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# Regulatory Reform in the Russian Federation

ENHANCING TRADE OPENNESS THROUGH  
REGULATORY REFORM

Blanka Kalinova

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**by Blanka Kalinova**

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## ABSTRACT

This study forms part of Russia's regulatory reform review undertaken under the OECD regulatory reform programme. It describes Russia's trade environment and its recent trade and foreign investment policy developments with a focus on trade-related regulations and their role in supporting Russia's market openness. It examines in particular to what extent Russia's trade regulations comply with the principles of transparency and non-discrimination and facilitate foreign trade operations and international competition. The paper proposes a series of policy recommendations to make Russia's regulatory framework more market-oriented and trade-and-investment friendly.

*Keywords:* Russia, regulations, trade, liberalisation, transparency, non-discrimination, customs, trade barriers, WTO.

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**ABBREVIATIONS AND SYMBOLS**

APEC	Asia Pacific Economic Cooperation
BIT	Bilateral Investment Treaty
CBR	Central Bank of Russia
CEFIR	Centre for Economic and Financial Research
CIS	Commonwealth of Independent States
CU	Customs Union
EEC	Eurasian Economic Community
EU	European Union
FAS	Federal Antimonopoly Agency
FATRM	Federal Agency for Technical Regulation and Metrology (former <i>Gostandart</i> )
FDI	Foreign direct investment
FSSS	Federal Service for State Statistics (former <i>Goskomstat</i> )
GATS	General Agreement on Trade in Services
GDP	gross domestic product
IEC	International Electrotechnical Commission
ISO	International Standardisation Organisation
MEDT	Ministry of Economic Development and Trade
MFN	Most-Favoured-Nation
MRA	mutual recognition agreement
RIA	regulatory impact analysis
SMEs	small and medium-sized enterprises
SPS	WTO Agreement on Sanitary and Phytosanitary Agreement
TBT	WTO Agreement on Technical Barriers on Trade
TRIMs	WTO Agreement on Trade-related Investment Measures
USAID	United States Agency for International Development
VAT	value-added tax
WB	World Bank

## **Introduction and Executive Summary**

1. The main objectives of the OECD regulatory reform programme are to assess the regulatory framework of countries examined and suggest its possible improvements to enhance economic growth, competition, innovation and market openness. The country regulatory reform reviews adopt a multi-disciplinary approach and address the governments' capacities to manage the regulatory reform agenda, macroeconomic aspects of regulatory reform, the enforcement of competition policy and the regulatory framework in some selected sectors (railway and electricity sectors in the case of Russia). The programme is also an interactive exercise since the reports prepared by the OECD Secretariat are based on the replies to a standard questionnaire by countries' authorities and are subject to peer-review examinations by OECD countries. The Russian Federation is the first non-member country to benefit from this OECD programme.

2. One chapter of the country regulatory reform reviews is traditionally devoted to the role of regulatory reform in supporting market openness. This is so because the success of regulatory reform - improving countries' economic efficiency and competitiveness - depends to a great extent on the capacities of individual countries to integrate a foreign trade and investment perspective into their regulations and regulatory practices. Recognising the decreasing role of conventional trade barriers such as tariffs, the analytical focus is on behind-the-border measures and practices and their possible effects on economic and business environment. The chapter on regulatory reform and trade openness thus examines to what extent domestic regulations directly or indirectly distort or facilitate international competition and suggests possible improvements in the domestic regulatory framework to promote international trade and investment liberalisation.

3. This paper analyses Russia's progress in developing and implementing trade-related regulations and proposes a series of policy recommendations to make it more market-oriented and trade-and-investment friendly. After an overview of Russia's trade environment and its recent trade policy developments, the paper examines Russia's trade-related regulations in light of six efficient regulatory principles identified by trade policy makers as essential elements to ensure effective market access and openness. These six principles refer to the two basic international trade disciplines of transparency and non-discrimination, stress the need to avoid unnecessary trade restrictiveness, recommend the use and recognition of internationally harmonised measures and finally urge countries to apply competition principles also in the international perspective.

4. Russia's recent fast trade growth and, albeit to a lesser extent, FDI data reveal the country's increasing external opening. The data also point to an unused potential for further trade diversification and FDI expansion, both indispensable for sustaining durable economic growth. Russia has also advanced in its trade policy reform driven both by autonomous liberalisation efforts and the WTO negotiation process. Despite the growing reliance on conventional trade policy instruments such as tariffs and better compliance with international trading disciplines, Russia's legal and regulatory trade policy framework still does not fully contribute to creating a trade and investment friendly business environment. Excessive or restrictive regulations, particularly various barriers on entry and exit, prevent available capital and labour resources moving to more competitive sectors and production of goods and services with comparative advantage and can restrain the expansion of the most efficient and innovative firms. Integrating efficient regulation principles and adopting good regulatory practices will help Russia to realise economic and productivity gains potentially generated by trade liberalisation and external exposure.

5. The country has integrated some aspects of efficient regulation principles into its domestic regulatory framework. Notably, access to information on legal and regulatory measures has been considerably improved, especially through an extensive use of the internet. The de-bureaucratisation

programme has addressed some of the most business-obstructive regulations such as state inspection, registration and licensing procedures. The new Law on Technical Regulation (standards) introduced some innovative aspects into the regulatory process, namely mandatory consultations of proposed technical regulations and standards prior to their introduction. Various business surveys, including one carried out for the purpose of this study confirm positive developments in the areas subject to recent legal and regulatory efforts. However, these surveys also show that smaller firms and enterprises with foreign participation, especially those in the Russian regions, find the business environment still difficult and meet more frequently serious obstacles to their operations.

6. These weaknesses of Russia's regulatory environment can be addressed through a number of regulatory practices, which have proved effective in OECD countries. Although a number of trade-related issues have been discussed with representatives of the Russian business community, notably in relation with the WTO negotiation process, the authorities ought to associate more systematically various stakeholders potentially affected by legislative and regulatory changes within the law- and the rule-making process. New regulations should be designed in clearer terms to avoid possible contradictory interpretations, especially at the local level. These objectives can be achieved by adopting regulatory impact analyses to assess the impact of proposed regulatory measures on trade openness and the business environment. Russia maintains a number of general and sectoral restrictions on foreign activities, some of which are being currently discussed with its trading partners in the WTO framework. Russia should not view these liberalisation demands exclusively as trade concessions but rather as an opportunity to accelerate development and modernisation of key sectors throughout their greater exposure to competitive pressures.

7. Trade facilitation issues and particularly customs problems have been identified as major impediments to external trade activities. They not only hamper foreign operators but also Russian exporters, importers and consumers, which are all affected by excessive delays, unpredictable and high costs of trade transactions. One possible way to address these shortcomings is to design governmental trade facilitation programmes involving close public-private partnerships that would set up specific targets and a clear timetable for improving trade facilitation performance and trade supporting services. Recognising the critical importance of FDI for the modernisation of many, especially services, industries and Russia's currently disappointing record in attracting such investment, the report also suggests upgrading the status of the country's FDI promotion agency. It is proposed to increase external and internal visibility of such an agency and provide it with sufficient financial and human resources to allow its efficient assistance to foreign investors in their establishment and operations in Russia.

8. These proposals for Russia's regulatory reform presume that the country will successfully complete its WTO accession process and will thus fully integrate into its trade regime fundamental multilateral disciplines that underpin efficient regulatory principles. Russia's WTO membership will enhance its trade openness and consolidate its adherence to international trade disciplines. It will also submit Russia's trade regime to regular international scrutiny, in particular through trade policy review mechanism and mandatory notification procedures embodied in WTO agreements. Sustaining regulatory reform efforts will remain nevertheless indispensable to ensure that domestic regulations and regulatory process support the country's openness and foster economic gains of its trade and investment liberalisation.

## **1. Economic and Policy Environment**

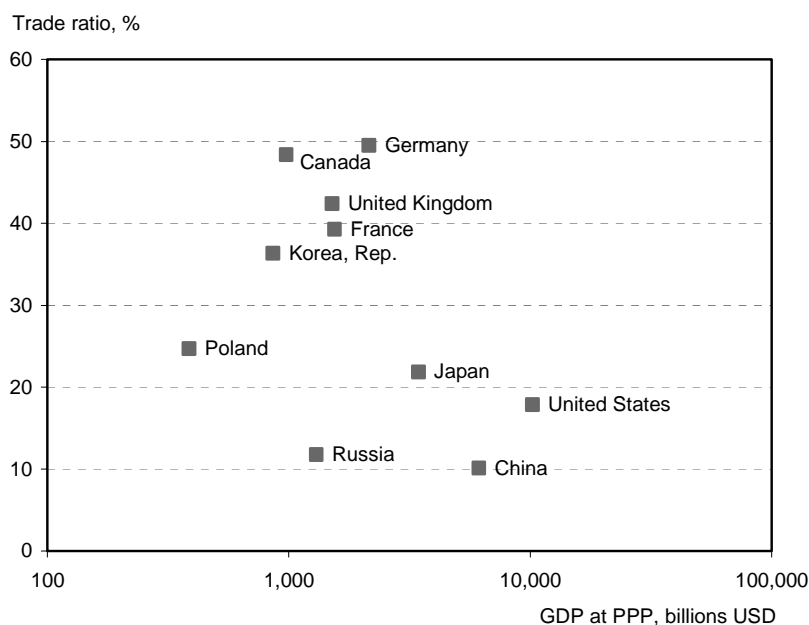
### ***1.1. Trade Openness***

9. Russia's external trade exposure can be measured by the indicator of trade openness corresponding to the ratio of total exports and imports in GDP, usually expressed in purchasing-

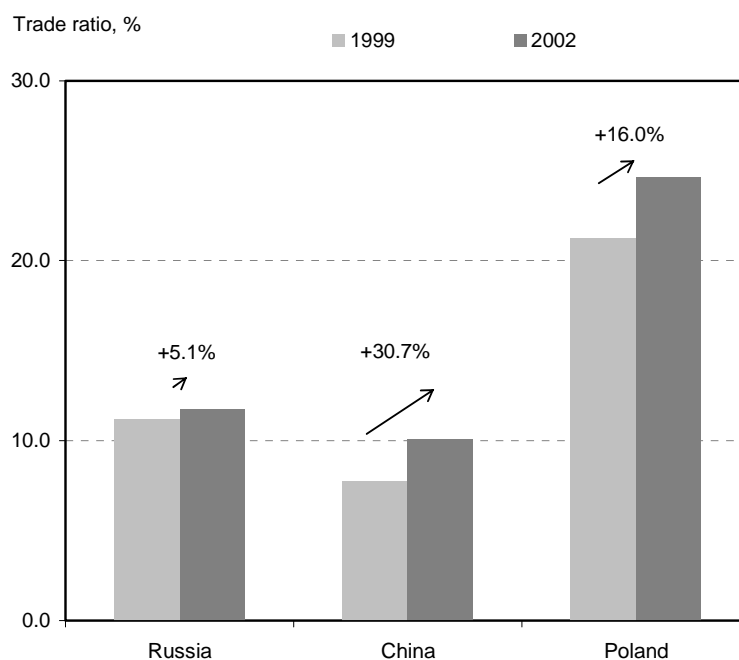


power-parity terms. In general, the value of this ratio is influenced by various endogenous factors, in particular the dimension of the territory and economy of individual countries and their distance from major or dynamic markets as well as by variations in their economic growth and trade shocks. Moreover, Russia's wide regional differences make some regions structurally similar to landlocked countries while other regions display a larger degree of trade openness due to their considerable exportable natural resources or their proximity to external markets. Overall, Russia's trade turnover/GDP ratio remains lower than in OECD or transition economies (Figure 1). In recent years, Russia's openness has increased but in a slower pace than in other countries in transition and especially in China (Figure 2). Russia's current participation in world trade remains modest: in 2003, the country ranked 17<sup>th</sup> among major world exporters, representing 1.8% of total world exports (WTO, 2004).

**Figure 1: Trade Openness - Selected Economies, 2002**



*Notes:* Trade openness is the ratio of total imports and exports to gross domestic product (GDP) based on purchasing-power-parity (PPP). Data for EU countries take into account intra-EU trade flows.  
*Source:* IMF, World Economic Outlook Database, UN Commodity Trade Statistics Database (COMTRADE).

**Figure 2: Comparison of Trade Openness Growth in China, Poland and Russia, 1999-2002**

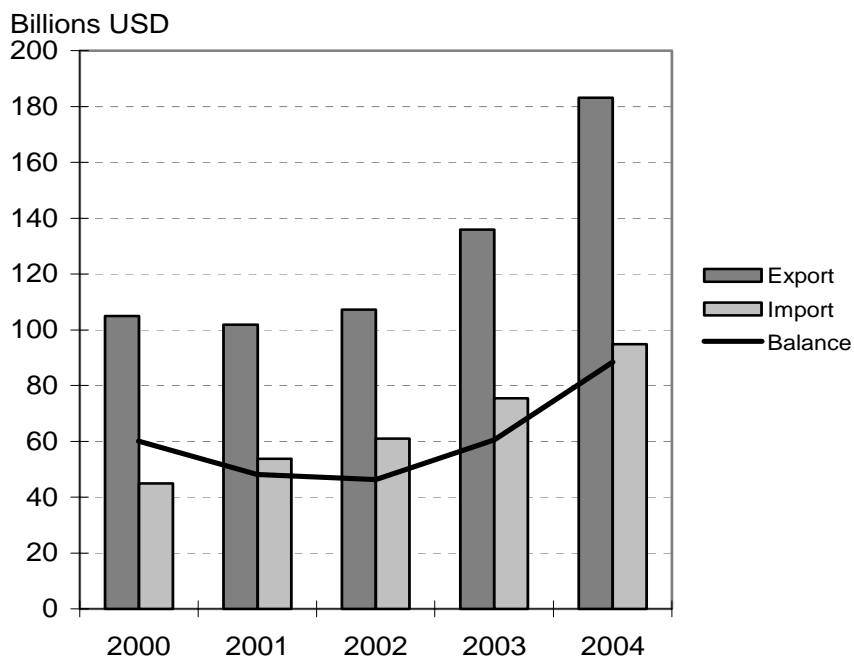
Source: IMF, World Economic Outlook Database, UN Commodity Trade Statistics Database (COMTRADE)

10. After Russia's 1998 financial crisis and the related strong import decline, the country's foreign trade has recovered since 2000. Exports have benefited primarily from favourable world price developments of Russian key commodities but oil exports have also strongly expanded in volume terms. Since 2001, import growth has also accelerated fuelled by the appreciating rouble exchange rate and strong domestic demand. In 2004, Russia's trade surplus remained strong and reaching USD 88 billion (Figure 3).

11. However, Russia's overall trade exposure and recent dynamic trade developments provide only a part of the overall picture and its trade fragilities clearly appear in its product structure. The predominance of energy products in Russia's exports reflects a narrow export base and exposes the country to oscillations in external demand and world commodity prices. In recent years, the share of oil and gas exports continued to rise from 50% of total exports in 1999 to 61% in 2003. Other commodities and industrial inputs generally with low value-added content constitute the second major export category while machinery, capital goods, transport equipment and consumer goods represented only 10% of Russian total exports in 2003 (Figure 4).

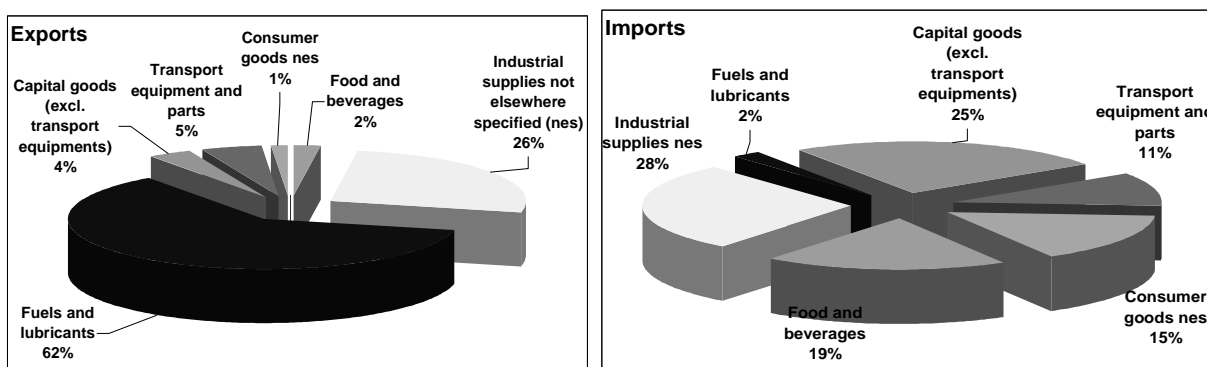
12. Growing Russian imports have in principle strengthened the exposure of its domestic market and enterprises to international competition, but not all product categories have been evenly concerned by this trend. Between 1999 and 2003 the share of consumer goods and transport equipment increased in total imports, but the proportion of investment goods stagnated at 25% of total imports and the part of industrial inputs decreased significantly (from 33% in 1999 to 28% in 2003) (Figure 4).

**Figure 3: Russia's Foreign Trade - Total Export, Imports and Trade Balance, 2000-2004**



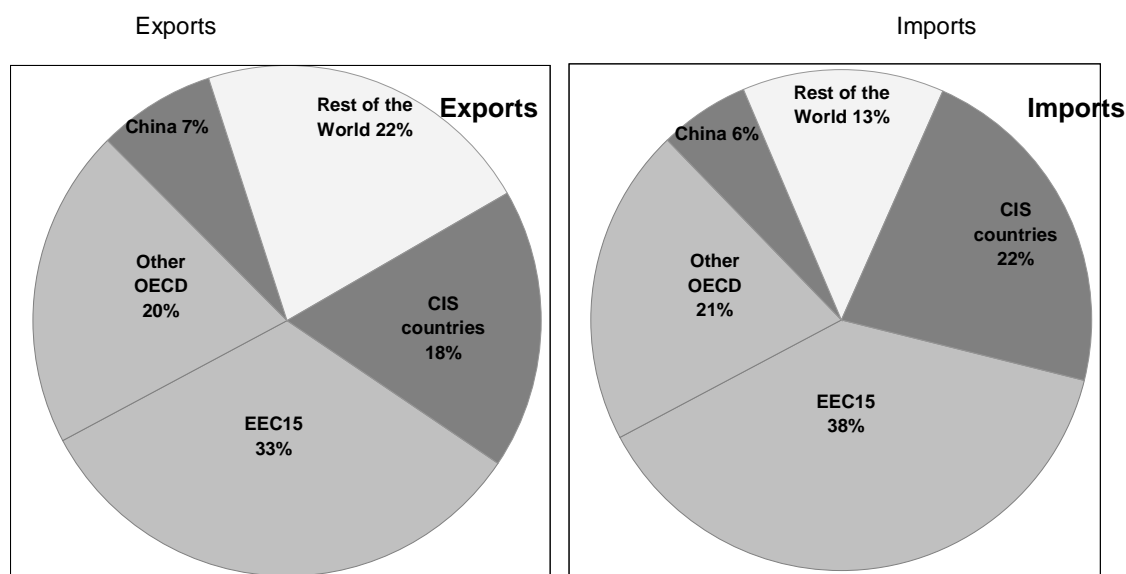
Source: UN Commodity Trade Statistics Database (COMTRADE)

**Figure 4: Russia's Foreign Trade – Product Structure, 2003**



Source: UN Commodity Trade Statistics Database (COMTRADE)

13. In recent years, the geographical structure of Russia's foreign trade has stabilised, with OECD countries now representing more than 50% of both exports and imports. In 2003, EU countries constituted over 60% of the OECD trade share (and more than 30% of Russia's total trade). Following the 2004 enlargement, the weight of the EU as Russia's largest trading partner has further increased. Various intra-CIS regional initiatives have not allowed boosting the participation of the CIS in Russia's trade: from 25% of the total turnover in 1995, their share has decreased to 20% in 2003. Within the CIS group, Belarus and Ukraine are the largest partners, representing three quarters of Russia's total exports to and imports from this area. Although still marginal, China's role in Russia's trade has become recently more important (Figure 5).

**Figure 5: Russia's Foreign Trade - Geographical Structure, 2003 (in %)**

Source: UN Commodity Trade Statistics Database (COMTRADE)

14. So far Russia's trade in services remains below its potential, mirroring a relatively slow development of the service sector in the domestic economy.<sup>1</sup> With only 0.9% of total world exports of commercial services in 2003, Russia ranks 27<sup>th</sup> among world leading services exporters. Russian services exports represented less than 11% of its total merchandise and services exports, compared to the world average of 19.5% (WTO, 2004). Russia's service trade balance is structurally negative and its deficit has been increasing steadily, reaching some USD 10 billion in 2003. Traditional service sectors constitute the major share of services trade: in 2002, transportation represented more than 40% of Russia's export service revenues and travel 48% of its services expenditures.

15. In comparison with recent dynamic trade growth, Russia's performance in attracting foreign direct investment (FDI) remains disappointing. This is especially the case considering its huge investment and modernisation needs; significant natural resource endowments; sizeable educated labour force, and a potentially large domestic market.

16. Notwithstanding statistical discrepancies in FDI data reported by different Russian sources,<sup>2</sup> inward FDI flows into Russia are modest both in absolute and comparative terms. According to statistics provided by the Federal Service of State Statistics, FDI inflows that more or less stagnated in 2001-2002 (USD 2.8 billion annually) started to increase in 2003 and continued to grow in 2004, reaching USD 5.6 billion in January-September 2004. This remains, however, low compared in particular to China,

<sup>1</sup> According to the Russian official statistics, services represent almost 60% of GDP *i.e.* the level relatively close to OECD countries. However, taking into account transfer pricing practices used especially by Russian oil and gas companies (that sell their production cheaply to their trading subsidiaries, mainly for tax purposes) changes considerably Russia's GDP sectoral distribution. The share of services drops to 38% of GDP while the contribution of the energy sector and industry to GDP increases correspondingly (see World Bank, 2004 and OECD 2004h).

<sup>2</sup> There are two main sources for FDI data in Russia, which diverge not only in annual amounts of FDI but often also as regards overall trends. In general, the data provided by the Central Bank of Russia, based on balance-of-payments methodology are lower and less detailed than the statistics reported by the Federal Service of State Statistics (Goskomstat) that uses different methodology and collects its data from other sources (OECD, 2004g).

which attracts some USD 50 billion annually. On a per capita basis, FDI inflows represented in 2002 USD 28 per head in Russia as against for example to USD 818 in the Czech Republic. By the end of 2003, stock of net inward FDI corresponded to 12% of GDP in Russia, compared for instance to 25% of GDP of Poland (UNCTAD, 2004).

17. According to Russian statistics, UK businesses were the major foreign investors in 2003 (almost 16% of total annual flows), followed by Germans and Cypriots (each with more than 14% of the total). A large amount of FDI originating from Cyprus (19% of cumulative FDI up to end-2003) indicates that an important part of FDI to Russia still consists of returning capital flight. The geographical distribution of FDI within Russia is uneven since the Central Federal District (*i.e.* Moscow and the neighbouring Moscow oblast) absorbs more than half of total FDI. The industrial sector is traditionally the main beneficiary of foreign investment (almost 50% of the total in 2004), concentrated mainly in oil extraction, and followed by trade and catering activities. In 2004, the financial sector represented for the first time more than 2% of total foreign investment inflows.

18. Russia's recent trade developments and, to a lesser extent, FDI data show the country's growing external opening, but also its persistent "trade and investment gap". The high export oil prices have allowed for financing the country's increasing import needs and stimulated strong domestic demand without, however, prompting product diversification of its exports and attracting sufficient FDI inflows. A narrow export base and weak FDI performance can be partly explained by Russia's economic and geographical specificities, but the main reasons for unsatisfactory trade and investment developments are delays in economic restructuring and shortcomings in the domestic regulatory framework.

19. The full impact of external exposure has been constrained by the inappropriate domestic legal and regulatory system, implementation difficulties and the extent of corruption (Babetskii *et al.*, 2003). Russia's example thus confirms growing anecdotal and analytical evidence showing that highly regulated economies do not take full advantage of increased openness, which can even accentuate their existing economic distortions (Bolaky *et al.*, 2004). Excessive regulations prevent available investment and human resources moving to more competitive sectors and production of goods and services. Within the sectors, barriers on entry and exit restrain the expansion of the most efficient and innovative firms. In order for Russia to reap the full benefits of trade and investment liberalisation and achieve rapid and balanced economic growth and enhanced international competitiveness, the country needs to promote pro-market and pro-competitive patterns of its trade-related regulations.

## **1.2. Trade Policy Developments**

20. The gradual liberalisation of Russia's trade regime over the last decade has been part of the overall reform of the economic and policy environment, involving a shift towards less government intervention in the economy and support for private sector development and an outward oriented economy. Russia's trade policy has become more market-oriented and has sought to instil more competition into the domestic economy. From the perspective of trade policy, the most important reform steps were the liberalisation of price and foreign exchange, and the de-monopolisation of foreign trade activities. The major policy impetus for trade liberalisation was the government's decision to make Russia's WTO accession its economic and trade policy priority. The country has undertaken intensive legislative work aimed at accelerating harmonisation of its trade regulations with international trade disciplines. However, this general trend towards trade liberalisation has encountered some setbacks due to recurring pressure by certain parts of the administration and some sectoral interest groups for a stronger state role in the economy and an import-substitution strategy.

21. One of the key transformations in Russia's trade regime has been the switch from direct interventions based essentially on non-tariff measures to tariffs as the main trade policy instrument. The analysis of Russia's tariff regime (OECD, 2002a) shows that the country's mean tariff (both the simple arithmetic mean

and the trade-weighted average) has been falling in recent years. In 2002, Russia's (simple) mean tariff stood at 10.8% (11.4% in agriculture and 10.7% in industry). Measured by some specific tariff indicators, Russia's tariff structure is now closer to OECD countries than to non-OECD countries. For example, the share of international tariff peaks (*i.e.* the share of lines with tariffs exceeding 15%) is relatively limited in Russia (approximately 17% of all tariff lines), but the proportion of duty free lines in Russia's tariff schedule (less than 1%) is still significantly lower than in the OECD countries (where almost one fourth of all tariff lines are duty free) (Table 1).

22. The most problematic features of Russia's tariff regime are addressed in ongoing WTO accession negotiations, in particular its lack of predictability. The most important current shortcoming in Russia's tariff regime is the absence of binding international commitments regarding the levels of tariffs, which reduces the predictability not only for external trade operators but also for domestic producers and consumers. The legal obligation limiting the government's tariff revisions to twice a year have introduced more stability to tariff policy, but the WTO accession will be a decisive step in this area, also allowing the government to resist pressures by specific industries for *ad hoc* protection. The lack of transparency results mainly from a comparatively high proportion of non-*ad valorem* duties (one third of lines in agriculture and almost 10% in industry) that gives to customs officials a relatively large room for discretion in establishing the tariff duty levels in individual cases.

**Table 1: Main Tariff Indicators of Russia's Tariff Schedule in 2002**

Tariff Indicator	In per cent
Mean tariff	
• all lines	10.8
• in agriculture	11.4
• in industry	10.7
International tariff peaks	
• all lines	16.9
• in agriculture	8.9
• in industry	18.1
Tariff lines intervals (all lines)	
• Duty free	0.6
• 0-5%	41.3
• 5-10%	16.9
• 10-15%	24.7
• 15-20%	15.8
• 20-50%	0.5
• >50%	0.1
Share of <i>ad valorem</i> duties	
• all lines	85.4
• in agriculture	66.3
• in industry	90.5
Escalation	
• raw materials	8.1
• semi-finished goods	8.6
• finished goods	12.7

Notes: The calculations are made using the national tariff HS 6-digit level. International tariff peaks are the share of lines with tariff exceeding 15%. The scope of tariff escalation is measured by consolidating the tariff levels at the three main stages of processing.

Source: CCNM/TD(2002)4: Russia's tariff regime

23. Given that the fiscal role of customs and foreign-trade related revenues is more important in Russia than in OECD countries, the impact of customs-related reform on government revenues should not be ignored. Russian customs revenues are mainly generated by export duties levied on raw materials and energy products, which represented more than 40% of total customs collection in 2000-2001, followed by VAT on imports and import duties (Table 2). The collection of customs duties and fees is very concentrated:

in 2001, 80% of the customs duties and fees were paid by 1 240 firms. However, customs reform can yield substantial gains and even increase customs collection. For example, better control over the use of exemptions and management of customs arrears allowed for increasing customs revenues between 1989 and 2001 despite the simultaneous decrease in the average import tariff and the cuts in import duty exemptions.

**Table 2: Foreign Trade Related Revenues in Russia**

Types of tax	2000	2001
Total foreign trade related taxes (in million roubles)	358 808	539 851
Of which (in %)		
• Export duties	45.8	41.6
• Import duties	17.9	19.3
• VAT	28.2	29.9
• Excise taxes	2.8	2.5
• Customs fees and other payments	5.1	6.2
• Other	0.2	0.5

Source: The World Bank Customs Project in Russia, March 2003

24. Whereas the WTO contains strong trade disciplines, namely the most-favoured nation (MFN) and national treatment commitments as well as the obligations of transparency and non-discrimination, its guidelines for regulatory and institutional aspects of trade policy are more limited. This WTO approach is in contrast to a number of regional integration agreements that often adopt a more pervasive policy stance and impose comprehensive regulatory disciplines on their members. For instance, as candidates for EU membership, the Central and Eastern European countries benefited from strong regulatory guidance embedded in the EU *acquis communautaire*, which allowed them to modernise rapidly their regulatory framework and institutional structure, including in the trade-related areas (OECD, 2004a).

25. Russia's policy regarding FDI has evolved in recent years. General FDI provisions are covered by the Federal Law No. 39-FZ of 25 February 1999 "On Investment Activity in the Russian Federation Implemented in the Form of Fixed Capital Investment", in particular Article 5 that provides for the supremacy of international agreements in this area. After having been integrated into the new Civil Code, national treatment for foreign investors was confirmed in the Federal Law No. 60-FZ of 9 July 1999 "On Foreign Investment", including their right to carry investment activity in any form authorised by the law. The Russian legislation guarantees incumbent large foreign investors involved in "priority projects" against unfavourable tax or other legislative changes that would intervene after the initiation of their project (OECD, 2001). However, Russia's current FDI framework contains several limitations on entry and operations of foreign investors as well as their participation in the privatisation process (see below). Disappointing FDI inflows to Russia clearly indicate the shortcomings in the country's FDI policy and its failure to make Russia sufficiently attractive for foreign investors.

26. One of the important requirements regarding Russia's FDI policy regime is its compliance with WTO disciplines as contained in the Agreement on Trade-Related Investment Measures (TRIMs), which Russia must accept as part of its overall WTO commitments. The Illustrative List annexed to the TRIMs Agreement prohibits in particular the local content requirement (imposing an obligation on foreign firms to source locally), trade balancing requirements (restricting the volume of imports which a foreign firm can buy or use to the volume of its exports) and supply to local market requirements (export restrictions). Several Russian legal acts and regulations contain measures that are incompatible with TRIMs, notably the Federal Law on "Production Sharing Agreements" (imposing that certain equipment for production and processing to be purchased by investors in Russia) and specific measures concerning FDI in the automobile industry (offering some import exemption to investors).

27. Russia's progress in reforming its trade policy over the last decade has been the result of autonomous liberalisation efforts reinforced by the WTO negotiation process, which have both contributed to the

introduction of more transparent trade policy instruments and harmonisation of its trade-related legal framework in accordance with international trade principles. This path should be actively pursued by strengthening efforts to reduce trade and investment barriers at both the macro and microeconomic levels, and to adjust the domestic regulatory framework. The success of this process also depends on the capacity of the Russian authorities to integrate the principles of market openness into the domestic regulatory framework.

## 2. The Policy Framework for Market Openness: The Application of the Six Efficient Regulation Principles

28. The general objective of regulatory reform is not deregulation or less regulation, but more efficient and better quality regulations supported by adequately designed and functioning regulatory institutions. The OECD's six "efficient regulation principles" for market openness (Box 1) propose the guidelines for developing a sound trade-related policy and institutional regulatory framework and can also serve to monitor the progress of individual countries in this process. Inspired by fundamental disciplines of the multilateral trading system, these guidelines recommend integrating into domestic regulations and practices, especially those affecting foreign suppliers, the principles of transparency and non-discrimination. They also urge countries to avoid introducing excessively burdensome regulations adversely affecting foreign trade and investment activities, to favour the use of internationally harmonised measures and apply the competition principle also in the international perspective.

### Box 1: The OECD Efficient Regulation Principles for Market Openness

To ensure that regulations do not contradict and reduce market openness, "efficient regulation" principles should be built into the domestic regulatory process and practices. These principles have been identified by trade policy makers as key to market-oriented trade and investment-friendly regulations. They reflect the basic principles underpinning the multilateral trading system.

1. Transparency and openness of decision making: Foreign firms, individuals and investors seeking access to a market must have adequate information on new and revised regulations so that they can base their decisions on accurate assessment of potential costs, risks and market opportunities.
2. Non-discrimination: Non-discrimination means equality of competitive opportunities between like products and services irrespective of country of origin.
3. Avoidance of unnecessary trade restrictiveness: Governments should use regulations that are not more trade restrictive than necessary to fulfil legitimate objectives.
4. Use of internationally harmonised measures: Compliance with different standards and regulations for like products can burden firms engaged in international trade with significant costs. When appropriate and feasible, internationally harmonised measures should be used as the basis of domestic regulations.
5. Streamlining conformity assessment procedures: When internationally harmonised measures are not possible, necessary or desirable, the negative effects of cross-country disparities in regulations and duplicative conformity assessment systems can be reduced by recognising the equivalence of trading partners' regulatory measures or the results of conformity assessment performed in other countries.
6. Application of competition principles: Market access can be reduced by regulatory action ignoring anti-competitive conduct or by failure to correct anti-competitive practices.

*Source: Regulatory Reform and Market Openness: Understanding the Links to Enhance Economic Performance, OECD Trade Policy Working Paper No. 9; Integrating Market Openness into the Regulatory Process: Emerging Patterns in OECD countries [TD/TC/WP(2002)25/FINAL].*

29. These general principles have been further developed in a joint initiative of member economies of APEC and the OECD by establishing an integrated checklist for self-assessment of regulatory, competition and market openness policies (APEC/OECD, 2004). This checklist, which is a voluntary tool, sets up a coherent framework and key concepts of regulatory, competition and market openness policies to assist policymakers to evaluate their regulatory reform performance. Based on good international regulatory practices, the checklist also provides guidelines for improving the regulatory framework and its enforcement, taking into account countries' economic, social and political diversity which influences their



policy priorities and methods used to achieve general objectives. With respect to market openness policies, the checklist recommends in particular to foster awareness of trade and investment implications in regulatory decision-making, promote trade friendliness in regulatory approaches and reduce discrimination against or impediments to foreign ownership and supply, especially in the service sector.

30. By examining the integration of the efficient regulation principles into domestic regulations and their implementation, the regulatory reform analysis goes beyond the scope of WTO commitments, which do not systematically cover domestic regulations. In the case of Russia, which is currently negotiating its WTO accession, the regulatory reform perspective is particularly important. Without duplicating the WTO negotiating process, the regulatory reform review can contribute to Russia's efforts to modernise its legal and regulatory system and ensure that the country's openness and competitive environment will be enhanced through effective implementation of domestic regulations. The core objective of this study is therefore to assess to what extent Russia's trade policy-making process integrates the regulatory perspective and translates it in practice into a growth conducive and trade and investment friendly environment.

31. In addition to general regulatory reform issues, Russia has some specific problems in adapting its regional trade policy and regulations to comply with its future international commitments. It has already undertaken significant efforts to adjust its legal framework in conformity with the WTO general rules for countries with a federal structure, in particular by defining more clearly the respective roles and responsibilities of central and regional authorities in the trade policy area. However, this general legal framework has not always translated into concrete domestic regulations and the business community continue to complain about uneven implementation of trade-related regulations throughout the Russian territory, especially with respect to customs administration and government procurement.

#### **Box 2: Addressing the Regional Dimensions of Russia's Regulatory Reform**

The Russian Federation comprises 89 "Subjects of the Federation", or regional administrative units. They include 21 ethnic republics, 49 *oblasts* (or provinces), six *krais* (or territories), ten autonomous *okrugs* (districts) and one autonomous oblast. The cities of Moscow and St. Petersburg are also Subjects of the Federation.

The Constitution of the Russian Federation gives clear pre-eminence to the central government in the direct regulation of foreign trade, but assigns joint responsibility to the central and regional governments in many trade-related areas. The delineation of jurisdictions and powers between the Russian Federation and its Subjects is based on the Articles 71, 72 and 73 of the Constitution, which define (i) the spheres of exclusive competence of the Federation (including the legal framework of a single market, financial, currency and customs regulations, foreign policy and foreign economic relations), and (ii) joint jurisdiction of the Russian Federation and its Subjects (including for example the issues of ownership, usage and management of land, mineral resources and establishment of general principles of taxes and levies in the Russian Federation).

To counter strong decentralisation trends in the 1990s, seven federal districts headed by presidential representatives were established in 2000. These districts are sometimes seen as adding another overlapping layer to the already complex institutional and regulatory system. The representation of the Subjects of the Federation in the Federation Council (the upper house of Parliament) was also changed in 2000. Instead of the regional governors, who used to be *ex officio* members, the 89 federal administrative units are represented by two permanent representatives, one named by the region's legislature and another appointed by its executive branch. Moreover, the new tax system has reduced the regions' share of revenues.

These recent developments show the challenge of managing the reforms and regulatory issues in a federal context. The previous extensive decentralisation trends have often undermined the central government's reform efforts, with regional governments sometimes unwilling or lacking the capacity to implement federal legislation and regulations. The strengthening of federal prerogatives, however, runs the risk of inhibiting regional initiatives and diminishing government's responsiveness to local conditions.

In spite of ongoing efforts to clarify the responsibilities of central and local administrations, trade policy measures and regulations are not always implemented uniformly throughout the Russian territory, in particular in the area of customs and public procurement procedures. The resulting lack of transparency, predictability and risk of discrimination are particularly harmful for foreign suppliers.

*Source: Trade Policies in Russia: The Role of Local and Regional Governments (OECD, 2003a).*

### 3. Transparency

32. Regulatory transparency, *i.e.* the equal access to information on the legal and regulatory framework, is a pre-requisite for effective competition. It is essential to all market participants, but particularly to foreign operators that cope with additional obstacles such as language barriers and country specific business practices. Regulatory transparency has three main aspects: (i) access to information on existing regulations, (ii) openness to the rulemaking process through public consultation prior to the adoption of final regulations, and (iii) the possibility of market participants to access appropriate appeal procedures. Furthermore, the scope of transparency in two critical areas – technical regulations and standards, and government procurement – is an additional test to assess concrete application of this efficient regulation principle.

33. Supervising transparency requirements is an integral part of the functions of several Russian governmental agencies, in particular the Federal Antimonopoly Service (FAS) and the Federal Service for Financial Markets (FSFM), which were both renamed and reorganised within the recent reform of the public administration. In implementing its main task to prevent monopolistic activities and unfair competition, the FAS that replaced in 2004 the former Antimonopoly Ministry ensures information transparency on mergers and acquisitions and controls unrestricted information access to all operators. The FSFM, which took over the functions of the former Federal Commission for Securities Markets, is responsible for public information disclosure on the securities market.

#### 3.1. Access to and Dissemination of Information

34. Since the beginning of its reform process, Russia has made considerable progress in improving the transparency of its legal framework. Several laws stipulate procedures for publication of legislation and set time limits for publishing different categories of legal acts such as federal laws, government resolutions and presidential acts. Federal laws must be published within seven days following their signature by the President. The acts of the President and the Government should be published within ten days after their signature in the “*Rossiyskaya Gazeta*” or in the “*Sobraniye Zakonodatelstva Rossiskoy Federatsii*” (Collected Legislation of the Russian Federation). The normative legal acts of the federal organs of the executive power must be published in the “*Rossiyskaya Gazeta*” within 10 days after their registration and also in the Bulletin of the normative acts of the federal organs of the executive power edited by the “*Yuridicheskaya literatura*”. International agreements concluded by the Russian Federation are also published in the “*Bulletin of International Treaties*”. Federal laws usually enter into force six months after their signature by the President, following the release of corresponding regulations by responsible governmental bodies.

35. Several other measures adopted recently have led to an improvement in the transparency of Russia’s legal framework. Government Resolution No. 98 of 12 February 2003 “On Providing Access to Information on Activity of the Government of the Russian Federation and the Federal Executive Authorities” provides a list of data which should be made regularly and timely available to the public by the government. The state registration of existing legal texts, notably in the Federal Register for Legal Acts issued by the Subjects of the Federation, has considerably enhanced the transparency of the legal texts and regulations applied at the regional and local levels.

36. The Internet is a powerful instrument to disseminate information and can also be used for interactive purposes, namely information requests and consultations. The federal target programme “Electronic Russia” for 2002-2010 promulgates a greater public awareness of government activities and more interaction between the government and citizens through a more extensive and efficient use of information and communication technologies. The main governmental portal provides the citizens with information on the government’s general activities and legal initiatives ([www.government.ru](http://www.government.ru)). The website of the Scientific and Technological Centre for Legal Information - Sistema ([www.systema.ru](http://www.systema.ru)) presents the texts of the

federal laws and other governmental legal acts. The website of the legislative assembly ([www.duma.ru](http://www.duma.ru)) publishes draft laws under preparation and informs the public on the process of their consideration by the State Duma. Several online databases such as GARANT disseminate the texts of existing laws and regulations in English, but they are usually not available free of charge but only on a commercial basis.

37. In accordance with Article 62 of the Constitution, foreign citizens in the Russian Federation enjoy the same rights and are subject to the same obligations as Russian citizens, except if stipulated otherwise by federal laws or international treaties signed by the Russian Federation. Since the Russian legislation does not contain any special provisions regulating the access of interested foreign parties to draft legislation and regulations, foreigners have in principle the same rights in this area as do nationals. International and bilateral chambers of commerce and specialised associations in Russia have played an important role in assisting foreign suppliers and investors to accede to and interpret Russian legislation and regulations, both before their establishment and during their operations in the country.

38. The 2004 OECD business survey, which was carried out within the framework of Russia's regulatory reform project,<sup>3</sup> shows considerable improvement in availability of information on existing government policies: more than 40% of surveyed firms considered access to information as no or a minor problem, though the respondents from Russian regions reported more difficulties in this area (only 12% were satisfied with the current situation). Compared to a previous business survey in 1995, there have also been positive developments regarding the sources of information on new government regulations, given that in 2004 the surveyed firms have declared that they now rely less on personal contacts and use more extensively special official publications and business newspapers.

### **3.2. *Openness of the Rulemaking Process (Public Consultation)***

39. In order to assess the general transparency of the legal and regulatory framework, it is important to consider not only the transparency of the final legislative acts, but also the extent to which different stakeholders inside and outside the government are involved in the law-making process. Since 2000 several Government Decisions have codified intra-governmental co-ordination, in particular by unifying the law-making process<sup>4</sup> and ensuring better implementation of existing legislation.<sup>5</sup> The prominent role of the Ministry of Justice in the preparation and assessment of draft bills seems to indicate that the main objective is to ensure the legal coherence of different acts, while probably less attention is currently paid to the cost-effectiveness of regulations and the economic and regulatory rationale of the proposed legislation.

40. The Public Administration Reform introduced in spring 2004 has several consequences for the law-making process. In the new government structure, the ministries (reduced from 23 to 15) are now responsible for drafting and proposing legislative initiatives, while the federal services and agencies are in charge of enforcement and implementation of adopted laws and regulations. The recent administrative reform has also streamlined the structure of the Government Apparatus, which has in principle similar

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<sup>3</sup> The survey of business environment in Russia, committed by the OECD, was conducted in the beginning of 2004 by Mr. Tibor Opela (Moscow State Institute of International Relations). Detailed results of this survey are provided in the OECD document TD/TC/NME(2004)8/FINAL: Recent developments in the business environment in Russia (OECD, 2004i).

<sup>4</sup> See Government Resolution No. 347/2000 (of 15 April 2000) "On enhancing the law-drafting activity of the Government of the Russian Federation" and Resolution No. 576/2001 (of 2 August 2001) "On approving basic requirements to the concept and elaboration of federal draft laws".

<sup>5</sup> Government Resolution No. 803/2002 (of 11 November 2002) "On enhancing implementation of federal laws".

functions to the chancelleries or prime minister's offices in some OECD countries.<sup>6</sup> This restructuring should help to clarify the role of this governmental body in the legislative and regulatory process in which it has used to intervene, often duplicating the functions of other parts of the government.

41. Prior consultation of planned laws and regulations with interested parties can take various forms in different countries. Depending on their cultural specificity and administrative traditions, countries adopt notice-and-comments procedures and/or formal or informal consultations between the government and other stakeholders. Some countries, for example Scandinavian countries, rely on informal consultations while other countries prefer to create specific and more formal structures, such as consultation or advisory committees. Most countries must deal with the problem of the selection of interlocutors for such consultations, in particular ascertain to what extent the selected counterparts are representative and significant players in a given sector and their capacity to apprehend and treat sometimes very technical aspects of consulted measures.

42. In spite of a few examples of consultations with foreign representatives, for instance regarding the Foreign Exchange Law, the formal participation of the private sector and especially foreign firms in the law-making process is not yet a common practice in Russia. Some legal acts envisage the participation of business associations in the elaboration of draft laws affecting the interests of entrepreneurs, for example the Federal law No. 5340-I (July 1993) on Chambers of Commerce and Industry in the Russian Federation. The government is allowed setting up councils when preparing its recommendations and regulations. Such bodies can include government officials and representatives of public organisations and the business sector. The main examples of such instances involved in preliminary discussions of trade-related matters are the Consultative Council of the Russian State Customs Committee for Customs Policy and the Foreign Advisory Council.<sup>7</sup>

43. The decision to consult other stakeholders during the rule-making process will require a radical change in the mindset of the Russian administration which has not yet completely abandoned its tendency to secrecy and mistrust towards outsiders. It should be underlined that the absence of consultations between the administration and interested parties does not avoid and often even encourages the so-called state capture when different interest groups seek and frequently succeed to influence the legislative and regulatory framework directly or indirectly through informal and political channels. To reduce the risk that the legal and regulatory process is influenced mainly by politically connected groups or firms, it would be preferable to introduce the obligation of consultation procedures explicitly into the legal framework and create formal consultation structures, also associating - when justified - representatives of foreign investors.

44. At present, the only federal legislative act, which establishes a detailed mechanism for mandatory and systematic public consultation prior to the introduction of new regulations, is Federal Law No.184-FZ (December 2002) "On Technical Regulation". The procedures for elaboration, adoption, amendments and cancellation of technical regulations are described in particular in Article 9 of this law. It prescribes that the notice on planned regulation should specify the product or the process to which the new regulation will apply, justify its goals and indicate whether and why the new requirement differs from relevant international standards or current requirements valid in Russia. Draft technical regulations and standards are to be made available to interested parties and subject to public discussions. The party entrusted to draft a

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<sup>6</sup> For more detailed explanation of the role of the Government Apparatus in Russia see Chapter II of the Regulatory Reform Review of the Russia Federation on Governmental Capacities to Carry out Regulatory Reform.

<sup>7</sup> It is interesting to note that the term "public discussion" is referred to in the Memorandum of Understanding between the Republic of Belarus and the Russian Federation in the context of the possible adoption of the Charter of the Union between the two countries. The term and related procedures have not been, however, defined further in the Russian legislation.

regulation should establish a list and a summary content of comments received and make them available at request to the State Duma or other authorities responsible for the final approval of the new regulation. The period for public discussion of draft regulations starting by the publication of the draft regulation and ending by the completion of public discussion shall not be less than two months. The law spells out some particular cases when prior consultations are not mandatory, in particular in emergency cases representing a direct threat to citizens and the environment (Article 10), specific procedures applied to defence products (Article 5) and regulations concerning the communication network, which are subject to the Law on Communications.

45. The 2004 OECD business survey shows a clear correlation between lack of consultations prior to introducing new laws and regulations (judged unsatisfactory by 35% of interviewed firms) and the share of the firms that consider the consistency of government regulations with the interests and needs of the business community as a serious and very serious problem (33%). There are also a relatively large proportion of firms (41%) that have characterised the government's overall programmes for regulating their sector as unpredictable.

46. The WTO negotiating process has been instrumental in improving transparency and consultation procedures in Russia. The examination of major foreign trade laws by WTO members and the WTO requirements concerning the publication of legislation have encouraged the Russian authorities to codify the procedures related to the publication and registration of current legislation. The WTO negotiating process has also prompted the Russian authorities to intensify their efforts to develop consultations with different stakeholders and establish a regular policy dialogue between the executive and legislative branches. The critical contribution of the WTO negotiating process for enhancing transparency is confirmed by the fact that the Ministry of Economic Development and Trade (MEDT) plays a prominent role in initiating and leading consultation procedures at various levels, for example during the preparation of the federal "Electronic Russia" programme.

### **3.3. *Appeal Procedures***

47. Remaining ambiguities and loopholes in Russia's current legal and regulatory framework make the existence of appropriate appeal procedures especially important. Appeal procedures are also necessary given the absence or complexity of administrative guidelines that leave room for different interpretations, poor enforcement or lengthy implementation of existing laws and regulations by responsible agencies and officials.

48. The Public Prosecutor's Office is the main body responsible to ensure general observance of legal acts and regulations by federal and regional administrations. Depending on the nature of the violation of the law by an official, the prosecutor decides whether the case should be under the jurisdiction of common law court or administrative proceedings. Foreign citizens and organisations can appeal against any action of the Russian authorities, including in case of the violation of their rights due to the lack of transparency or unavailability of regulations. Article 27 of the Civil Procedural Code of the Russian Federation (No. 138-FZ of 14 November 2002), which entered into force in February 2003, foresees the possibility of an appeal to the Supreme Court against legal acts of the president, the chambers of the Federal Assembly and other federal state power bodies infringing the rights, freedom and lawful interests of citizens and organisations. Customs regulations and measures for the protection of the domestic market can also be subject to such appeal procedures. A special federal law (No. 5338-I of 7 July 1993) deals with dispute settlements with a foreign party in international commercial arbitration court.

49. According to the 2004 OECD business survey, among 307 interviewed firms almost half of them viewed appeal and arbitration procedures in Russia as a serious or very serious problem. The need for more efficient appeal procedures is obviously critical in an environment where some 50% of companies consider

current enforcement of existing laws highly inadequate as also shown in the same survey. After having put in place legal procedures for resolving disputes between administration and private entities, the next challenge is to apply them in practice and ensure that relevant bodies have sufficient human and technical resources for exerting their functions.

### **3.4. *Transparency in Technical Regulations and Public Procurement***

50. For WTO members, transparency in technical regulations and standards is ensured by mandatory notification procedures under the WTO Agreements on Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary (SPS) measures. The signatory countries of the WTO plurilateral Agreement on Government Procurement (AGP) are also subject to additional disciplines regarding transparency. Some regional integration agreements, in particular the EU, impose on their members more explicit commitments in these fields. As Russia is not yet subject to such multilateral or regional obligations, its existing relevant laws and regulations are under particular scrutiny by the international community.

51. In addition to codifying for the first time prior consultation procedures, the Russian federal law on “Technical Regulation” has also reinforced transparency disciplines in the area of its competence. The law stipulates that the agreed standards and technical regulations should be made publicly available both in the printed version in the special publication “*National standards*”, published by the Federal Agency for Technical Regulation and Metrology (the former *Gostandart*) and at the organisation’s internet website ([www.gost.ru](http://www.gost.ru)).

52. Regulations concerning government procurement are subject to Federal law No. 97-FZ of 6 May 1999 “On Tenders for the Placement of Orders for Deliveries of Goods, Performance of Works and Provision of Services for State Needs”. (Government procurement for defence purposes are managed by a special federal law). In analysing countries’ legislation on government procurement, the main aspects relevant for foreign firms are the conditions for their access, sectoral limitations, applicable thresholds and the provisions concerning local contents. The participation of foreign firms also depends on transparency of existing rules and their timely publication. The Russian law imposes transparency obligations, including the publication of the notice on opening of tenders in mass media that provide basic information on the object and conditions of tender procedures. The result of tenders should be published not later than 20 days after the declaration of the winner. If requested, the organiser of a tender should explain its decision within 30 days after receiving such a demand. Article 24 of the Russian law on government orders stipulates that decisions of the tender organisation may be appealed in courts, without specifying any special appeal procedures for foreign entities. The MEDT is the main agency responsible for supervision of tender procedures.

53. The 2004 OECD business survey shows that more than 40% of interviewed firms consider information on rules and requirements of tenders as inadequate and untimely and see transparency in this area as a serious or very serious problem. Access to relevant information is even more difficult within the regions, given that dissatisfaction in this area is higher among regional respondents (60%). Furthermore, more than half of surveyed firms (57%) complain about the lack of transparency of tender procedures, especially among transportation companies (almost 75% of them view this issue as a serious and very serious problem).

### **3.5. *Summary Remarks on Transparency Issues***

54. Russia has been quite successful in improving access to information on the legal and regulatory framework. Prompt publication of adopted laws and regulations is legally guaranteed and their large public dissemination ensured through a number of official publications. The internet is increasingly used to make legislative acts available to the business community and the public at large. The progress in transparency of

the law-making process, especially by generalising prior consultations of planned legal or regulatory measures with potentially affected stakeholders, has been, however, less significant. At present, only the Law on Technical Regulation explicitly prescribes the obligation for consultations with interested parties for the regulations within its competence.

55. To further improve the application of the transparency principle, the Russian authorities ought to consider further development of prior consultations between the administration and interested parties. Given traditional reluctance of the administration vis-à-vis outsiders, it would be preferable to introduce such consultation procedures formally into the law-making process and organise them in formal settings, for instance in the form of permanent advisory committees attached to relevant ministries or federal services. The formalised and fully transparent participation of the private sector in the rulemaking process would also help in limiting currently non-transparent interference of private interests into the rulemaking process and thus contribute reducing the risk of state capture that is still widespread in Russia.

56. Transparency of public procurement is in principle ensured by relevant legislation, but in practice, regional and foreign producers continue to find that information concerning these procedures is not always timely and easily available. As in other areas, most surveyed firms consider that these transparency problems are particularly acute in the regional context.

#### **4. Non-Discrimination**

57. The non-discrimination principle corresponds to the two core obligations of the multilateral trading system: the MFN treatment (ensuring that goods and services from all countries are treated equally) and national treatment (guaranteeing that foreign goods and services are treated equally as similar domestic goods and services). WTO members must comply with these basic disciplines and integrate them into their relevant legislation acts. The application of the regulatory principle of non-discrimination nevertheless goes further and seeks to ensure that domestic regulations give equal competitive opportunities to like-goods and services from all sources, both domestic and foreign. In the domestic economy, ending discriminatory policies by governments at all levels is seen as an important tool for promoting greater efficiency for producers and improving the welfare of consumers.

58. WTO disciplines have played a key role in removing discriminatory policies. While some discriminatory measures - for example, certain kinds of subsidies, some preferences in government procurement, restrictions affecting foreign investors and service providers, and preferential trade agreements - are permitted, they remain subject to WTO rules on transparency, non-discrimination and some other specific obligations. Since Russia is not yet a member, the removal of policies that are not consistent with WTO rules is very much a work in progress. The Russian government has changed many laws and regulations to remove discriminatory measures, but further steps and reforms are warranted to introduce the non-discrimination principle into all relevant legislation and implement it through domestic regulations.

##### ***4.1. Restrictions on Entry and Operations of Foreign Firms***

59. The Russian government maintains a number of restrictions on foreign ownership and participation especially in mineral extraction and service industries, such as oil and gas, banking, insurance, mass media, aviation, domestic transportation, and telecommunications. The restrictions consist of ceilings on total foreign ownership, special criteria for evaluating the financial condition of foreign investors, special licensing requirements, and prohibitions on providing certain kinds of services (see Table A.1 in the Annex). Some of these explicit restrictions on entry of foreign operators are subject to ongoing WTO accession negotiations between Russia and its trading partners, notably within the GATS framework.

60. The possibilities of entry of foreign firms and their operations are also directly or indirectly influenced by certain general laws. Some of them contain explicit discriminatory conditions affecting foreign firms, such as provisions concerning land ownership. According to the new Land Code, foreign firms are now able to purchase non-agricultural land. However, contrary to Russian citizens, foreigners are not allowed to own agricultural land and can only lease for up to 49 years. Some other laws, though they do not target explicitly foreign firms, can make their operations more difficult. For instance, the recent Foreign Exchange Law introduces significant liberalisation steps and most remaining controls apply irrespective of domestic or foreign origin of the firms. The recent reduction in mandatory surrendering requirement of export earnings in foreign currency from 25% to 10% introduced in November 2004 is therefore a welcome measure also for foreign operators. Other measures in principle aimed at controlling illegal capital flight could also be burdensome, for example the so-called “reserve system” requiring residents to deposit in certain cases 100% of transaction value for up to one year. Finally, the applied bankruptcy procedures and the efficiency of the courts in dealing with debt issues also influence the activity of foreign firms in Russia (Table 3).

**Table 3: Main Legal Acts Relevant for Foreign Firms**

<b>Laws</b> (date of entry into force)	<b>Main provisions</b>
Land Code (October 2001)	It allows for foreign ownership of non-agricultural land except some limited restrictions (e.g. in border areas). Foreign nationals, foreign legal entities and Russian legal entities with majority foreign capital are forbidden from owning agricultural land and can hold it only on lease for a period up to 49 years. In urban areas, the right or purchase or lease land is granted on the basis of public tenders, though only few tenders have so far taken place.
Law on Licensing of Specific Activities (February 2002)	Article 17 contains the list of activities for which a license may be required. Federal, regional and local bodies are forbidden to add other activities subject to licensing. A number of activities are excluded from this law and are covered by sectoral legislation, e.g. credit organisations, communications, customs activities, insurance, securities markets, television broadcasting, natural resources extraction, atomic energy and education.
The Arbitration Procedural Code of the Russian Federation (September 2002)	All disputes concerning corporate relationships are brought under the jurisdiction of a single body, the arbitration courts. The list of subject areas within the exclusive competence of these courts has been significantly expanded and amicable dispute resolution encouraged. However, enforcement mechanism remains weak and suffers from resource constraints.
Bankruptcy Law (December 2002)	Its coverage was extended to agriculture, the defence industry, securities market activities and insurance, which were previously excluded. The new version of the law provides creditors with better possibilities of settling or restructuring overdue obligations.
Foreign Exchange Law (June 2004)	Several controls, including the surrender requirement for foreign currency revenues apply until end-2006. To control leads and lags in trade payments, foreign purchasers of goods exported by Russian entities must be paid within 180 days. Both Russians and foreigners are now allowed to export the equivalent of USD 10 000 without supporting documentation.

61. Similar to many domestic firms, foreign investors often consider that their operations are less affected by explicitly discriminatory measures but rather by the complexity or unnecessary restrictiveness of existing regulations often aggravated by their inconsistent and not uniform application by regional and local authorities. Possible discriminatory effects are thus not necessarily due to *de jure* status of existing measures and regulations but result from their *de facto* impact on trade and business operations.

#### **4.2. Possible Discriminatory Effects of Regional Trade-Related Policies**

62. Like most governments, the Russian government has put in place deliberate policies to aid certain domestic firms, thus discriminating among producers of similar products. For example, both national and sub-national governments provide subsidies to some domestic producers, targeting primarily the



restructuring needs of some industries (the coal mining industry has been a major beneficiary). The subsidies have taken various forms: direct transfers from the budgets of the national and regional governments; official credits; special tax rates, tax deferrals and tax credits; and subsidised energy inputs. Most of the subsidies from the national government are regulated by budget and tax legislation. The government is developing a new State Aid Law, which it says will be fully consistent with the WTO Agreement on Subsidies and Countervailing Measures.

63. Many informal practices of government officials and regulations promulgated by sub-national governments have the effect of discriminating against foreign and frequently even among domestic firms. Discriminatory measures result not necessarily from formal laws, such as those that provide for subsidies or preferential government procurement, but also from regulations that give extensive discretionary authority to officials in regional branches of federal agencies or to officials in regional and local governments. In particular, foreign but also Russian foreign-trade operators see regional customs agencies exercise considerable discretion in setting rules on customs classification and valuation and this practice often means that the same product is subject to different customs rates in different regions and offices. Similarly, laws and regulations on licensing do not always provide clear and straightforward criteria for granting licenses. Such situations tend to favour well-connected and politically powerful enterprises at the expense of small firms with lesser political and economic leverage. It also makes it difficult for the federal government to ensure that trade policy is applied uniformly in compliance with multilateral rules.

64. The federal government has initiated a major effort to harmonise regional and local laws with federal laws and to reduce the ability of sub-national government officials to administer laws in a discriminatory manner. The MEDT and the Federal Antimonopoly Service have special responsibilities in supervising economic policies under their jurisdiction and ensuring a uniform application of economic policy throughout the Russian territory. Both administrations could be appealed for non-observance of the non-discrimination principle by foreign parties.

#### **4.3. Government Procurement**

65. Legislation and enforcement of public procurement procedures is an important test for assessing the application of several efficient regulation principles, in particular transparency (see above) and non-discrimination. The respect of the non-discrimination principle requires that domestic and foreign suppliers can participate in public procurement proceedings on an equal basis, though some exceptions concerning national preference and local content often limit the scope of this rule.

66. The current Russian legislation on government procurement (Federal Law No. 97-FZ of 6 May 1999) contains a number of discriminatory features. In particular, Article 6 of the current law says that foreign suppliers can take part in tenders only if the production of relevant goods or services for the state's needs in the Russian Federation is "absent or is economically inefficient". Methodological instructions for this law specify that if the offer of the foreign supplier is better compared to domestic providers, the price preference granted to a Russian participant can be 25%.

67. Many regional governments discriminate, not only against foreign firms, but also against firms from other regions when making government purchases. The Moscow city law "On Municipal State Orders," for example, stipulates that suppliers of goods and services in Moscow and firms registered in Moscow will be given a preferential right to fill state orders if their bids do not exceed the bids of other suppliers by more than 10 % (OECD, 2003a, pp. 65-66).

68. According to Russian authorities, a new federal law "On the Placement of Orders for Delivery of Goods, Performance of Works and Provision of Services for State Needs" currently under consideration will eliminate existing discriminative aspects and harmonise the legal basis for regulating government

procurement in compliance with the plurilateral WTO Agreement on Government Procurement, to which Russian trade negotiators have said that the country will accede. Even after the entry into force of a new law on government procurement, the major challenge for Russia in this area will be to ensure conformity sub-national laws and regulations with relevant national legislation and guarantee their unified implementation on the Russian territory.

#### **4.4. Preferential Agreements**

69. By giving to specific countries a more favourable trade treatment, preferential free trade agreements (FTA) represent in principle a departure from MFN commitments. However, WTO members can conclude such agreements under certain conditions, though WTO disciplines in this area are rather limited. In particular, the WTO requires FTA members to provide information about the content and operations of preferential agreements to third countries to allow them to assess the possible impact on their own commercial interests. The WTO procedures for considering possible discriminatory effects of preferential agreements are quite general and focus on direct trade effects, while leaving aside other important features such as investment and regulatory aspects, which are increasingly covered by recent preferential trade agreements and regional co-operation initiatives.

70. Russia has concluded a number of different types of preferential trade agreements and treaties, which contain some trade preferential aspects (Table 4). Preferential tariff treatment is granted in particular within the FTA with its CIS partners and the former Federal Republic of Yugoslavia. The customs union treaties were transformed into the Agreement on the Establishment of the Eurasian Economic Community (between Russia, Belarus, Kazakhstan, Tajikistan and the Kyrgyz Republic). The customs union between Russia and Belarus is still negotiated. Russia grants preferential tariff treatment to some developing countries under its national system of preferences subject to periodical revisions by the government. Russian negotiators in the WTO have made commitments to make these agreements consistent with Article XXIV of the GATT and Article V of the GATS.

71. Russia signed the "Agreement on Encouragement and Mutual Protection of Capital Investment" or Bilateral Investment Treaties (BIT) with 56 countries, including with most OECD countries. However, only about half of these agreements have been so far ratified. Since 2001, Russian authorities have proposed as a starting point of negotiations a model agreement on the promotion and reciprocal protection of investment, which contains usual provisions on compensation for expropriation and guarantees for monetary transfers. But this model treaty does not contain the explicit references to the principles of non-discrimination, national treatment and MFN treatment. In particular, Article 3 of Russia's model agreement provides that "each contracting party shall ensure in its territory fair treatment of the investment", which shall be "at least as favourable as that granted to the investments of its own investors and investors of a third state". Article 8 of the model agreement also sets up the procedures and designates possible arbitration instances where dispute settlements between a contracting party and an investor of the other contracting party can be made in the case the dispute is not settled by the way of negotiations within the period of six months starting from the date of the request of one party.

**Table 4: Main Regional Trade Agreements and Trade-Related Treaties Signed by the Russian Federation**

<b>Treaty</b>	<b>Signatory countries</b>	<b>Date of signature</b>
Bilateral Free Trade Agreement (in addition 36 basic intergovernmental documents regulating functioning of free trade zone within the CIS were concluded)	Russian Federation - all CIS; former Federal Republic of Yugoslavia	April 1994
Customs Union Agreement (CU) transformed into a single Agreement on the Establishment of the Eurasian Economic Community (EEC)	Russian Federation - Belarus, Kazakhstan, Kyrgyz Republic and Tajikistan	CU: January 1995 ECC: October 2000
Economic Union	Russia Federation - Belarus	January 1995
Agreement on Encouragement and Mutual Protection of Capital Investment (Bilateral Investment Treaties - BIT)	Up to 2004, Russia has signed (but not always ratified) the BIT with 56 countries, including with 24 OECD Member countries, 5 CIS, 6 South Eastern European countries, several developing countries and China.	
Partnership and Co-operation Agreement (PCA)	Russian Federation - EU Member States. In April 2004, Russia agreed to extend the PCA to new EU Member States.	Signed in June 1994, entry into force in December 1997
Energy Charter Treaty	51 signatory countries. Provisions focus on the protection and promotion of FDI in energy, free energy trade, and freedom of energy transit. It includes mechanism for the resolution of State-to-State or Investor-to-State disputes.	Russia signed in 1994 but not yet ratified
Shanghai Co-operation Organisation	Russian Federation - China, Kazakhstan, Kyrgyz Republic, Tajikistan, Uzbekistan	June 2001

72. Going beyond traditional debates on possible trade distortion effects of preferential trade agreements in general and in specific cases, several recent analyses consider that some preferential trade agreement can have a positive impact if they are used to foster competition in domestic markets and as a pro-competitive device (Schiff and Winter, 2003). To promote this objective, regional co-operation should focus on regulatory reform, harmonisation of trade-related regulations, infrastructure projects and trade facilitation issues.

73. These general observations seem to be particularly relevant in Russia's context. Preferential trade agreements concluded with its CIS partners have been so far unsuccessful to boost and even maintain regional trade and investment flows. At the same time, regional trade relations have suffered from numerous trade obstacles and infrastructure problems, which could be alleviated through regional co-operation and regulatory harmonisation. Certain agreements, in particular the Agreement on Partnership and Co-operation with the EU, seek to enhance co-operation in the regulatory area and this potential should be fully exploited.

#### **4.5. Summary Remarks on Non-Discrimination Issues**

74. The Russian legislation still contains a number of explicitly discriminatory measures penalising the entry and operations of foreign investors. Some of these restrictions are currently discussed in the WTO, in particular within the negotiations on Russia's commitments in trade in services and on the conformity of its regulations with the WTO/TRIMs Agreement. In addition to explicit discriminatory restrictions, the main problem is effective and uniform implementation of legal and regulatory measures through the Russian territory. Whereas the key legal inconsistencies in legal responsibilities of federal versus sub-federal government levels in the trade policy area have been addressed, the local authorities continue to exert large discretionary power in interpreting and applying existing laws and regulations in some areas, such as

subsidies, licensing, customs procedures and government procurement. To avoid this risk, it is important to deal with remaining legal and regulatory ambiguities and continue to develop adequate human and technical capacities at different levels of administration.

75. Most preferential trade agreements signed by Russia are with its CIS partners, often with overlapping membership and unclear application modalities. Russia should clearly state the nature and coverage of its trade preferential agreements under relevant WTO procedures. Available analyses of current intra-CIS trade and investment flows indicate, however, that their current stagnation is mainly due to infrastructure problems and non-tariff barriers, which can be efficiently addressed through regional co-operation on trade facilitation issues and regulatory matters.

76. Integrating the non-discrimination principle into domestic regulations should be viewed as a device for encouraging fair competition between domestic and foreign firms and among different countries and therefore as a means to promote sound economic environment conducive to durable economic growth. In the same vein, multilateral liberalisation commitments related to MFN and national treatment should not be considered exclusively as bargaining concessions to trading partners, but rather as the part of modernisation efforts to expose different sectors progressively to domestic and external competition pressures.

## **5. Avoiding Unnecessary Trade Restrictiveness**

77. Several WTO Articles (in particular Article XX) and Agreements, especially the Agreements on Technical Barriers on Trade and Sanitary and Phytosanitary measures, include the obligation for countries to adopt regulatory measures that are not more trade restrictive than necessary to fulfil the designed objective. Frequent complaints by domestic and foreign firms on the unnecessary complexity of business-related regulations reported in various business surveys indicate that Russia's record in this area is still unsatisfactory. Complaints on over-strict and uneven applications of existing regulations are especially widespread at the regional and local levels. It should also be noted that while in some areas, for example customs or sanitary measures, firms undergo many and burdensome controls and inspections, for some other important matters, in particular intellectual property rights, Russian legal provisions are insufficient and their enforcement weak.

78. This section first assesses recent developments in the business environment in Russia, based on recent monitoring studies carried out in Russia, some international comparative studies and a business survey that was undertaken in Russia on behalf of the OECD in 2003-2004. Recent initiatives of the Russian government to address administrative and trade barriers are also considered. Finally, this section focuses on two key areas - customs and trade facilitation issues – in which regulatory improvements could greatly contribute to enhance trade and investment friendliness of the business environment in Russia.

### **5.1. Assessing the Impact of Regulations on Trade and Investment**

79. Regular monitoring of the administrative barriers to small business development in Russia, carried out by the Russian Centre for Economic and Financial research (CEFIR) in collaboration with the World Bank and financial support of the US Agency for International Development (USAID), measures the regulatory burden on small and medium enterprises (SMEs) in different Russian regions and assesses the impact of recently introduced laws and regulations. The first round of surveys was conducted in spring 2002, followed by two successive rounds in the fall 2002 and spring 2003<sup>8</sup>. The first round provided benchmark information on the situation before the implementation of the de-bureaucratisation reform, whereas the subsequent surveys considered the effects of new regulations concerning inspection, licensing

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<sup>8</sup> Results of the three rounds of *Monitoring of administrative barriers to small business development in Russia* are available at the web site of the Centre for Economic and Financial Research (CEFIR): [www.cefir.ru](http://www.cefir.ru).

and registration procedures. The CEFIR/World Bank (WB) surveys and de-bureaucratisation campaign do not explicitly target foreign firms and external economic activities, but the reduction of regulatory barriers has of course a strong impact on the general economic and business environment and therefore also helps to reduce trade restrictiveness and remove discriminatory aspects of regulations affecting foreign firms.

80. The Federal Law “On the Protection of Legal Entities and Individual Entrepreneurs in the Process of Exercising State Control (Supervision)” that entered into force in August 2001 limits regular (planned) inspections to no more than once every two years. Although the frequency of unplanned inspections is not limited, the procedures for their initiation are better specified. The law also prescribes the duration of an inspection, which should not exceed one month (or two months in special cases). The CEFIR/WB survey has shown that after the introduction of this law, the number of inspections did decline considerably compared to the same period of 2001 (by 21%). However, important regional disparities subsist as in some regions (*i.e.* Primorsky *krai*, Samara, Moscow *oblasts* and St. Petersburg) the number of inspections actually increased in comparison with the previous survey.

81. The Federal Law “On Licensing of Certain Activities”, introduced in February 2002, reduced the number of activities subject to licensing. The CEFIR/WB survey measured its effect through the two important improvements introduced by the law - the extension of the term of validity of licenses (from three to five years), and the reduction of licensing fees (from 3 000 to 1 300 roubles). In both areas, the general trend has been positive, as the average term of validity of licenses increased and licensing fees diminished (by 25% on average). However, “illegitimate” licenses, *i.e.* those which in principle should not be required, were still frequent, and the average reported fees (8 000 roubles) still higher than stipulated by the law. As in other surveyed areas, progress at the regional level was far from uniform.

82. The subsequent rounds of business surveys have shown that the perception of the business climate, including assessments of the tax burden and administration, macroeconomic stability, access to capital and levels of corruption, has gradually improved. However, almost 44% of the surveyed firms still considered at least one among ten examined regulations (in particular business registration, licensing and permits, price control, certification, documentation requirements) as a very significant problem. In 2002, surveyed firms declared for the first time that competition aspects have become more problematic compared to the previous monitoring round. As noted in the CEFIR evaluation, “this is the first time in Russia’s transition history when firms started to perceive competition to be more serious problem than government regulations”.

83. The third round of monitoring carried out in spring 2003 focussed on the effect of the new registration law (entry into force in July 2002) and the new simplified taxation system for SMEs, introduced in January 2003. Under the new registration law, the registration procedures were streamlined for a new business to take no more than five days after the submission of the application (instead of one month previously). The law also stipulates that all entry-related procedures are to be conducted at “a single window”. The 2003 survey revealed that registration procedures have become simpler and faster, but more expensive. The “single window” principle has not yet been operational, though the most time-consuming dealings with local administration were eliminated. The firms, which adopted the simplified tax system, consider its objective globally attained. It remains that regular business surveys also show that the impact of new laws gradually fades: for example, the positive trends in licensing and inspection observed in the two first rounds have not been confirmed in the last business survey. Regional differences in implementation also remain considerable.

84. The OECD business survey of trade barriers in Russia, conducted at the end of 2003 and the beginning of 2004 used a questionnaire similar to the one used already in Russia in 1995, as well as in the

Baltic countries in 2001 and in South Eastern Europe in 2002.<sup>9</sup> The Russian sample consisted of 307 companies, of which 50 were located outside Moscow. Almost 30% of firms came from the trade and distribution sector, 10% were manufactures of consumer goods and some 9% were involved in business services. Most surveyed companies belonged to SMEs (60%), while 16% were firms with more than 2 000 employees. The majority of the firms (75%) work primarily for the domestic market and 12% export more than half of their production. Firms with more than 50% of foreign participation represented 22% of the sample. Foreign participation is concentrated mainly in the firms with more than 500 and less than 2 000 employees, while it is comparatively less important in SMEs and large enterprises with more than 2 000 employees (OECD, 2004i).<sup>10</sup>

85. Overall, the OECD 2004 business survey confirms general trends observed in other analyses, but it also provides some additional interesting insights. Transparency, predictability and access to information seemed to improve in 2004 compared to the previous survey in 1995. Infrastructures for business operations became more readily available, especially in telecommunications. However, the situation is less favourable in the regions, as the access to banking credit and transportation facilities are judged more critically by the firms operating in the regions. In 2004, major complaints concerned excessive red tape (71% of firms continue to consider it as a serious or very serious problem). Support programmes for SMEs are viewed insufficient and ineffective by 62% of all surveyed companies (and even by 72% of firms located in the regions).

## **5.2. Recent Initiatives to Reduce Administrative and Trade Barriers**

86. Several recent governmental initiatives have addressed specifically regulatory reform issues, notably the de-bureaucratisation reform and the Medium Term Programme of Social and Economic Development for 2002-2004. The declared goals of these programmes have been to change the current balance between state involvement and economic liberalisation and to shift the role of the government from direct control over assets and market power towards greater reliance on laws and regulations. A number of laws introduced within the de-bureaucratisation programme, such as the laws on inspection, licensing, registration and technical regulations, clarified and simplified several key conditions of firms' establishment and operations. These objectives are thus similar to "administrative simplification" initiatives undertaken by a number of OECD countries. Various business surveys, commented above, indicate that some concrete effects of these legislative steps have been felt, though the implementation especially at the regional level is not yet satisfactory.

87. Other recent legal acts, especially the long expected law on foreign trade and the reform of the public administration, are also relevant for the business climate in Russia. The Federal Law No. 164-FZ "On the Fundamentals of State Regulation of Foreign Trade Activity" (of 8 December 2003) entered into force in June 2004, replacing the previous law dealing with the same matters. The new Law covers the most important aspects of trade in goods and services activities, including the competences of the central and regional governments in this area and the main principles regarding tariff and non-tariff regulations and their implementation. Although the Law does not contain the explicit reference to the WTO, it often uses the language of WTO agreements and refers to main international trade and efficient regulation principles (Box 3). The law also stipulates relatively detailed provisions on barter trade, pre-shipment controls and

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<sup>9</sup> The main findings of the business surveys in the Baltic States are summarised in the OECD publication "Promoting Trade in Services: Experience of the Baltic States" (OECD, 2004a). The results of the business surveys in South Eastern European countries are analysed in the OECD document "Domestic business environment for service providers in South Eastern European countries" (OECD, 2003b).

<sup>10</sup> More details on the sample and the results of the survey are presented in the OECD document "Recent developments in the business environment in Russia" (OECD, 2004i).

responsibilities of federal authorities in promoting foreign trade activities and collecting trade-related statistics.

**Box 3: Russia's New Law on Foreign Trade and the OECD Efficient Regulation Principles**

The Federal Law No. 164-FZ "On the Fundamental Principles of State Regulations of Foreign Trade Activity" defines the main relevant concepts such as foreign trade in goods and services, barter transactions, service providers, free trade zones, international transit, etc. It also specifies the responsibilities of the federal, regional and local authorities in regulating foreign trade activities. Among the basic principles of the state foreign trade regulations, Article 4 of the Law quotes the equality and non-discrimination among participants of foreign trade activities, the openness in development, adoption and application of trade measures and the "objectivity" in the application of state regulations. These general principles are also referred to in other Articles of the Law.

1. National treatment is granted by Article 29, which stipulates that "the goods originating from a foreign state shall be subject to a regime that is no less favourable than a regime granted to similar goods of Russian origin or to directly competing goods of Russian origin". The technical, sanitary, ecological and conformity requirements should apply to goods originating from foreign countries "in the same manner as they are applicable to similar goods of Russian origin". Trade in services is subject to similar provisions (Article 34). However, the Law also states that this regime does not apply to government procurement.

2. Transparency: Article 15 recommends to hold consultations with "the constituent members of the Russian Federation, Russian organisations and individual businessmen whose economic interest may be affected" on proposed regulations. The executive authority decides the methods and forms of such consultations, but their non-holding may not serve as a basis for invalidating a regulatory act.

3. Non-discrimination: any Russian and foreign persons have the right to carry out foreign activity, unless restricted by international agreements or other federal laws (Article 10). A foreign trade participant has the right to appeal a "decision, action (inaction) of a state body or its official" if he considers that they violated his rights (Article 18). Quantitative export or import restrictions should be applied irrespective of the country of origin. In case of the introduction of quotas, they should be allocated, when appropriate, through auctions and respecting the equality of all participants. The governmental body in charge of issuing licenses for export/import of specific goods should maintain a federal data bank of the issued licenses (Article 24).

4. Avoidance of unnecessary trade restrictiveness: According to Article 4, in designing foreign trade regulations, the authorities should opt for those measures that are not "more burdensome" than necessary to achieve their purpose.

88. The long awaited public administration reform was launched in March 2004. It streamlines the government structure by limiting the types of government bodies to three categories, *i.e.* federal Ministries, Services and Agencies, assigning to each of them specific and distinctive roles:

- Federal Ministries perform the objectives of state policy, including policy analysis, development and evaluation of activities within their competence. They are responsible for proposing legislative acts and regulations in their designated areas. They coordinate and control the activities of federal Services and Agencies under their jurisdiction.
- Federal Services supervise and regulate activities in their designated field. Given that their activities are mainly destined to the state, their funding comes from the state budget. Like federal Agencies, they can only issue individual regulations but not normative legal acts.
- Federal Agencies provide state services and property management, including for the private sector and citizens. They could be collegiate bodies and their funding can also include charges and fees paid by their users.

89. The reform reduced the number of ministries from 23 to 15 and abolished for example the ministries of public health, education, industry, science and technology, railways, communication and information and energy to form larger ministerial bodies with broader responsibilities in the related fields. The former Ministry of Antimonopoly Policy and Entrepreneurship was replaced by the Federal Antimonopoly Service (FAS) under the jurisdiction of the government. Its former functions concerning protection of consumer rights transferred to the Ministry of Health and Social Development and its responsibilities regarding the

support of small business are now taken by the MEDT. The new Federal Service on Financial Markets, also reporting directly to the Government, takes over the functions of the former Federal Commission for the Securities Markets.

90. Within the new governmental structure, the MEDT was initially (see Decision of the Government No. 187 of 7 April 2004) in charge of the Federal Service of State Statistics (former *Goskomstat*) and the Federal Service of Tariffs, which have been subsequently transferred under the responsibility of the Prime Minister. At present, the following services and agencies are directly supervised by the MEDT:

- Federal Customs Service
- Federal Agency on State Reserves
- Federal Agency of Cadastre of Real Estate Entities
- Federal Agency for Management of Federal Property

91. The main responsibilities of the MEDT include the formation of programmes and plans of socioeconomic reforms, trade and economic relations with foreign states (jointly with the Ministry of Foreign Affairs), formation of the single economic space, application of special, antidumping and compensatory measures in imports, tariff and non-tariff regulations concerning exports and imports (except for goods concerned by export controls), state regulation of the economy and prices (tariffs), insolvency (bankruptcy), investment activity and state investment, entrepreneurial activity, including SMEs, state statistics, customs-tariff policy and customs administration, market of land, purchase of goods and services for state needs and development of competition. According to the Decision of the Government, the MEDT has to have two deputy ministers and up to 16 departments. The staff in Moscow headquarters could amount up to 1940 persons (excluding the personnel of protection and maintenance of the buildings) and to 346 persons for the staff of its territorial bodies.

92. Several other services and agencies have also been renamed and reorganised. In particular, the former State Committee of the Russian Federation on Standardisation and Metrology (*Gostandart*) becomes the Federal Agency for Technical Regulation and Metrology under the jurisdiction of the newly created Ministry of Industry and Energy. The Agency remains responsible for registration of conformity documents and accreditation in the sphere of technical regulations and standards.

93. Leaving aside the inevitable disruption in normal functioning of most governmental bodies in the aftermath of the introduction of public administration reform, several issues concerning its possible modalities and impact can be raised. First, it can be noted that the reorganisation of such magnitude was introduced without prior consultations within the government. Second, the declared intention to streamline the government structure is not obvious considering that despite the reduction in the number of ministries, the overall number of governmental bodies, including federal services and agencies, has in fact increased after the reform. Moreover, there is a question whether this essentially formal organisational reform will be sufficient to attain the legitimate objective of reinforcing the internal control, disciplines and accountability of different governmental bodies. It is not certain that the planned reduction in a number of civil servants especially in Moscow headquarters and among high level staff, which is expected to generate financial resources to increase the salaries of remaining workforce, will bring expected results if it is not accompanied by the salary reform introducing some performance-based elements.



### 5.3. Customs Related Issues

#### 5.3.1 Customs Statistics

94. Illegal or “grey” practices in Russian foreign trade and their partial responsibility in capital flight are widely debated issues, but their extent and developments are difficult to measure. One possible way to apprehend customs-related fraud is to analyse mirror trade statistics, i.e. compare Russian customs data with corresponding trade flows as recorded by its partners. For the purpose of this study, such an analysis was carried out on trade flows between 1996 and 2001, based on Russian data provided by the State Customs Committee (SCC) compared with the OECD International Trade Statistics by Commodities and available trade statistics of some CIS countries (*i.e.* Belarus, Kazakhstan and Moldova) and China. The quantity, the value and the unit values were compared for 35 product categories on the export side (representing approximately 70% of Russian total exports) and for 89 product categories on the import side (corresponding on the average to some 35% of Russian total imports) (Zhukovskaya *et al.* 2003).

95. This detailed statistical analysis reveals several interesting findings:

- In the period 1996-2001, the discrepancies between Russian and partner countries’ statistics are significantly larger on the side of Russian imports than for Russian exports. In its trade with the 15 major trading partners (representing 50% of Russian imports), Russia reports cumulated imports of USD 123.8bn compared to USD 174.6bn recorded as exports by these countries. Given that import prices in the c.i.f. terms (cost, insurance and freight) are generally estimated to be higher by 10% than corresponding export prices in the f.o.b. terms (free on board), it could be considered that the Russian data underestimate imports flows by more than USD 50bn during the period concerned. In absolute terms, the largest discrepancies between the two sets of data are observed in case of Germany (Russian imports from Germany in 1996-2001: USD 31.2bn compared to German exports to Russia: USD 45.2bn). In relative terms, the differences are also significant for Turkey, Belgium, China and Korea.
- On the export side, the divergence between the two sets of data is significantly smaller. Russian cumulative exports in 1996-2001 are lower by USD 5.5bn compared to partners’ imports from Russia. However, this general trend masks contrasting variations during the whole period and among the countries.
- Among the 89 products imported by Russia from 28 countries, the largest Russian underreporting concerns foodstuffs (in particular meat, chicken broilers, cheese, apples, sugar-based confectionaries and chocolate products), followed by clothing (especially from Turkey and China), and pharmaceuticals.
- The analysis of Russian exports by products is more difficult given that energy products which dominate Russian sales are sometimes subject to specific trade transactions (*e.g.* barter or compensation schemes) and often inadequately covered by available statistics (*e.g.* excluding transit or temporarily imported goods). For some categories such as natural gas, Russia provides mainly data in quantitative terms, but such data are not always available in partner countries. The analysis shows that several categories of Russian exports are systemically below of the values reported by its partners, especially non-ferrous metals (nickel, cooper) and frozen fish (*e.g.* Russian exports representing only 18% of the export value recorded by its partners).

96. The systemically large underreporting of Russian imports compared to partners’ exports indicates that Russian traders are quite successful in avoiding the payment of high customs duties and other trade-related fees. In some cases, the motivation could just be to reduce long customs delays. It is estimated that only some 20% of Russian imports is adequately registered, while some 70% are subject to grey practices and 10% are smuggled. The two main methods used to reduce the payment of customs duties and fees

consist in: (i) understating the declared price, quantity or both; (ii) declaring the imported product under another product category subject to lower customs duty. These methods often suppose the “consent” of customs authorities and related “remuneration”.

97. Obviously, declared corruption of customs officials must be addressed by more far-reaching reforms, in particular the combination of sanctions, better salaries and training. However, these practices, in particular the fraud in declaring imported product under another category, would be less frequent if Russia has a more uniform tariff structure and does not rely extensively on combined customs duties (*ad-valorem* and goods-specific), which lead generally to higher tariffs than statutory *ad-valorem* rates. Problems with fraudulent exports and VAT refunding could also be reduced if information exchange between customs and fiscal authorities is reinforced.

### 5.3.2 Challenges of the Customs Reform in Russia

98. The new Customs Code that entered into force in January 2004 represents an essential step in Russia’s customs reform and significant progress in harmonising Russian customs procedures with international practices, in particular the WTO relevant disciplines and the principles of the International Convention on Simplification and Harmonisation of Customs Procedures under the standards of the revised Kyoto Convention. The new Code also clarifies many existing rules and practices of the customs regime as well as prerogatives of different administrations. In the past, the State Customs Committee (SCC) issued a large number of *ad hoc* Orders, Instructions and Directives to grasp with many legal ambiguities or loopholes in the general legislation. This prerogative of the former SCC to interpret laws has been abolished as bylaws should now be issued only by the government. Some other customs-related activities continue to be managed by other legislative acts, for example Foreign Exchange Law or the Tax Code for VAT and excises taxes. Enforcement of penalties and appeals against decisions of customs authorities are regulated by the Law on Administrative Offences, effective since July 2002.

#### **Box 4: Russia’s new Customs Code and the OECD Efficient Regulation Principles**

The new Code is a comprehensive document that seeks to improve clarity of customs regulations, increase predictability of customs payments and make customs controls and clearance more rapid and effective. The main principles of efficient regulation are addressed by several provisions of the Code.

1. Transparency and openness of decision making: The Code requires customs officials to publish legal acts and facilitate access to information about changes in regulations that have not yet come into effect, particularly by means of information technology. They also have to respond to requests from importers and exporters for information about specific decisions that affect them. The Code ensures easy access to customs regulations for foreign operators (see Chapter 4 of the Code).

2. Non-discrimination: The Code clarifies the authority of higher customs officials to ensure that the decisions of lower officials comply with the provisions of the law. It prohibits regional and local governmental bodies from interfering in customs affairs. The Code also spells out procedures for individuals to file appeals of decisions made by customs officials.

3. Avoidance of unnecessary trade restrictiveness: The customs clearance period has to be reduced from ten to three days. Customs clearance procedures are simplified and streamlined with the aim to reduce the risk of arbitrary interpretation by customs officers. The demand of additional documentation and data not envisaged by the Code are banned (Article 120). Shortening of customs clearance time should be facilitated in particular by giving the possibility to operators to declare some additional information on the products after customs clearance.

4. Use of internationally harmonised measures: The Code emphasises the need to use internationally accepted commodity classification systems.

5. Recognition of equivalence of other countries’ regulatory measures: The Code invites customs authorities to conclude agreements with foreign customs bodies on the mutual recognition of customs documents. Procedures for customs controls should be based on international norms and practices, such as the application of risk analysis. While the new Code promises major improvements in Russia’s customs regime, its ultimate success will depend on effective implementation. In particular, major work remains in drafting regulations to provide precise direction to customs authorities and carefully monitoring the new regime to ensure that the principles and guidelines enunciated in the Code are translated into new operating procedures.

99. Several customs procedures in Russia do not yet fully comply with WTO requirements, in particular unduly high customs fees that do not reflect the costs of services provided, and customs valuation procedures. For the customs valuation purpose, Article VII of the GATT/WTO stipulates the use of the transaction value of goods or price actually paid, but in Russia some arbitrary methods are still applied, in particular the use of fixed import prices or the impossibility to withdraw goods against guarantees pending final determination.

100. To improve trade-related duties collection, the main objective is to continue to reduce illegal or grey practices. The system of import exemptions, which still represented 9% of total imports in 2000, should remain under close scrutiny, especially in Kaliningrad *oblast*, which seems to be one of the main users of this system. The efforts to improve the payments of customs arrears have to be pursued and customs administration in co-operation with tax authorities should also be able to control better export claims for VAT refunding and drawback claims, which can represent considerable budget revenue losses.

101. From the business community perspective, the main problems are long and unpredictable delays in customs proceedings. Customs documentation is excessively detailed and all shipments are inspected individually. The situation could be improved if Russia adopts systematically the risk analysis and management to allow customs officials to concentrate on high-risk cases (see below).

102. The customs regulatory reform will be inefficient without institutional reforms of customs administration. The Russian customs administration is not a single unified administrative body, but a conglomerate of legally independent entities. It is therefore necessary to streamline the organisational structure, by redefining more precisely the functions of different organisational entities, namely headquarters, regional directorates, customs offices and customs posts.

**Box 5: Russian Customs Administration**

In 2003, the Russian customs administration had 2 150 staff in its headquarters and more than 60 000 customs officers in 7 regional customs directorates, 141 customs offices processing goods and vehicles and 670 posts, of which 416 were border checkpoints and 216 inside posts. More than half of the staff works in four main regions: Central (11 900), North-West (10 250), Southern (7 642) and Siberian (5 450) regions. Almost two thirds of all staff have a university education.

*Source: The World Bank Customs Development Project, March 2003*

103. Without strengthening human management, customs reform has little chance for success. The efforts should focus on reviewing the salary and incentive structure, education and training activities and the programme to improve the integrity of the customs administration, in particular by adopting the guidelines of the Arusha Declaration of the Customs Co-operation Council concerning Integrity in Customs.

104. The Russian customs administration has not yet sufficiently developed its partnership with the trade community and continues to lack a “service culture”. One of the essential steps in this process is to improve consultation mechanism with the trade community, especially prior consultation of planned customs-related regulations. For this purpose, existing structures could be used, in particular the Advisory Council on Customs Policy, which includes business associations, such as the Chamber of Commerce and Industry. The Foreign Advisory Council, created in 1994, which also established the Working Group on “Improvements of Customs Procedures during Transfer of Goods”, should enhance the communication with the foreign business community. Accessible and efficient dispute settlements and appeal procedures for customs-related matters are also indispensable to create good working relations based on mutual confidence between customs administration and business.

105. Pursuing customs reform and harmonising customs regulations with the WTO requirements is compatible with improvements in customs collection. Better transparency and simplification of customs

regulations will facilitate the implementation of customs regulations and reduce fraudulent practices, thus ensuring more predictable budget revenues generated by customs duties and trade-related taxes. For business, costs of trade transactions can be further cut if the reform succeeds to rationalise customs documentation and expedite customs clearance and controls.

#### 5.4. Trade Facilitation Issues

106. Russia's negotiations in view of its WTO accession have contributed to its progress in adopting existing international disciplines, for example in customs procedures. However, WTO accession and resulting improvement in market access would have a limited impact on the country's integration into world markets if its transport and logistics services fail to support and facilitate trade operators and transactions.

107. In parallel with the decreasing role of conventional barriers such as tariffs in international trade, the relevance of trade facilitation issues for governments and business has considerably increased both in the national context and international environment. In a broad sense, trade facilitation covers customs procedures, transport and other logistics aspects involved in moving goods from one country to another. A number of recent studies have sought to estimate the costs and benefits of trade facilitation and analyse its impact on trade flows, business activity and governmental revenues in specific countries, product sectors or internationally, including several OECD papers (Wilson *et al.*, 2004, OECD, 2004e). Some other studies have adopted a business perspective and developed specific methodologies to measure trade facilitation performance. The so-called logistics index, which can be estimated for individual countries, regions or firms, can be used as a tool for assessing the overall logistics performance of individual countries and comparing it in time and across countries. This method was recently used to assess Russia's capacities to handle trade facilitation issues (OECD, 2004j)<sup>11</sup>.

108. Market surveys carried out in Russia and other selected countries in 1997 and 2003 measured the lead time (*i.e.* the time span between the day an order has been received and the day of the delivery), warehousing and distribution costs and safety stock levels in three sectors, *i.e.* food products, pharmaceuticals and high technology products. In 1997, Russia ranked last among nine surveyed countries in all examined sectors. Its underperformance was striking not only compared to OECD countries but also to the three Baltic countries, which were the part of the sample. Russia's gap was due to the bottlenecks in all components of the logistics index: its lead time and warehouse costs were for example six times longer/higher compared to the best performers (Denmark), but also more than double compared to the Baltic States. In 2003, Russia's situation has deteriorated further compared to other surveyed countries, reflecting its higher transport costs, longer and unpredictable lead time, more important inventory levels and warehousing costs.

109. Based on the techniques often used by firms to select the most competitive supplier, the so-called add-ons index from origin to consumer considers different elements of the final price of a product, including various duties, taxes, transport, and inventory costs. Table 5 provides the calculations of the final cost of specific machinery and parts delivered from Russia, Poland, Italy and Estonia to Denmark. It shows that even if a Russian product is initially cheapest, transport, logistics and other costs make it finally most expensive for final consumers. In addition to their existing handicaps, in particular often inappropriate quality and lack of conformity to specifications, the competitiveness of Russian exports is further eroded due to higher official and informal costs. For example, transport costs represent proportionally one third of the initial price of the Russian product compared to 11% and 14% for other surveyed countries. As a result, for instance Estonian producers, in contrast to their Russian competitors, succeed in maintaining their initial competitive edge even after transport, logistics and other costs are taken into account.

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<sup>11</sup> More details on the methodology used and estimates for several countries, including Russia are provided in TD/TC/NME(2004)7: Trade Facilitation Issues in Russia: A Business Perspective

**Table 5: Add-On Index from Origin to Consumer**

<b>Components of the index</b>	<b>Russia</b>	<b>Poland</b>	<b>Italy</b>	<b>Estonia</b>
Basic price	80	100	120	95
Transport costs	24	12	16.8	10.4
Transport risk costs	2.4	0.48	0.34	0.1
Duty	15.6	8.96	0	8.4
Inventory capital costs	12	3.75	0.57	0.43
Inventory costs	9.36	2.24	1.36	1.05
Obsolete costs	36.4	16.8	4.1	4.22
Delay costs	6.24	2.24	1.36	1.05
<b>Sub-total I</b>	<b>186</b>	<b>146.47</b>	<b>144.53</b>	<b>120.65</b>
Mark-up wholesaler	65.1	51.26	50.58	42.22
<b>Sub-total II</b>	<b>251.1</b>	<b>197.73</b>	<b>195.11</b>	<b>162.87</b>
VAT 25%	62.7	49.43	48.77	40.77
<b>Sales price to retailer</b>	<b>313.8</b>	<b>247.16</b>	<b>243.88</b>	<b>203.64</b>
Retailer mark-up (30%)	75.33	59.37	58.53	48.86
Sales price excl. VAT	328.43	257.1	253.64	211.73
VAT 25%	81.6	64.27	63.41	52.93
<b>Consumer price</b>	<b>408.03</b>	<b>321.37</b>	<b>317.05</b>	<b>264.66</b>

Source: Logistics Consulting Group, Denmark

110. Lengthy, unpredictable and costly import and export procedures are burdensome for foreign exporters and importers, but they also have a negative impact on Russian exporting firms and final consumers. The difficulties in anticipating correctly transport and logistics expenses and delays entail higher capital costs and inventory levels for companies and force them to adopt “buffer” arrangements inducing inevitably higher prices of imported goods for Russian consumers. On the export side, poor transport and logistics efficiency, often combined with problems of quality standards, further reduce the competitiveness level of Russian manufactured goods.

111. In light of successful trade facilitation reforms carried out in other countries, for example in Estonia, several policy proposals could be made for improving the trade facilitation framework in Russia, in particular:

- Increase public and business awareness of the importance of trade facilitation and logistics issues through specific initiatives, for example by establishing a strategic plan on “trade supporting infrastructure and services”.
- Develop a series of trade facilitation and logistics indicators, based on the methodology of logistics and related indexes; proceed with the benchmarking exercises assessing the current situation in Russia and set up a timetable and numeric targets for improving Russia’s performance measured by specific indicators.
- Encourage co-operation between the administration and the private sector in trade facilitation issues, for example by creating a National Trade and Transportation Facilitation Committee that would put together officials from relevant governmental agencies and business representatives, including foreign firms operating in Russia. This organisational structure would be consulted prior to introducing legal and regulatory measures concerning trade facilitation issues and could propose specific initiatives or programmes aimed at improving transport and trade facilitation environment in Russia.

### **5.5. Summary Remarks on Unnecessary Trade Restrictiveness**

112. Recent governmental initiatives and the ongoing WTO accession process have contributed to improving the general business and trade environment in Russia and addressed several aspects of explicit or implicit trade restrictiveness of existing laws and regulations. A number of new or amended laws, adopted

within the de-bureaucratisation campaign, simplified and clarified basic conditions for firms' establishment and operations, especially procedures related to licensing, state inspection, registration and technical regulations. These laws have been designed to comply with WTO requirements in relevant areas.

113. Available business surveys show that the initial impact of these laws has been generally positive, though the level of satisfaction with their implementation often varies depending on the regions, the sectors, the size and ownership of interviewed firms. A certain worsening in the application of recent laws and regulations evidences the need to maintain the reform momentum and implementation efforts. It has to be seen whether ongoing reform of governmental structure will allow for better and timely interaction between federal and regional governments and business community and enhance responsiveness of government to legitimate business concerns.

114. A single window facility envisaged by the federal law on registration is not yet operational in Russia. The experience of many OECD and non-OECD countries shows that such an organisational structure reducing the number of procedures and interlocutors for nascent firms is extremely useful, especially for SMEs. It is therefore critical that Russian authorities accelerate the establishment of this facility, especially at the regional and local levels, where enterprises face major difficulties during their establishment procedures.

115. The Russian law-making process could be further improved if regulatory concerns are taken into consideration in the early stage of legal procedures. At present, the Resolution of the State Duma No. 2134-II "On Regulations of the State Duma and the Federal Assembly of the Russian Federation" (of 22 January 1998) requires the following documents to be submitted together with the text of a draft law: (i) an explanatory note to the draft law describing the subject of regulation and presenting the concept of the proposed draft law; (ii) a list of federal legal acts to be recognised void, suspended, amended, augmented or adopted in connection with the adoption of the draft law under consideration; (iii) feasibility study, in case the implementation of the proposed draft law requires material expenses.

116. Russian authorities may consider introducing the regulatory impact analysis (RIA), applied in a number of OECD countries (Box 6). This procedure assesses the regulatory quality of proposed measures and looks on possible alternative solutions, which would fulfil the final objective without imposing unnecessary administrative restrictions on business activities. The experience of many OECD countries in introducing RIA in the early stages of the legislative and regulatory process shows that such an approach significantly reduces the risk of adopting unnecessary administrative procedures and excessively detailed and complex regulations, which often induce delays, uncertainties and therefore higher costs for business.

**Box 6: Regulatory Impact Analysis (RIA)**

RIA is a systematic process aimed to identify and if possible quantify main benefits and costs that are likely to result from the adoption of a regulation under consideration. It also provides policy makers with information on possible regulatory alternatives responding to a particular regulatory objective. RIA may be based on cost/benefit analysis, cost effectiveness analysis, business impact analysis, etc. RIA can be used to consider the impact of regulations on market openness, in particular to assess whether proposed regulations do not restrict market entry, business activities and competition. Many OECD countries that apply RIA also assess possible trade restrictiveness of proposed measures, for example Denmark, Hungary, Korea, Mexico, Netherlands and the United States.

Source: OECD Trade Policy Working Paper no. 9: *Regulatory Reform and Market Openness: Understanding the Links to Enhance Economic Performance; Trade and Regulatory Reform: Insights from the OECD Countries Reviews and Other Analysis* [TD/TC/WP(2002)21/FINAL].

117. In addition to *ex ante* regulatory assessment, best carried out through RIA, it is also important to undertake regular *ex post* assessment of regulations already applied. In Russia, such procedures are envisaged for some specific trade issues. The MEDT has to analyse the impact of tariff and non-tariff regulatory measures “with a certain frequency”. According to the Federal Law No. 63-FZ (of 14 April 1998) “On Measures for Protection of Economic Interests of the Russian Federation in Foreign Trade”, the government also has the obligation to review the impact of special safeguard measures after one year of their application in case these measures were introduced for the period exceeding one year and consider their possible alleviation. This procedure is carried out by the MEDT in co-operation with other interested federal agencies and the results of such analysis are to be presented to the Governmental Commission for Foreign Trade and Customs Tariff Policy Safeguards. Russian authorities can envisage making such an *ex post* regulatory assessment more systematic and using it for a broader variety of trade measures.

118. Main challenges for integrating the principle of unnecessary trade restrictiveness into the domestic regulatory trade-related framework are in the domain of trade facilitation issues and more specifically customs procedures. It should be underscored that existing shortcomings in cross-border operations, including excessive delays and unpredictable costs of customs formalities as well as high infrastructure costs hinder not only foreign operators but also domestic firms, be they direct exporters and importers or producers using imported inputs.

119. The scope and complexity of trade facilitation problems require a broadly designated and multifaceted programme addressing different legal, regulatory, institutional and implementation aspects. In the legal area, remaining inconsistencies with international disciplines, especially customs valuation procedures, have to be eliminated. Existing customs procedures should be made widely available in a timely manner and implementation instructions sufficiently clear to prevent discordant interpretations by local customs officers. Planned regulations should be as much as possible discussed with trade operators and users to avoid unnecessary administrative burdens and protracted trade transactions. Successful reform also requires sufficient financial resources to modernise technical equipment and ensure staff training of customs administration. A global trade facilitation programme cannot ignore the weakness of infrastructure services in Russia, especially transport and warehouse facilities. The lack of efficiency of these services adversely affects competitiveness of Russian exports and penalise final consumers and producers depending on imported inputs in Russia.

## 6. Use of Internationally Harmonised Measures

120. Regulatory divergence in technical regulations and standards is often viewed by business circles as a source of additional transaction costs. The WTO’s TBT and SPS Agreements, designed to take into account the legitimate concerns of unnecessary hindrance to trade of technical standards and sanitary measures, urge countries to avoid using them as disguised protection (Article 2.4 in the TBT Agreement and Article 3 in the SPS Agreement). The TBT Agreement stipulates that when designing their domestic technical requirements

the countries should rely as appropriate and feasible on internationally harmonised standards. The TBT Agreement contains a Code of Good Practices for the Preparation, Adoption and Application of Standards that sets guidelines on how central and local governments and non-governmental bodies should establish and apply technical regulations. The Code calls on WTO members to ensure that such regulations are non-discriminatory and transparent and invites them to adopt international standards when appropriate and to recognise testing procedures of other countries. In negotiations on Russia's accession to the WTO, trade partners have encouraged Russia to reform its domestic standards and technical regulations system and bring it into conformance with the TBT Agreement and the Code of Good Practices.

121. Several regional agreements go further than rather general recommendations referred to in the multilateral agreements. For example, for the Central European transition economies the adoption of EU technical regulations, standards and conformity assessment procedures have significantly facilitated and accelerated their abandon of specific domestic technical regulations and standards and acceptance of international equivalents. The APEC initiative also represents an innovative approach to tackle the problem of specific technical standards and regulations in different countries.<sup>12</sup> Russia might examine these experiences and consider strengthening co-operation on standard issues with its main trading partners.

122. The Russian Federal Law "On Technical Regulation" is a significant step in Russia's modernisation of standard procedures, aimed at replacing the past prevalence of mandatory norms and a limited acceptance of international standards by more flexible and market oriented system complying with international practices in this area (Box 7). As already stated, the new law has brought some innovative aspects into the Russian legislative framework, in particular by introducing mandatory consultations of technical regulations with interested parties prior to the adoption of new standards and technical regulations. The principle of consultations was already applied during the preparation of this law, in which several foreign firms (e.g. IBM, Motorola, Siemens and the US Chamber of Commerce) also took part. However, the law imposes a seven year implementation period and it will therefore take some time before its effects can be fully assessed.

**Box 7: Russia's Law "On Technical Regulation" and the OECD Efficient Regulation Principles**

The Federal Law "On Technical Regulation" (No. 184-FZ) was approved 27 December 2002 and came into force in July 2003. It represents a major reform of Russia's system of establishing standards and procedures for conformity assessment. The reform was undertaken as a part of the government's efforts to meet the requirements for accession to the WTO. A number of provisions of the law reflect the OECD's efficient regulation principles.

1. Transparency: The Law introduces a detailed mechanism of systematic public discussion of draft technical regulations. It requires the developer of a draft technical regulation to publish the draft, provide access to the draft for all interested parties, present any written comments to the national standard body, and organise the public discussion of the draft. The national standard body is required to publish a notification of approval or, if it rejects the proposed standard, its reason for doing so. According to Article 7 of the Law, technical regulation accepted by the law comes into force not earlier than six months after its official publication.

2. Non-discrimination: Article 7 stipulates that technical rules are applied irrespective of the country or place of origin of the product. The law does not restrict the participation of foreign entities in consultations prior to the introduction of new technical regulations and standards.

<sup>12</sup> More detailed information on APEC initiatives in this area can be found on the website of the Sub-Committee on Standards and Conformance (SCSC) at: [http://www.apecses.org/apec/apec\\_groups/committee](http://www.apecses.org/apec/apec_groups/committee).



**Box 7: Russia's Law "On Technical Regulation" and the OECD Efficient Regulation Principles (continued)**

3. Avoidance of unnecessary trade restrictiveness: Article 7 provides that the requirements of technical regulations shall not serve as an obstacle to entrepreneurial activity to a greater extent than is minimally necessary for the attainment of the purposes of the law. Similarly, Article 12 states that one of the principles of standardisation is avoidance of creating obstacles to the manufacture and circulation of goods and services to a greater degree than the minimum needed for the attainment of the goals of the law.

4. Use of internationally recognised standards where possible: Article 7 stipulates that international standards are to be used fully or partially as the basis for elaborating draft technical regulations. According to Article 12, international standards are to be used as the basis for the development of national standards, except for cases in which international standards do not comply with the requirements of specific Russian climatic, geographic, technical or other peculiarities.

5. Recognition of equivalence of other countries' regulatory measures: Article 30 provides that conformity assurance documents, marks of conformity, and tests and measurements of a product that are obtained in other countries may be recognised in accordance with Russia's international treaties.

6. Application of competition principles: Article 3 states that one of the principles of technical regulation is avoidance of any restrictions to competitiveness for accreditation and certification. Articles 18 stipulates that a purpose of conformity assessment is to create conditions for free transport of goods throughout Russia and implement international economic, scientific and technical co-operation and trade.

The Federal law provides for a transition period of seven years to fully implement the new system.

123. The new law on technical regulations promotes the use of international standards, which are viewed as an important means to increase Russia's export potential and investment opportunities. In case national standards and technical regulations do not correspond to international norms and rules, the government should initiate procedures to modify them. Any person, public or business organisation can develop and propose national standards. According to information provided by Russian authorities, the Russian Federation applied in 2003 some 40% of international standards developed by the International Standardisation Organisation (ISO). The best sectoral coverage by international standards is in automobiles (100%), machine-tools (74%) shipbuilding industry (65%) and informatics (60%). In several sectors, international standards represent between 30 and 40% (oil, gas and chemical equipment, medical appliances, railway, electrical equipment), while in a few sectors, such as aviation and space technology, international standards are applied only for five and less percent.

124. The Russian Federal Agency for Technical Regulation and Metrology (FATRM), which replaced the former State Committee on Standardisation and Metrology (*Gostandart*) is the national standardisation body responsible for designing and approval of technical regulations and international standards. This central federal body, now under the authority of the Ministry of Industry and Energy, concludes co-operation agreements with executive authorities of the Russian Federation Subjects in the sphere of its competence. The Agency has 104 standardisation, metrology and certification centres located in most Russian regions. The total number of employees is 13 000 persons, including 2 200 government inspectors. The information on the activities of the FATRM and its centres is published in several periodicals, such as "*Standards and Quality*". Draft technical regulations and national standards and information on their preparation are available on the Agency's website ([www.gost.ru](http://www.gost.ru)).

125. Like with the general public administration reform, it is for the moment premature to assess the effect of the reorganisation, which has only been implemented since the summer 2004. In particular, it has to be seen what the relations will be between the new Agency and the (also newly created) Ministry of Industry and Energy, which supervises its operations.

126. In addition to mandatory certification directly managed by the FATRM, private companies can take part in the process of voluntary certification. They can submit an offer to the government directly or through the Federal Agency on their agreement on mutual recognition of results of proof of conformity with certain

states. The main criteria for approval of such offers are whether they help to achieve protection of the life and health of citizens, property of physical or legal persons or preservation of the environment.

## **7. Recognition of Equivalence of Regulatory Measures Adopted by Foreign Countries**

127. Although the reliance on internationally agreed standards has been increasing, many internationally traded goods continue to be subject to specific testing and certification procedures in importing countries. Reducing multiple assessment procedures can considerably cut down trade transaction costs. Different procedures and mechanisms have been developed in OECD countries to facilitate acceptance of foreign measures when circumstances permit, in particular mutual recognition agreements and suppliers' declaration of conformity (self-declaration). By concluding sectoral mutual recognition agreements (MRA) trading partners agree to accept mutually their regulations that can concern product-related regulations but also the procedures used to assess the conformity of a product or services. The self-regulatory scheme of suppliers' declaration of conformity is a more flexible approach leaving the producers to choose the modalities of conformity assessment with technical requirements. These suppliers' declarations of conformity are usually based on in-house procedures or implemented by private organisations and are often limited to specific products. In general, all these procedures suppose a high level of mutual trust between all parties concerned, including the end-users. The EU "Global Approach" is an example of mutual recognition and accreditation procedures enabling the products recognised in conformity to be freely marketed throughout the EU Single Market.

128. These various initiatives require the existence of adequate domestic capacities for accreditation, in particular the establishment of efficient accreditation mechanisms and accreditation institutions. National accreditation bodies, which usually operate under the supervision of the public authorities, are responsible for inspecting and acknowledging the competency and reliability of conformity assessment and share inspection results through international networks, such as the International Accreditation Federation.

129. In Russia, the national standardisation body maintains the main responsibility in considering the recognition of the equivalence of regulatory measures and results of conformity assessment performed in other countries. The new Federal Law on Technical Regulation (Article 30) stipulates that technical regulations, conformity assessment, protocols of tests and product measurement can be adopted and recognised in accordance with international agreements signed by the Russian Federation. Russia is a member of several international certification systems: in addition to the already mentioned the International Standardisation Organisation (ISO), Russia participates for instance in the System of International Electro-technical Commission for Testing Electrical Equipment Compliance with Safety Standards, the Certification System of Cars, Trucks, Buses and Other vehicles and the System of Electronic Equipment Certification. In March 1992, Russia concluded the Agreement on Co-ordinated Policy of Standardisation, Metrology and Certification with the governments of the CIS, followed in June 1992 by the Agreement on Principles of Performance and Mutual Recognition of Certification signed by national standardisation, metrology and certification bodies of these countries.

130. According to information transmitted by Russian authorities to the OECD, private initiatives for mutual recognition are not regulated or restricted by the state in Russia and therefore there are no official monitoring and data available regarding these activities.

131. Although the desirability to adopt international standards and recognise equivalence of foreign regulatory measures are clearly stated in relevant Russian legislation, it seems that in practice the implementation of these targets remains rather slow and patchy. The main impetus for changing this situation will probably come from the private sector, especially as its commercial interests are likely to be directly affected by EU enlargement, which implies that most Russian trade partners apply or require the compliance with relevant standards. Mandatory consultations on proposed standards and technical

regulations, recently introduced in the Russian legislation, are probably the best guarantee that these business interests will be taken into account.

## **8. Application of Competition Principles in an International Perspective**

132. Competition aspects are particularly important in Russia where a number of natural monopolies exist and the privatisation process has not eliminated high market concentration in some sectors. The risk of the abuse of dominant market position, restrictive agreement or unfair practices remains therefore high in the country. Within the OECD regulatory reform project, the countries peer reviews consider to what extent competition policy and institutional structures responsible for its enforcement stimulate regulatory reform. Taking into account that anti-competitive practices can also have a negative impact in the foreign trade activities, this section completes the detailed analysis of Russia's competition law and policy (OECD, 2004c) by focusing on international aspects of competition policy.

133. The Federal Law "On Competition and Restriction of Monopolistic Activity on Goods Markets" adopted in 1991 and since then several times amended, is the main legal act governing competition policy in Russia. It was supplemented by the specific legislation concerning natural monopolies in 1995 and the federal law on financial markets in 1999. The provisions of the general competition law apply in principle not only to conduct occurring in Russia, but also in all instances in which actions or agreements occurring outside of Russia lead or may lead to the restriction of competition on the Russian market. In practice, the Russian competition authorities have relatively limited resources and instruments to get relevant information and therefore consider the interaction between domestic and external markets. Several bilateral agreements concluded with foreign antimonopoly counterparts, including at the CIS level, can, however, facilitate exchange of information to be used in some investigations on anticompetitive behaviour involving Russian and/or foreign firms. According to the Article 18 of the above mentioned federal law, the Russian competition authority might allow the merger or acquisition applications if the participants of such a transaction can prove that the positive effects of their actions, including in the socio-economic area, outweighs the unfavourable effects for the given commodity market.

134. Foreign firms operating in Russia are at present mainly concerned by the application of Article 18 of the general competition law, which stipulates that important mergers and acquisitions are subject to prior notification and preliminary consent of the antimonopoly authority. The number of cases involving foreign firms has remained so far relatively modest: in 2002, only 10% of pre-transaction petitions and over 4% of post-transaction notifications within the total of notified transactions concerned foreign firms (OECD, 2004c, paragraph 85).

135. According to the general competition law, the antimonopoly authority has to intervene to ensure that state bodies at the federal and regional level do not violate the antimonopoly legislation and respect antimonopoly requirements in bidding procedures for state purchases. In particular, the federal bodies of executive power, the subjects of the Russian Federation and bodies of local self-government are banned to adopt acts or perform action which would create discriminating conditions for particular transactor units. They are also forbidden to make agreements or commit concerted actions between themselves or together with specific transactor units that may result in restricting or eliminating competition (see Articles 7 and 8 of the general competition law). The Federal Antimonopoly Ministry then the Federal Antimonopoly Service (FAS) follows carefully the observance of these provisions: in 2003, its actions in this area represented some 40% of all its actions.

136. Following the recent reorganisation of the Russian government's structure (see Presidential Decree No. 314 of 9 March 2004 "On the System and Structure of Federal Bodies of Executive Power), the former Ministry of Antimonopoly Policy and Entrepreneurship was abolished and most of its functions are now carried out by the new Federal Antimonopoly Service (FAS), placed under the direct jurisdiction of the

Government of the Russian Federation. The FAS is responsible in particular of supervision and control over the observance of the legislation on competition on the commodity markets, the market of financial services, on natural monopolies and advertising. The Resolution of the Government (no. 189 of 7 April 2004) concerning the new FAS establishes the number of staff to 350 persons in its central office and to 1 477 persons in its territorial bodies. The FAS and the MEDT are currently preparing a new federal law "On Protection of Competition", which will in particular establish the clear rules and principles for state aid to economic subjects and define the collective dominant position. It is also envisaged to introduce new amendments concerning the fines and administrative sanctions for violation of antimonopoly legislation.

137. Former responsibilities of the Ministry of Antimonopoly Policy concerning consumer protection have been transferred to Federal Service for Supervision in the Area of Protection of Consumers' Rights and Human Welfare. The newly created Federal Service on Tariffs, also under the jurisdiction of the Government of the Russian Federation, is in charge of the regulation of natural monopolies and prices (tariffs) in the power industry, in the oil-and-gas complex, railways and transport terminals (ports, airports), postal communication as well as products of the nuclear cycle and defence purpose. This reorganisation follows certain recommendations of the OECD peer review on Russia's competition law and policies as it allows the FAS to focus its action to competition issues, leaving the support for small business and price policies of natural monopolies to specialised agencies. It is nevertheless too early to judge the concrete effects of this broad administrative reform of governmental structure, in particular the respective roles and interactions of the antimonopoly authority and the unified tariff setting body.

138. It is expected that the new FAS will continue to play an important role in designing trade policy and supervising its implementation. Previously, the Ministry of Antimonopoly Policy took part in elaborating foreign trade policy, participating for example in the preparations of the new Customs Code. It also initiated the establishment of regional commissions for eliminating administrative barriers, in which its regional representatives participated. The new FAS should be able to recommend amendments to regulations susceptible to violate or restrict freedom of trade and competition. It should ensure the respect of antimonopoly policy in case of introduction of tariff and non-tariff measures, especially through its participation as a permanent member of the Governmental Commission for Foreign Trade and Customs Policy Safeguards.

## **9. Regulatory Environment in the Service Sector**

139. To attain its growth objectives and increase the welfare and economic efficiency, Russia needs to develop and modernise its infrastructural and business services. The Russian service sector continues to operate in a strongly regulated domestic environment and, as a result, it is not sufficiently exposed to competitive pressures both internally and internationally. Reduction of barriers affecting service providers, including the entry of foreign firms, would help diversify and improve the quality of services available to Russian final consumers and also to firms that use such services thus allowing them to increase their productivity. In this perspective, trade and investment liberalisation of services should be viewed as the major contributor to Russia's economic growth and as the critical element for improving the business climate in the country.

140. Russia imposes a number of restrictions on foreign ownership and activities in several key services sectors. In banking, the main limitations concern a *de facto* ceiling on foreign ownership, prior approval requirements and regulations regarding the participation of foreign and Russian citizens in management of credit organisations. Potential foreign insurance providers see their activities constrained by the imposed ceiling on total foreign investment in this sector and prior approval in case of charter capital increase. Other limitations mainly on carrying out certain types of insurance activities concern non-EU partners. In telecommunications, there is no limit on entry into the mobile segment but Russia plans to maintain the

monopoly of the incumbent in fixed-line segment on long distance and international lines for six years after its WTO accession (see Table A.1 of the Annex).

141. The WTO/GATS negotiations represent a great opportunity for Russia to accelerate the services liberalisation process. Available quantitative analyses concur that the most important gains from WTO-led liberalisation would come from FDI liberalisation in services. The World Bank study estimates Russia's overall medium-term gains of WTO accession to 7.2 % of its consumption (or 3.3% of GDP), of which tariff reduction would be responsible for 1.3 percentage points, improved market access for 0.6 percentage points and the remaining gains, *i.e.* 5.2% of the value of Russian consumption would be due to FDI liberalisation in services. In other words, services trade opening through FDI liberalisation represents over 70% of the total potential gains resulting from Russia's WTO accession (Jensen *et al.*, 2004). The study committed by the OECD based on the GTAP (General Trade Analysis Project) model and its database also comes to the conclusion that the impact of WTO liberalisation, relatively modest in overall GDP terms, would be especially beneficial to the service sector, in particular if Russia accepts more far reaching commitments than currently proposed. Liberalisation of firms' entry/exit in the service sector, notably in financial and telecommunication sectors, would encourage domestic and foreign investment, the main factor of steady economic growth (OECD, 2004f).

142. The positive contribution of the WTO-led liberalisation to service development is twofold. In addition to dealing with explicit sectoral limitations on foreign entry and operations, the GATS provides the guidelines for a sound regulatory framework for services trade and contains several references to efficient regulation principles. GATS Article III (Transparency) sets up basic disciplines for transparency, asking Members to publish promptly all relevant measures related to the operation of the GATS. The countries should inform at least annually the Council for Trade in Services of the introduction of any new or changed laws and regulations that significantly affect trade in services covered by their specific commitments. They should establish enquiry points to provide upon request specific information to other Members. Moreover, several specific transparency requirements concern notification of regional trade and mutual recognition agreements affecting services trade.

143. GATS Article VI (Domestic Regulation) addresses several efficient regulation principles, in particular non-discrimination and unnecessary trade restrictiveness requirements. Concerns regarding non-discrimination are dealt with through the obligation for Members to establish procedures for prompt, objective and impartial review of and appropriate remedies for administrative decisions affecting trade in services. Unnecessary trade restrictiveness is targeted by the commitment to ensure that all measures affecting trade in services are administered in a reasonable, objective and impartial manner. Finally, Article VI also stipulates that in developing measures related to technical standards, qualification and licensing requirements concerning services providers, countries should make sure that such measures do not constitute unnecessary barriers to trade and are based on objective and transparent criteria.

144. Russia's acceptance of GATS/WTO binding sectoral commitments and general disciplines is therefore a first and indispensable step for services development. Russia's commitments in specific services sectors should not only consolidate current situation but encourage further trade and investment liberalisation in key service sectors. The experience of some recent WTO members among transition economies confirms that the acceptance of high standard GATS commitments can bring rapid and significant boost to the service sector and large economic gains as forecasted in theoretical analyses (OECD, 2004a). The WTO/GATS key disciplines for transparency, non-discrimination and avoidance of unnecessary trade-restricting barriers for services trade will significantly improve the stability and predictability of the legal and regulatory framework for services, thus addressing the main concerns of many services providers in Russia.

145. It is nevertheless important to emphasise that trade and investment liberalisation and the improvement of the regulatory framework will not bring expected gains if some other fundamental economic preconditions are not realised. The main issue in countries such as Russia that have undertaken but not yet completed their economic transformation is first to level playing field in the basic economic areas for all firms. It entails in particular to eliminate soft budgetary constraints and energy price subsidies that provide to some categories of incumbent enterprises unjustified competitive advantage. Equalising business conditions also means to allow for and encourage restructuring of existing enterprises, promoting new activities and creation of SMEs, which still remain underrepresented in Russia. Recent observations and some analyses confirm that the theoretical assumption of the positive impact of increased competitive pressure also operates in Russia. According to a Russian empirical study, between 1995 and 2001 total productivity of Russian firms and industries exposed to higher competition from trade and FDI grew faster than in other parts of the Russian economy (Besonova *et al.*, 2003).

146. Similarly to what has been observed in merchandise trade, some regional initiatives have sought to go beyond WTO/GATS sectoral and regulatory commitments in services trade and have deepened cooperation among participating countries in other areas, especially regulatory issues. This is the case for instance of APEC that focuses on trade facilitation, including customs procedures and administration, technical regulations and the mobility of business people. The improvements in those areas are pursued through various means such as development of common principles and agreements in main regulatory and administrative areas, establishment of networks and regular exchanges between trade operators and by providing technical assistance to less-developed partner economies in selected areas (APEC, 2002).

147. As described earlier in this paper, Russia participates in a number of regional trade agreements, mainly with its CIS partners but so far these agreements have had a limited impact on development (or resumption) of mutual trade and investment flows, including in services. In recent discussions within the OECD Trade Forum (OECD, 2004b), several CIS countries, including Russia, observed that preferential trade agreements are probably not the best solution to deal with the current lack of economic complementarity and the divergence in trade regimes of participating countries. In comparison, multilateral liberalisation implying the adoption of WTO standards by all countries would be at this stage more beneficial also for mutual trade relations by making trade regimes more transparent and predictable also for regional partners. Russia can follow the example of successful co-operation initiatives such as APEC and develop trade dialogue with its CIS partners, focussing on trade facilitation issues and more specifically customs problems. Moreover, the experience of some regional groupings shows that the regional framework could also be useful to engage a constructive dialogue with the business community. Following the experience of some countries that have initiated regional co-operation on regulatory issues in the service sector, Russia should also pursue and deepen its co-operation with regional partners in these areas.

148. Recognising that inward FDI is one of the most important channels of services liberalisation, most developing countries and transition economies created special investment promotion agencies to overcome their retard in attracting FDI. In general, such agencies focus their activities on the three main areas. First, they contribute to establish a positive perception of a country as attractive for FDI and help identify potential sectors and investors. Second, they assist investors providing them information on FDI opportunities and required procedures for establishment. These services, together with the assistance in approval procedures, are often proposed in an “one-stop shop” facility. Finally, investment promotion agencies have also a policy advocacy role performed usually through their participation in various public and private initiatives that seek to improve countries’ investment climate.

149. There are several public and private organisations in Russia performing some of these functions, in particular the Foreign Investment Promotion Centre (FIPC), which is a part of the MEDT and State Investment Corporation (*Gosincor*), which is responsible for assisting foreign and domestic investors and provides various investment support services such as legal consulting. The Foreign Advisory Council is a

forum that allows for discussions between the authorities and incumbent foreign investors on possible improvements in the investment climate. International Chambers of Commerce also seek to establish a regular dialogue with Russian authorities on various issues concerning the activities of foreign investors in Russia.

150. Russia needs, however, to take a more pro-active stance in promoting inward FDI and launch a more constructive and permanent dialogue with incumbent and potential investors. Moreover, an one-stop shop facility assisting foreign investors in their first stages of establishment, which has proved to be very helpful in many other countries, would certainly greatly contribute in improving business climate for foreign investors in Russia, especially for smaller investors and those wishing to establish in the Russian regions. The 2004 OECD business survey showed that except some specific aspects, such as excessive red tape, which seems to affect likewise all categories of enterprises, the business environment is perceived less favourably by certain categories of firms, especially small regional enterprises and firms with foreign participation. In particular, regional respondents and the firms with more than 200 and less than 500 employees were the most critical of existing incentives to attract foreign participation in their business.

## **10. Conclusions and Policy Options**

### ***10.1. General Assessment and Main Challenges***

151. Over the last decade, Russia's external opening has widened due to fast trade growth and, to a lesser extent, FDI inflows. However, the data also reveal the urgent need for product diversification of its trade and a still unused potential for FDI expansion. Russia has advanced in its trade policy reform driven by autonomous liberalisation efforts and the WTO negotiation process. Its trade regime now relies on conventional trade policy instruments such as tariffs and integrates gradually international trading disciplines, including the transparency and non-discrimination principles. However, the country's business climate is still constrained by a number of trade inhibiting measures. In particular, barriers on entry and exit restrain the expansion of the most efficient and innovative firms. To realise economic and productivity gains potentially engendered by trade liberalisation and external exposure, Russia needs to address more systematically efficient regulation principles and integrate them into its regulatory practices.

152. Russia has already introduced some aspects of efficient regulation principles into its domestic regulatory framework. The increasing use of internet has improved the access of trade operators to legal information and the de-bureaucratisation programme has addressed some of the most business harmful regulations, including state inspection, registration and licensing procedures. The new Law on Technical Regulation (standards) introduced mandatory consultations with interested parties on proposed standards prior to their implementation. Available business surveys, including one carried out for the purpose of this study confirm significant progress in the areas subject to recent legal and regulatory efforts. However, the assessment of business environment is still less favourable in the case of smaller firms, many enterprises operating in the regions and companies with foreign participation.

153. In the area of transparency, one important weakness of Russia's regulatory environment is the lack of regular consultations between the government and the business community on proposed legislative and regulatory changes. The law and rule-making process still does not take systematically into account the regulatory impact of planned measures and their possible trade restrictiveness. The non-discrimination principle is stipulated in several trade and investment related laws, but there is a number of general and sectoral restrictions on foreign activities, some of which are currently subject to negotiations within the WTO/GATS framework. These trade restrictions often shelter uncompetitive firms and industries from market forces and prevent potentially productive enterprises to grow. Moreover, many regulations continue to be unequally applied through the Russian territory due to large discretionary power of local authorities in interpreting and implementing existing laws and regulations, for instance regarding subsidies, licensing and government procurement.

154. Unnecessary trade restrictiveness remains the major challenge of Russia's regulatory reform. Trade facilitation issues and more specifically customs problems affect foreign operators and also Russian exporters, importers and consumers, which all suffer from excessive delays, unpredictable and high costs of trade transactions. In this sense, regulatory reform efforts and removal of remaining trade and investment restrictions should not be perceived as concessions to trading partners but rather as an integral part of economic strategy for economic development, growth and trade diversification.

## **10.2. Policy Options**

155. In proposing the options for future actions in Russia's regulatory reform, it should be taken into account that Russia is negotiating its accession to the WTO and therefore still in the process to fully integrate into its trade regime fundamental multilateral disciplines, which underpin efficient regulatory principles examined in the context of this paper. Russia's first and overriding goal is thus to successfully complete its WTO accession, which will enhance its trade openness and consolidate its adherence to international trade disciplines. Assuming Russia's future WTO membership, different policy options can be envisaged to better integrate each of six efficient regulation principles into the domestic regulatory framework.

156. To enhance transparency of the domestic regulatory framework, the following recommendations are proposed:

- Continue to ensure transparency and timely dissemination of information on the regulatory framework using as much as possible the internet. Develop relations with business associations, including foreign chambers of commerce in Russia, and use them as a relay to disseminate regulatory information to firms. Offer more systematically the opportunities to concerned constituencies to participate in the early stages of the law and regulation making process. Associate when possible and appropriate foreign trade operators and investors within prior consultations procedures.
- Reinforce existing or create new permanent consultation structures on trade-related regulatory measures. Such consultative or advisory bodies can be created and managed by relevant governmental bodies (federal ministries, services or agencies) and include other parts of administration with responsibilities in a given area and different stakeholders such as representatives of sector associations and main players in the field concerned. These advisory bodies ought to be consulted prior to introducing important regulations susceptible to affect different constituencies. In addition to this main role of undertaking *ex-ante* examinations of relevant regulatory measures, these consultative bodies might also be involved in regular *ex-post* assessment of adopted trade-related regulations.

157. To eliminate remaining discriminatory aspects in the regulatory environment, the following suggestions can be made:

- Continue to improve the general and sectoral regulatory framework and eliminate explicit discriminatory restrictions affecting foreign traders and investors, in particular the limitations on the level of foreign ownership in some sectors, specific permit procedures applied only to foreign investors and restrictions on employment of foreign personnel in foreign owned firms in sectors concerned.
- Pursue the legal harmonisation of federal and regional trade policy and ensure its unified implementation on the territory of the Russian Federation. Several conditions should be at hand to achieve this objective, in particular clear and straightforward formulation of exiting regulatory



measures, limiting the possibility of contradictory interpretations, and timely availability of existing regulations at different governmental and operational levels.

- Evaluate the status and the objectives of existing preferential agreements, in particular with the CIS. Rather than focus on trade preferential treatment, consider developing regional co-operation with these countries in some key areas such as technical standards, regulatory requirements and trade facilitation matters.

158. To continue to tackle efficiently unnecessary trade restrictiveness, several measures could be suggested:

- Consider to integrate regulatory impact analysis (RIA) into the preparatory process of new regulations to assess systematically their trade friendliness and examine possible regulatory alternatives, which would achieve the fixed objective without imposing additional administrative burdens.
- Pursue regular monitoring of the impact of regulatory measures on the business environment. Maintain the awareness of authorities at different levels and responsible agencies of the primary objective of adopted regulatory measures and ensure that these regulations continue to be thoroughly applied not only immediately after their introduction but also in the longer term.
- Maintain the momentum of the de-bureaucratisation programme and consider further initiatives to improve the business environment and reduce red tape.
- Carry on customs reforms: finalise the compliance of the legal framework with relevant WTO requirements, especially concerning customs valuation procedures; streamline and simplify customs regulations so as to avoid their possible divergent interpretations by local customs officers; ensure adequate financing and technical equipment of customs administration to reduce the extent of grey practices. Promote a “service and client culture” of customs administration also through regular communication with its users within existing or newly created consultative and advisory bodies.
- Increase awareness of the importance of trade facilitation issues and consider designing specific target programmes on trade supporting infrastructure and services. The starting point would be to develop a series of trade facilitation and logistic indicators and set on basic specific numeric targets to improve performance in corresponding areas. Monitor the progress through regular dialogue with all concerned constituencies within a special advisory group on trade facilitation issues.

159. To promote the use of internationally harmonised measures and recognition of equivalent regulatory measures adopted by foreign countries, the following recommendations are proposed:

- Make sure that the intentions of the recently adopted Federal Law “On Technical Regulation”, especially promotion of international standards, mandatory public consultations prior to introducing new standards and increased reliance on international standards, are implemented. Consider to shorten the transition implementation period of this Law from currently seven to five years.
- Reinforce technical and human capacities of the national standardisation body to accelerate alignment of Russian standards and technical regulations with their internationally harmonised equivalents. When developing national standards and technical regulations, increase the reliance on internationally harmonised standards. Consider strengthening co-operation on standards and technical regulations with Russia’s main trading partners.

- Reduce the complexity and therefore costs of conformity assessment procedures in Russia. Develop domestic capacities for accreditation. Promote the recognition of the equivalence of the results of conformity assessment procedures performed in other countries, including by joining mutual recognition agreements of conformity assessment. A more efficient conformity assessment system will not only facilitate operations of foreign trade operators but it is also indispensable for domestic producers to develop their export capacities.

160. The application of competition principles in the international perspective can be enhanced in particular by:

- Integrating market openness perspective into the prerogatives of the FAS. Reinforce participation of antimonopoly authorities in elaborating trade policy, especially in the case of tariff revisions and antidumping investigations.
- Clearly defining the relationship and respective responsibilities of the competition authority and existing or future sectoral regulatory authorities to limit the risk of inconsistent approaches on competition issues and avoid potential uncertainty for business.

161. The OECD business survey carry out within this study shows that although significant progress has been already accomplished by Russia in developing services necessary for business such as telecommunications, banking and transportation, there is scope for further improvement. Available studies confirm that welfare and productivity gains from further liberalisation of these services are important and in fact larger than resulting from liberalisation in other sectors. It is therefore important that remaining general and sectoral restrictions in services are eliminated, including on foreign investment, which constitutes the main channel of modernisation and technical and managerial upgrading in most sectors.

162. Russia's disappointing performance in attracting FDI indicates that further efforts in this area should be undertaken. It is therefore recommended that Russia follows the example of many transition and developing countries that established highly profiled foreign investment promotion agencies with significant financial and human resources to improve the positive perception of their countries by foreign investors and to assist them in their establishment and activities.

163. At present, Russia has established only a limited number of national regulatory agencies to supervise activities in specific sectors or activities. In designing such agencies and defining their functions, it is important to ensure their independence from the government and the sectors under their supervision. From the trade policy perspective, it is essential to develop close and regular co-operation between regulators, competition authorities and trade policymakers to ensure mutual coherence of different policies and promote trade friendliness of regulations and of their implementation. Regulatory authorities and trade officials should also co-ordinate their activities in the context of international negotiations and agreements.

## ANNEX

Table A.1: Indicative list of main FDI restrictions in Russia

Sector	Main restrictions affecting foreign investors
Banking	<ul style="list-style-type: none"> <li>a) Ceiling on total foreign ownership: the Law on Banks and Banking Activity stipulates that a quota on foreign participation in this sector is to be established by a federal law, but no such law has been enacted. The CBR introduced in 1993 a <i>de facto</i> quota of 12%, though this is not officially applied.</li> <li>b) Prior approval by the CBR for capital increases and equity participation by individual foreign investors.</li> <li>c) Regulations concerning the management of Russian credit organisations: if a foreigner serves as the single executive body, the management must consist of not less than 50% Russian citizens. Of the total number of employees of the credit organisation, at least 75% must be Russian citizens.</li> </ul>
Insurance	<ul style="list-style-type: none"> <li>a) Ceiling on total foreign investment: The Law on Organisation of Insurance Activity, in effect since January 2004, increased the maximum quota on foreign insurers in the charter capital of insurance companies in Russia to 25%. (In January 2004, the share of foreign capital was 2.7% of total charter capital in the Russian insurance industry.)</li> <li>b) Prior approvals are requested in case of an increase in the charter capital to be paid by foreign investors or the sale by the insurance company of its shares to foreign investors. (The previous difference between minimum amount of paid-in charter capital required of Russian insurance companies and the subsidiaries of foreign insurance companies was eliminated.)</li> <li>c) Restrictions on non-EU based foreign-controlled insurance companies (or in which non-EU foreign participation exceeds 49% of charter capital): they are prohibited from engaging in certain types of insurance and must obtain the prior approval to open branches. They also remain subject to additional requirements concerning their previous activity in the insurance industry (at least 15 years in the country of origin and 2 years in Russia).</li> <li>d) Remaining limitations on EU insurance companies: In line with the PCA concluded between Russia and the EU, subsidiaries of EU insurers are admitted to provide all types of insurance. However, they cannot possess more than 49% of the charter capital of the Russian insurance companies for specific insurance lines.</li> </ul>
Aviation	The share of foreign ownership in aviation entities involved in cargo, baggage, passenger and mail transport by air should not be more than 49%; the manager must be a Russian citizen. Foreign ownership in aircraft development, manufacture, testing, operation and repair is limited to 25%. (There is a 20% tariff on imported aircraft and aircraft components.)
Land transport	The use of foreign-owned trucks and buses to transport goods or passengers within Russia is prohibited, even if such means have been imported under a temporary import customs regime. Truck and bus transport of goods and passengers into or in transit across Russia is allowed only on presentation of a special permit.
Telecommunications	<ul style="list-style-type: none"> <li>a) Ceiling on foreign investment: no limit on foreign ownership in mobile telecommunications foreseen; the monopoly on long distance and international telecoms via lines owned by the incumbent Rostelcom/Svyazinvest to be maintained for six years after WTO accession.</li> <li>b) Reciprocity requirement: foreign organisations may take part in privatisation of state-run enterprises if such a regime is allowed in partner countries for Russian organisations.</li> <li>c) Transparency in licensing procedures for telecommunications: The Ministry of Information Technology and Communications has considerable discretion to grant licences to telecommunications operators.</li> </ul>

Source: Foreign Direct Investment Review of the Russian Federation: Progress and Reform Challenges (OECD 2004)

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