, have also become more prominent with the intensification of foreign investors' activities. Sudden changes in trade policy measures, most recently the increase in wood tariffs, were questioned because of their negative impact on the business plans of domestic and foreign operators and their uncertain economic rationale and implication in the context of Russia's WTO accession negotiations.

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1 The programme, presentations and background material from the seminar are available at: www.oecd.org/document/44/0,2340,en_2649_34893_38303340_1_1_1_1,00.html.

2 Participants included officials, experts and representatives of the business community from 12 OECD member countries. Russia was represented by the officials posted in Helsinki.

3 According to data published by the Central Bank of Russia, foreign direct investment to Russia almost doubled from USD 14.8bn in 2005 to USD 28.7bn in 2006 and total inward FDI stock amounted to USD 170bn by end of 2005. In the first quarter of 2007, inward FDI flows continued to grow and reached almost USD 8bn.

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Among the government's initiatives, the 2005 Concession Law has been welcomed by investors as an important step in encouraging the involvement of the private sector in the much needed modernisation of infrastructure and as an attempt to inject more competition in this process. The first project to be undertaken within the new law – the 47 km long Western High-Speed Diameter toll road in St. Petersburg – is expected to be approved in October 2007. To further develop public-private partnership in infrastructure several aspects have yet to be resolved, in particular the completion of model concession agreements for specific sectors and improvements of several key provisions, including the force-majeure clause, provisions on termination payments of fair market value for assets and on dispute resolution. As stated in the 2006 OECD Investment Policy Review of the Russian Federation[4], the success of the scheme continues to depend on the ability of the authorities to provide adequate regulations, offer appropriate projects and hold competitive tenders.

Since Russia's total investment, both public and private, has been lower than in transition countries and emerging economies, attracting private capital flows to Russia remains an important objective, including for EBRD operations in Russia. There is considerable need, not only in energy and infrastructure, but also in sectors such as the automotive industry where innovation and consumer orientation are critical. Russia should take advantage of other countries' experiences and put in place, in addition to current relatively low customs duties on cars and components, a predictable policy framework with a focus on the components industry. Rather than increasing state control, it has to encourage the entry of smaller component suppliers by simplifying administrative measures, improving coordination between local and central governments, and addressing bottlenecks related to shipment logistics, as well as access to land with reliable infrastructure connections.

The foreign business community is still waiting for clarification on the issue of strategic sectors. Delays in the adoption of the law seem to reflect hesitation within the government and pressure by certain sectors and local authorities regarding what sectors, in addition to those essential for national security, should be considered 'strategic' from the point of view of the country's economic development needs. The absence of clear indications regarding the sectors concerned has aggravated investment uncertainty and could explain recent intrusions by local authorities in relatively small projects on the grounds that they belong to strategic sectors. Such risks of political interference durably affect foreign investors' attitudes, especially amongst small and medium enterprises, and could have a considerable negative impact on overall investment inflows in the future.

Reaping the benefits of international investment in energy

It was recognised that the energy sector plays a 'strategic' role in Russia's domestic economy given its significant share in GDP, its contribution to government revenues and export earnings, as well as in its external economic relations due to the country's leading position as world energy producer and exporter. Although the demonstrated capacity of large Russian firms to raise capital on international financial markets may make the recourse to FDI less urgent today, Russia needs external technical and managerial know-how to develop, modernise and diversify its downstream and upstream energy facilities. It was emphasised that one of the key elements for sustaining Russia's future energy export capacity is its ability to reduce its high domestic consumption and energy intensity, which is due to a great extent to subsidized

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4 OECD Investment Policy Review of the Russian Federation: Enhancing Policy Transparency, Paris (2006).

domestic energy prices. Without dealing with this problem, it is unlikely that Russia will be able to ensure its current level of energy exports and will soon face domestic energy shortages.

The Policy Framework for Investment (PFI), based on good practices of OECD and non-member countries[5], can offer useful policy guidance to develop a sound regulatory framework for investment policy and serve as an evaluation tool for policy implementation. In the case of Russia's investment policy, including in the energy sector, the main recommendations based on the PFI include:

- increase policy coherence, in particular by considering the impact of state-controlled firms on the competitive environment;

- pay due attention to policy implementation, for example by taking into account not only the level of tax burden but also tax compliance costs;

- undertake regularly impact assessment and cost-benefit analysis of existing measures, including for example on the experience with special economic zones;

- improve policy co-ordination among different government agencies and authorities at federal, regional and local levels;

- enhance participation of the private sector in infrastructure development, notably through public-private dialogue and partnership.

The question of Russia's outward investment and corporate acquisitions abroad was also addressed by participants. The collusion between political and economic interests, especially in the case of state-controlled firms or companies with unclear shareholder structures remains of a serious concern. Many business representatives tended nonetheless to see Russian firms' external involvement less as a risk for host country firms but as an encouraging sign of the increasing integration of Russia's business in the world economy.

Promoting responsible business conduct

The presence of Russian firms abroad has drawn the growing attention of Russian firms and their partners to responsible business conduct practices. As documented in a study commissioned by the OECD[6], awareness and observance of standards of responsible conduct have been lower in Russia in comparison to both OECD countries' companies and firms in emerging market economies. However, the importance of responsible business conduct begins to be recognised in Russia, notably by the government seeking to enhance its international creditworthiness and by a number of large Russian firms which have recently seen their ambitions to expand abroad undermined due to perceived weaknesses in their business practices.

5 The Policy Framework for Investment identifies key issues in 10 policy areas which are critical for creating attractive investment environment both for domestic and international investment. It proposes a non-prescriptive approach to governments seeking to enhance coherence of their investment policy and evaluate its implementation. For more information, see www.oecd.org/daf/investment/pfi.

6 Corporate responsibility in the Russian Federation: Recent Trends, prepared by Jeremy Baskin; OECD document DAF/INV/WD(2007)9.

Several large Russian firms have been prompted, often due to their external exposure, to improve their transparency and accountability, including compliance with legal requirements, for example in the area of anti-corruption. Some Russian firms now integrate ethical, environmental and health considerations and stakeholder dialogue in their policies and management systems. OECD-based investors in Russia have an important contribution to make in encouraging these efforts by disseminating and promoting responsible business practices in their own local operations and relations with Russian partners.

The main responsibility for ensuring responsible business conduct rests with business, but governments have an important role to play in this area. Convergence of Russia's public policies for responsible business conduct towards best practices could be facilitated by the country's adherence to the OECD Guidelines for Multinational Enterprises.[7]

Concluding remarks

Participants to the Helsinki seminar were of view that macroeconomic stability, legal developments and improvements, for example in the financial sector, have contributed to enhancing the investment environment and business opportunities in Russia. Political and economic risks are nevertheless still significant, reflecting in particular unclear relations between the authorities and large state-controlled or private firms and uncertainty in policy decision-making due to forthcoming parliamentary and presidential elections. At the same time, the growing economic integration of Russian business provides an opportunity for Russian firms to adopt international standard practices. Russia's government can take an active part in the country's integration into the world economy by enhancing policy convergence through adoption of international disciplines and standards in the investment area.

[7] The OECD Guidelines for Multinational Enterprises are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. They provide voluntary principles and standards for responsible business conduct in a variety of areas including employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation. For more information, see www.oecd.org/daf/investment/guidelines.