



The Voice of OECD Business

BIAC Statement

OECD-Russia Accession Negotiations: *Improving the Business Environment in Russia*

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INTRODUCTION

The 2007 OECD Ministerial Council invited five countries (Chile, Estonia, Israel, Russia and Slovenia) to open accession negotiations and another five countries (Brazil, China, India, Indonesia, South Africa) to enhance their engagement with the Organisation with the view of possible membership. BIAC attaches great importance to the OECD accession negotiations as well as the enlargement process. Both processes have the potential to further increase OECD's global influence, broadening the Organisation's perspectives and turning the OECD into the hub of globalisation.

This paper sets out initial issues of concern to the OECD business community with regards to the accession negotiations with Russia. With a population of over 140 million people, a relatively well educated workforce, dynamic domestic demand and excellent resource endowment, the Russian economy potentially represents a very significant opportunity for international business as a market as well as an investment and production location. Fuelled by record energy and commodity revenues as well as favourable monetary conditions, the Russian economy has been growing significantly since it recovered from the 1998 financial crisis with annual real GDP growth rates averaging close to 7% for nearly ten years. Investment – both domestic and foreign – has surged to record levels. Nevertheless, Russia still has some way to go before it will reach its full economic potential, as confirmed by the findings of the 2006 OECD Economic Survey of the Russian Federation, and BIAC is concerned about certain challenges facing the business environment in the country. In the years following the financial crisis, Russia conducted important reforms which improved the business environment, such as by cutting and simplifying taxes, reducing licensing and inspection requirements, consolidating the government budget, improving the judicial system, and allowing a free market in land. However, since 2004 there appears to be much room for improvement in the government's reform ambitions. In recent years, for example, uncertainties concerning the protection of property rights have increased, corruption has become a more prominent problem, and there are concerns about the involvement of the State in business activities.

The OECD enlargement process offers a unique opportunity for Russia to address these issues. The accession process may significantly advance Russia's economic policy agenda and the full and effective integration of the country in the global marketplace. This would bring very substantial benefits for sustainable global economic growth for Russian and for OECD business.

In the case with Russia's accession, as with all the accessions to the OECD, BIAC's overarching objective is that enlargement does not dilute from, but rather clearly support, the Organisation in fulfilling its mandate. This mandate, as defined by the OECD Convention, is to achieve the highest sustainable economic growth and employment in member countries, sound economic development of non-members and the expansion of world trade. Much remains to be done to enhance the quality of Russia's economic policy-making so that the country can assume the obligations of membership as stipulated by OECD instruments and achieve maximum degree of coherence with OECD countries' policies in policy areas for which the OECD has no formal instruments.

The accession process affords an opportunity to review Russia's existing policies in areas that are listed in the Council Roadmap for the Russian Federation's Accession to the OECD Convention¹ as well as to ensure that it can implement all the accession requirements. The Council Roadmap, for example, states that "the Russian Federation will be requested to position itself vis-à-vis all the legal instruments adopted within the OECD framework prior to its joining the Organisation" (Paragraph 8). Moreover, it is stated in Paragraph 9 that the "accession process will also include the examination of the Russian Federation's general economic policies as well as its policies in a certain number of other key areas in which there are few or no OECD legal instruments". BIAC expects that Russia as well as any other accession candidate will undergo rigorous examinations by the OECD and only be invited to membership if it is clear that the country is willing and able to assume the obligations of membership. We hope that Russia will benefit from the OECD accession process in order to pursue necessary economic reforms.

The following parts of this paper outline initial priority issues of concern to BIAC Members regarding Russia's OECD accession. Much of the paper is based on contributions from BIAC Members: it is therefore not a complete summary of all business concerns, and any variance in detail between sections does not indicate any greater or lesser degree of concern. We call on the OECD to effectively address the concerns and recommendations provided in this paper throughout accession negotiations. BIAC reaffirms its keen interest in providing continued business input which will be critical for OECD's ability to adequately assess and develop an informed opinion about the actual impact that Russia's economic policies have on the business environment.

We are grateful to have received all of the country roadmap documents and some questionnaires from certain OECD committees. At the same time, we fully appreciate that much of the details of the accession negotiations between the OECD and all accession countries will and must remain confidential. However, we expect that the OECD will proactively offer opportunities for BIAC to share OECD business experience as important background information and input to all accession negotiations, including those that concern Russia.

¹ The Roadmap was adopted by the Council on 30 November 2007. It sets forth that the following OECD bodies will provide the Council with its formal opinion on Russia's ability and willingness to assume the obligations of membership in the respective policy field:

Investment Committee; Working Group on Bribery in International Business Transactions; Committee on Fiscal Affairs; Chemicals Committee; Environment Policy Committee; Steering Group on Corporate Governance; Committee on Financial Markets; Insurance and Private Pensions Committee; Competition Committee; Committee for Scientific and Technological Policy; Committee for Information, Computer and Communications Policy; Committee on Consumer Policy.

The following OECD bodies will provide formal assessments concerning areas in which there are few or no OECD legal instruments: Economic and Development Review Committee; Committee on Statistics; Employment, Labour and Social Affairs Committee; Trade Committee and the Working Party on Export Credits; Public Governance Committee;

The following sectoral bodies will consider and discuss the Russian Federation's policies in their respective areas of competence: Council Working Party on Shipbuilding; Fisheries Committee; Steel Committee; Committee for Agriculture; Health Committee

PRIORITY ISSUES

A. RULE OF LAW, TRANSPARENCY, PREDICTABILITY

OECD business notes that there have been some positive developments in Russia's regulatory environment, including greater consultation on new laws with business and other civil society representatives. However, many challenges remain and need to be addressed during the accession negotiations. Russia's existing federal, regional, and local laws and regulations are often vague or confusing. At the same time, government agency requirements and guidelines are unclear and vary by agency. This state of affairs often leads to misunderstandings in application and interpretation. Foreign investors have also noted the lack of clarity in legal regulation of certain areas of law such as environmental liability, confidentiality, and force majeure. Uncertainty about the ownership of assets in Russia prevents their use as collateral for export financing credits. Russia should continue to strive to establish an effective legal system, with clear and uniform laws that are properly implemented, rules and regulations protecting investors' rights, and the sanctity of contracts and private property. Russia should also further improve its judicial system in order to provide an impartial and reliable forum for settling disputes and enforcing rights on a non-discriminatory basis.

In addition, the dissemination of information to both domestic and foreign companies on legal and regulatory changes is still an obstacle for doing business in the country. The OECD should encourage Russia to intensify its efforts to develop adequate mechanisms to consult the business community and inform market participants well in advance of new measures. Developing mechanisms that enhance regulatory transparency and predictability will improve the overall functioning of the business environment.

There are two principal forums for dialogue between foreign investors and the Russian government. The Foreign Investment Advisory Council (FIAC) is reported to operate effectively, though it is geared more towards large, established investors. FIAC could become more responsive to the concerns of small and medium enterprises (SMEs) and new investors in Russia. The FDI ombudsman is reported to be less effective than FIAC due partly to resource constraint. Both structures provide an interface only between federal government and business, whereas many issues affecting investors on the ground relate to local authorities. There is scope for greater opportunities for foreign investors to engage with local government in Russia.

B. BUREAUCRACY

Excessive bureaucracy continues to pose challenges for investors in Russia. According to World Bank research it takes 28 days to start a business in Russia and there are 22 separate procedures involved in obtaining licences to operate². Registering property is particularly difficult, requiring 52 days³. Furthermore, excessive documentation is required for opening a corporate bank account in Russia, impeding smooth business activities. BIAC recognises that improvements are being made to bureaucratic requirements in Russia. However, further scope remains for streamlining and efficiency gains.

² World Bank, Doing Business 2007

³ Ibid.

Since the introduction of a new law on licensing in 2002 some improvements have been achieved in this area. Streamlined licensing procedures and requirements have reduced the number of activities subject to licensing and extended the duration of licenses. Nevertheless, high costs and time required to acquire licenses are still of significant concern to companies. According to the World Bank 2008 Doing Business Report, which compares license procedures, costs and duration of the process required to get all licenses needed for building a warehouse with international best practices, obtaining licenses in Russia costs about 60 times more than the prevailing amount in OECD countries and the time required with licensing procedures remains high (704 days) compared to other countries⁴. Moreover, Russia ranks second to last place out of 178 countries included into the ranking⁵. BIAC believes that the OECD could encourage Russia to significantly strengthen its rules and laws on licensing by substantially reducing the activities subject to mandatory licensing and by reducing the costs for companies to obtain licenses. Significant improvements in this field are also needed in order to improve the anti-corruption environment in the country (see Section I).

C. INVESTMENT POLICY ENVIRONMENT

Russia's FDI inflows have been increasing significantly in recent years and in 2007 reached the record level of USD 48 billion⁶. However, many foreign investors perceive the general business and investment environment outside the natural resources sector as less attractive than in other big emerging economies. OECD statistics⁷ also suggest that the country is not fully reaping its potential as location for foreign investment. Despite the inward FDI in recent years, the ratio of inward FDI compared to GDP is still much lower in Russia (9.5%) than for example in Brazil (20.1%) and China (25.7%). Incoming investment is also relatively narrowly focused on a limited number of sectors with mining and quarrying alone accounting for almost half of the inflows in 2007. The fact that a significant share of capital inflows (over 40% in 2006) takes the form of loans indicates that lending money to Russian firms is often preferred to direct foreign investment.

BIAC expects that Russia brings its investment policies fully into line with the standards promoted by the legally binding OECD investment instruments⁸ as well as the Organisation's Recommendations and Declarations⁹. Full compliance with the principles of non-discrimination and transparency, open FDI regimes for all sectors and liberalisation of other long-term capital movements, free transfer of payments, relaxation of restrictions on cross-border trade in services, and effective enforcement of property rights are cornerstones of sound investment policies. The effective implementation of these principles which are enshrined in the OECD investment

⁴ The World Bank. Administrative and Regulatory reform in Russia p. 21 (¶ 27)

⁵ World Bank 'Doing Business 2008', p. 14

⁶ Draft OECD Russia Investment Review, p3

⁷ see draft "2008 OECD Investment Policy Review of the Russian Federation: Strengthening the Policy Framework for Investment (DAF/INV/AGC/WD(2008)6, pp. 5-9"

⁸ Decisions on the Codes of Liberalisation of Capital Movements and Current Invisible Operations; Decisions related to the Declaration on International Investment and Multinational Enterprises

⁹ Declaration on International Investment and Multinational Enterprises; Recommendation on the OECD Benchmark Definition of Foreign Direct Investment; Recommendation on OECD Principles for Private Sector Participation in Infrastructure

instruments would represent a necessary and significant step forward in improving the Russian policy environment for foreign as well as domestic investment.

[Investment restrictions](#)

The OECD estimates that Russia's limitations on incoming foreign investment constitute a degree of restrictiveness that is almost twice as high as the average degree of restrictiveness of OECD countries¹⁰. Restrictions on FDI are most acute in the energy sector (discussed below), though other sectors are also affected. For example, even following WTO accession, the Russian government will retain the right to impose limits on FDI in financial sectors at its discretion. There are also foreign equity limits in certain manufacturing sectors, including aerospace, and some information and telecommunications systems.

Russia has very recently adopted a new law on foreign investments into strategic sectors of the economy. This law regulates investment in several so-called 'strategic sectors', ranging from energy and defence to the mass media and fishing. We understand that the number of these sectors has grown to 42, including aviation equipment and technology, some telecommunication segments, television and radio broadcasting, publishing and natural monopolies. The law requires that investment deals are to be reviewed by a committee chaired by the Prime Minister if they involve a foreign investor taking a 25-50% stake in a company operating in a strategic sector. Any agreements deemed to constitute a threat to national security will be rejected.

BIAC recognizes that the law will provide a clearer mechanism for foreign involvement in the Russian economy, compared to the non-transparent, ad-hoc decisions made to date. We appreciate that it will not be applied retrospectively and that an appeals procedures will exist which may strengthen the accountability of the review processes. However, the law's implementation procedures are still pending and there is little information as to how and where foreign investors should register.

In our view, the OECD should encourage Russia in the future to significantly limit the scope of sectors covered in the law. This would allow the economy to benefit more from the competition, capital and know-how that foreign investment can bring. In our view the Russian government would be well-advised to apply foreign investment restrictions only for narrowly defined national security objectives. Concerning most of the sectors included in the strategic sector law it is hard to see how any foreign investment could represent a threat to national security. Russia should be encouraged by the OECD to ensure that the appeals process provides for effective redress and even-handed ruling when foreign investors consider that their rights have been violated. The implementation of the investment approval procedures should be clear, transparent and efficient, in order to foster a predictable investment environment.

[Energy investment](#)

OECD business seeks to promote open, competitive energy markets that encourage investment, deliver security of supply and competitive pricing. In Russia, OECD business participation in energy projects has enhanced project performance and corporate governance standards. As the world's largest energy producer, Russia stands to benefit from the continued growth in energy

¹⁰ OECD, 'Investment Policy Reviews: Russian Federation', July 2006

trade, but reportedly requires investment of at least \$300 billion¹¹ over the next 8 years to modernise its power sector and to exploit fossil fuel reserves in order to maintain production levels.

A number of OECD countries have become increasingly dependent on Russia's vast energy reserves in order to meet their energy needs. For example, Russian oil and gas imports account for almost 30% and 45% of EU-27 energy imports, respectively, making Russia by far the largest energy exporter to many import-dependent European countries¹². Energy policy in Russia is therefore not solely a matter of domestic concern, but also a concern for international energy trade and investment. A reliable Russian energy supply that supports economic growth is therefore fundamental for business in many OECD countries and beyond.

However, foreign investment in the energy sector is significantly restricted. We understand that the law on foreign investments into strategic sectors foresees even stricter regulation for the energy sector than for the other 'strategic' sectors. For example, government authorisation would be necessary for acquisitions over 10% by foreign private companies of the stakes of Russian companies (the level of 'control' is deemed to be 5% in the case of foreign SOEs investing in Russian companies). It also appears to reinforce the position of the dominating State-owned enterprises in the energy sector. Investment opportunities are to be limited to minority equity participation and/or partnerships with Russian energy companies now steering future projects. Gazprom, for example, is empowered to exclude foreign participation in the development of the massive Shtokman gas field although it has recently readmitted European partners to the exploration project. There are concerns that Russia may be using its energy resources to exercise political leverage within its region, including vis-à-vis the European Union.

Russia has the world's largest supplies of gas and very substantial oil reserves. High economic growth rates in recent years in Russia have been largely sustained by the country's energy sector, as the share of oil and gas in Russia's GDP has increased from 12.7% in 1999 to 31.6% in 2007¹³. However, there are concerns that there is a lack of investment in the exploration and development of untapped reserves. Output from three of the largest gas fields in Russia is reported to be declining at a rate of around 6-7% per year¹⁴. Meanwhile, the annual growth of Russia's oil production is reported to have declined from 12% in 2003 to only 2.5%, and some project for 2008 to herald the first production decline since ten years¹⁵. This raises concerns about the long-term reliability of Russia as an energy supplier.

Substantial investment in oil and gas exploration is needed urgently in order to ensure sustainable production over coming years. The law on strategic sectors, however, is set to limit foreign investors' access to oil and gas exploration, and this will adversely affect Russia's future energy production. Greater openness to investment is required in order to allow foreign companies to provide necessary investment, technology, knowledge and skills.

The electricity sector is undergoing significant liberalisation in Russia. The Russian government aims to move towards market-based pricing through deregulation. The State electricity company

¹¹ Financial Times (April 21, 2008) Russia starts to pay price for its energy strategy

¹² European Commission (2007) Energy and Transport in Figures Pocketbook, p14(81)

¹³ Economist (February, 2008) Smoke and Mirrors

¹⁴ The Economist, 'A Bear at the Throat', April 2007

¹⁵ Financial Times (April 21, 2008) Russia starts to pay price for its energy strategy

Unified Energy Systems (UES) is being privatised in a piece-meal fashion to boost investment into this sector. BIAC welcomes these moves and hopes that the reforms are carried out in a consistent and harmonised manner throughout the Russian Federation. Yet the lack of investment in exploration could place significant pressure on Russia's domestic electricity supply as the country is expected to remain heavily dependent on its gas reserves until 2030¹⁶, despite an ambitious proposal for the construction of 20-25 nuclear reactors within the next twenty years¹⁷.

[Protection of Investment](#)

Companies remain concerned about the lack of investment protection in Russia. The Yukos affair of 2004 has undermined confidence that property rights in general and minority shareholder rights in particular would be upheld and that adequate compensation would be paid following any expropriation. Also, according to the World Bank, Russia only ranks number 81 in the world concerning investment protection. Investments are less protected in Russia than for instance in Brazil, Kazakhstan and India¹⁸. BIAC firmly believes that shareholder rights should be fully protected and fundamental principles of corporate governance should be promoted by the Russian government. Property rights should be fully respected and guaranteed equally for both domestic and foreign investors.

[Capital movement](#)

In 2004 Russia introduced the Foreign Exchange Law, which has led to significant improvements in capital controls and helped to facilitate investment flows. There remains scope for further enhancements, including a reduction in the costs of compliance with the regulations. The different forms of currency transactions should ideally have single, standardised procedures and customs authorities should oversee foreign trade transactions. There could also be a greater information flow between regulatory authorities and the financial institutions.

D. INTELLECTUAL PROPERTY RIGHTS

[Counterfeiting and piracy of goods](#)

Weaknesses in the protection of intellectual property rights (IPR) remain a very serious problem in the Russian Federation, posing negative consequences for the level of innovation in the country¹⁹. Violations and abuses of intellectual property are reported to be frequent. At least half of Russia's optical disc factories (producing CDs and DVDs) have been found to have engaged in pirate production since 2003²⁰. The OECD should urge Russia to ensure effective criminal enforcement, including against optical disc piracy. Stronger action should be taken to curb the high physical piracy rates (in the music industry sector, for example, the piracy rate amounted to 58% in 2007²¹), including regular surprise inspections of optical disc plants and prosecution of the owners

¹⁶ IEA (2007) World Energy Outlook, Reference Scenario, p620

¹⁷ World Nuclear Association (2008) Country Profile on Russia

¹⁸ World Bank, Doing Business 2008 Russia, p. 33

¹⁹ OECD (2006) Investment Policy Review of the Russian Federation

²⁰ Sourced from USTR (2008) "RUSSIA"

²¹ IFPI, Recording Industry In Numbers, 2008.

and operators of plants involved in illegal activities. Internet piracy also remains a serious problem. A number of illegal websites operate from Russia, offering illegal content either for free or for a small fee. The authorities should take swift action to close down and criminally prosecute unauthorized websites and operators of P2P networks. Sales of counterfeit and/or pirated goods, while having significantly fallen in recent years, remain prevalent in street markets in major cities including Moscow and St Petersburg. Civil enforcement also needs to be improved. Problem areas include inadequate civil damages, inadequate means to secure assets (for example there are restrictions on a potential litigant's ability to assess the financial position of a company before commencing litigation), insufficient provisions for personal liability of company directors, as well as burdensome evidentiary requirements.

Companies report particular problems related to counterfeit goods. Leading branded products of major OECD companies are frequently copied in Russia and then sold on to the consumer, who purchases under the assumption that the goods are genuine. A further problem is the use of lookalike products by private label manufacturers. These products are not identical to well-known brands but mimic their key attributes in order to encourage consumers to buy them. This problem of 'lookalikes' could be more adequately addressed by the Russian government. The Patent Dispute Chamber has in the past refused to accept non-traditional trademarks, for example colours and non-graphical signs. There is no protection for trademarks that are not registered with the Russian authorities, even if such trademarks have become well-known abroad. Meanwhile, obtaining patents and trademarks is particularly costly for foreign investors, partially due to the "two-tier" registration system that discriminates against foreign holders of intellectual property. Furthermore, trademark registrations are automatically cancelled if they have not been used for three years, but there are no provisions detailing what constitutes 'non use'.

Russian law does not specifically criminalize pharmaceutical counterfeiting and injunction measures are not applied²². A definition of a "pharmaceutical counterfeit" was introduced in the Law on Medicines in August 2004; however, no related prosecution articles have been added in the criminal and civil legislation. There is no procedure for evidence gathering and acceptance by courts to facilitate court proceedings in counterfeit cases. Trademark infringement is the only applicable article of existing Russian legislation, however the Criminal Code applies only in cases of numerous violations or involving significant damages, and the maximum penalties are negligible.

In BIAC's view, the OECD should strongly urge Russia to improve border control on pirated goods and increase Criminal Code penalties and sanctions for infringements of industrial property rights and copyrights, in a manner that makes the imposed penalties and sanctions work as an effective deterrent. It is in this context that BIAC welcomes the creation of the Chamber of Patent Disputes as a positive development in the enforcement area. BIAC hopes these reforms demonstrate a new commitment to enforcing intellectual property rights in Russia and to significantly reduce current piracy levels, which harm both domestic and foreign rights-holders alike.

[Data exclusivity](#)

Russia currently does not provide data exclusivity for pharmaceutical products. The legal regime fails to ensure a period during which test data in support of an application for product approval is

²² Sourced from USTR (2008) "RUSSIA"

sufficiently protected. This lack of data exclusivity has left the research-based pharmaceutical industry vulnerable to premature copying by domestic and foreign generic companies.

Prior to WTO accession which is a pre-requisite for the OECD accession, Russia should ensure that its regulatory framework is entirely compliant with the letter and the spirit of the WTO TRIPS Agreement. Within this context Russia agreed, in bilateral negotiations with the U.S. and others, to introduce a period of data exclusivity of 6 years for pharmaceuticals by June 2007. Although recent evidence suggests that Russia is currently developing legislation to introduce some form of data protection, the agreed upon deadline has unfortunately been missed. Russia should be encouraged to fulfill its commitment to introduce a 6-year data exclusivity period for pharmaceuticals.

Additionally, Russia does not adequately protect regulatory data provided for agricultural chemical products. The government should be encouraged to introduce a 10-year data exclusivity period for agricultural chemicals in 2008. Furthermore, the legislation must clearly state that for the period of protection, no other company can refer to or rely on the data when registering identical agricultural chemical products, and that the data remains confidential even after the initial period of protection. To ensure the legislation is robust, BIAAC encourages Russia to include appropriate penalties for misuse as part of the law.

Lastly, the Russia pesticides regulatory framework permits a 2-year temporary registration regime which provides an opportunity for any registrant to fulfill data gaps identified by the Russia pesticide registration authorities. However, it appears the clause is applied inequitably to favour domestic producers. Further, reliance on the first registrant's regulatory data without official permission from the developer is permitted which results in an unfair commercial advantage for domestic producers.

[Proprietary technology, copyright law, WIPO](#)

OECD companies also reported about a lack of guarantees that proprietary technology would be protected in a joint venture with a Russian company and the need to enact and implement the new bill before the Duma on the protection of trade secrets (preferably, without the provision requiring firms to list the commercial value of trade secrets on their balance sheets). In addition, Russia's law on the registration of research-based pharmaceutical products should incorporate a five to ten year data exclusivity period.

Russian copyright law has recently undergone certain welcome improvements, but more work remains to be done to ensure stiffer penalties to deter counterfeiters. Russia has ratified the Paris Convention for the Protection of Intellectual Property, but there are concerns that Part IV of the Civil Code, which came into force in January 2008, will not protect IP sufficiently because it contains no references to unfair competition. Part IV also inadequately addresses copyright issues and fails to implement TRIPS and WIPO Treaties standards. Deficiencies of Part IV include its exception provisions falling short of the Berne three-step-test, an overly broad private copying exception, and inadequate protection levels and available remedies with regard to the circumvention of technological protection measures. Companies also report concerns that the new law will not provide sufficient protection for geographical indications (GIs). Russia's GI register should be broadened to include all OECD products with GIs.

IP law should be consistent with established international norms. BIAC hopes that Russia will become a signatory to the World Intellectual Property Organisation's (WIPO) Internet Treaties. We also want to see improved enforcement and coordination between Russian authorities at national and local levels.

E. TRADE AND TRADE-RELATED ISSUES

BIAC fully supports Russia's expeditious accession to the WTO, subject to Russia's legislative and regulatory framework being entirely compliant with the letter and the spirit of the WTO TRIPS Agreement and the WIPO Treaties. We believe that the WTO accession will bring major benefits to the Russian economy, as well as ensuring that the process of liberalisation in Russia is strengthened and maintained. Russian accession to the WTO will also generate significant new commercial opportunities for OECD companies operating in the Russian Federation. Furthermore, since the WTO is the only authority regulating global trade, Russia's entry will substantially enhance the transparency, predictability and security of its trade regime. BIAC is disappointed that implementation of the reforms required to meet the WTO accession criteria has slowed. For business, Russia's WTO accession is a critical pre-requisite for Russia's accession to the OECD. Upon WTO accession, the Russian government must then ensure full and rapid implementation of WTO rules and the specific market access commitments according to the schedule agreed with its trading partners.

Market Economy Status

Many regulated prices in Russia remain far below world market prices, particularly in the energy and transportation sectors. This uneven distribution of market forces in the Russian economy, presents challenges for the WTO rules and disciplines, which should be addressed in the WTO accession negotiations. The OECD should encourage Russia, during the accession negotiations, to take steps to unify its domestic and export energy rates at world market prices. Through its control of the so-called "natural" monopolies in the generation of electricity by UES and production of natural gas by Gazprom, the Russian government is able to boost the competitiveness of many Russian products, especially in sectors such as steel and fertilizer. Russia should commit itself to a reasonable timetable for phasing out its dual pricing of energy (see section G).

Trade in Goods

It is believed that average bound tariffs will be reduced to between 7% and 8% following Russia's WTO accession²³. This reduction – if implemented fully and expeditiously – would represent a serious and significant liberalisation of import duties in Russia. Companies currently report paying duties ranging from 5% to 35%.

However, we are concerned that certain tariff peaks may remain following accession. In certain sectors BIAC members encounter unreasonably high import tariffs and taxes of up to 50% on certain products. Our members have indicated that high tariffs have severely limited trade in certain product lines (ranging from chicken products and agricultural equipment to toys to high-tech

²³USTR (November 2006) United States, Russia Sign Bilateral WTO Market Access Agreement.

materials and products), resulting in lost sales. Despite high tariff rates, the Russian Government has refused to impose a standstill on duty rates in advance of WTO accession.

The OECD should advise Russia to bind its tariffs at low levels comparable to other industrialized countries, particularly given the fact that high tariff levels incite customs circumvention and domestic counterfeiting and piracy. The country should apply national treatment to its tax policies. Furthermore, all export and import restrictions should be abolished without delay. Russia should eliminate duties on all IT products in line with the goals of full realization of the objectives of the Information Technology Agreement (ITA), including commitments at the broadest possible level for categories 84, 85 and 90. Finally, Russia should subscribe to a permanent moratorium on imposing customs duties or other border measures on electronic transmissions.

[Trade in Agriculture](#)

Russia is an important market for some agricultural products. However, trade in agricultural goods with Russia remains problematic. There are reports that processed food and drinks are subject to significant tariff volatility. BIAC members also indicated substantial increases in duties on confectionery and biscuit imports. Peak tariffs above 50% have been reported for chicken products. Russia's recent decision to apply import quotas on beef, pork and poultry is a major cause of concern. The OECD could encourage Russia to lower substantially its agricultural tariffs and bind them at the applied level upon Russian accession to the WTO. Further, all quotas should be abolished.

There remain serious problems with Russia's sanitary and phytosanitary standards (SPS) and other technical standards. For instance reports indicate that certain OECD exporters have been refused licences to export dairy and meat product into Russia even without scientific rationales. It is alleged that customs authorities refused to accept a certificate from individual OECD countries and insisted on site authorisations issued in the home country of the exporter. There are also reports that companies have come under diplomatic pressure to stop attempting to export their goods into Russia. It is alleged that Russia often uses SPS issues as cover for political issues, as well as discriminatory practices against imported products. If this is true, this practice should cease immediately. Russia should conform to the WTO Agreement on the Application of Sanitary and Phytosanitary Measures to insure that SPS measures are based on scientific principles and risk assessment. A commitment to ensure consistent enforcement and implementation of these agreements should also be considered a priority.

[Trade in Services](#)

Horizontal commitments: Russian accession to the WTO should be conditioned on an agreement to schedule meaningful market access and national treatment commitments for a broad range of services industries across all modes of supply. It is important that Russian standards for services should conform to international standards wherever possible. BIAC is concerned that, even after WTO accession, Russia will retain the right to restrict market access for service providers in certain circumstances. The OECD could urge the country to exercise this right with prudence and phase it out over time as it undermines commercial certainty.

Movement of natural persons: OECD business wants to see improved opportunities for the temporary movement of natural persons into Russia for business purposes. This should be

achieved through efficient visa issuance and both sides should consider visa-free travel for business people engaged in commercial activities, especially for intra-corporate transferees. Companies currently report substantial bureaucratic delays and difficulties in obtaining such visas, as well as work permits. The need for work permits should be determined in advance for the next year.

Sectoral commitments:

- Accounting: Russia should generally apply international standards wherever possible. In the accounting sector the International Accounting Standards should be the norm for Russian accounting practices. OECD should require Russia to reaffirm its commitment to the universal adoption of International Accounting Standards.
- Banking: Foreign banks, as opposed to foreign owned subsidiaries, are still prevented from opening branches in Russia. However, the granting of a retail banking licence to a foreign-owned Russian subsidiary indicates that conditions may be improving. BIAC calls for further steps to improve the business environment for foreign banks wishing to operate branches and subsidiaries in the country. Specifically, regulatory and legislative reforms in the areas of bankruptcy law, credit risk protection, deposit insurance as well as reforms designed to create more even banking supervision should be undertaken. Opening the Russian banking sector will spur the growth of corporate and retail banking services to the great benefit and long-term health of the Russian economy.
- Insurance: Russia should agree to raise the overall share of foreign capital in insurance companies well above the present 15% limit. Other restrictions on the activities of foreign insurance companies operating in Russia, such as the prohibition against the sale of life insurance and against the underwriting and reinsuring of State-mandated forms of insurance (e.g., motor vehicle insurance), should be scaled back. Sub national regulations and practices also discriminate against foreign providers of non-financial services. In particular, license and certification costs are much higher for foreign providers. Russia should end its “two-tier” protectionist system of license and registration fees for service industries and bring its practices into conformity with GATS requirements
- Telecommunications and Computer and Related Services: Given the importance of these sectors in and of themselves and as drivers of economic growth and development, Russia should ensure meaningful market opening commitments. At a minimum, these commitments should include a date certain for full market liberalization, and removal of foreign ownership restrictions. Moreover, there should be a full adoption of the WTO reference paper for basic telecommunications. In addition, to reap the full benefits of electronic commerce, we encourage Russia to schedule full market access and national treatment commitments for the sectors that are associated with the infrastructure needed for business-to-business and business-to-consumer e-commerce.
- Educational services: BIAC believes that there is great scope for enhanced trade in educational services between OECD countries and Russia. The Russian federation should be encouraged to provide greater opportunities to build on links between academic and vocational institutions in the OECD area and Russia.

Trade facilitation

BIAC welcomes Russia's progress in passing a revised State Customs Code and steps toward implementing the Revised Kyoto Convention on Simplification and Harmonization of Customs Procedures. The Russian customs system is sorely in need of modernization. Russia ranks 155th out of 178 countries in terms of efficiency of customs procedures²⁴. It takes an average of nearly 36 days to import into and export from the Russian Federation, compared to an OECD average of approximately 10 days²⁵. The methodology for calculation of customs valuation and the imposition of customs clearance fees do not appear to be WTO-compliant in many cases. In keeping with the practices of industrialized countries, the primary objective of Russian Customs authorities should not be to generate revenue. Russia should comply with GATT rules relating to movement of goods across borders, Article X requirements for transparency, WTO agreements on customs valuation, rules of origin, and pre-shipment inspection. The arbitrary, inefficient and often corrupt practice of customs authorities in interpreting, changing, and enforcing customs laws and regulations has been a major problem for our member companies. Customs entry processing procedures are complicated and inconsistently applied, resulting in the most routine of entries requiring several days to be processed. Russian customs should apply measurement of release times and strive to reduce them over time.

Rules surrounding customs security cause significant problems for companies doing business in Russia. A BIAC member reports that any lorry transporting goods on which over 50,000 USD in accumulated tariffs and taxes have been paid requires a compulsory customs convoy from the Russian border to its destination. This has caused delays and costs of around 400 USD per truck. Russia could allow companies with a good track record on delivery safety to be exempt from this requirement, which can represent a significant trade barrier. The availability of TIR carnets, which are needed to allow customs clearance, is often restricted in Russia, leading to further delays and increased costs. Furthermore, remaining discriminatory railway tariffs should be abolished.

A systemic issue is corruption at customs. While laws are often framed in an opaque manner, their application by customs officials is reported by BIAC members frequently to be arbitrary. There are reports that Russian customs officials sometimes demand bribes in lieu of purported legal fees. BIAC welcomes the new Customs Code that was established in 2004. This provides for speedier border crossings and provides a list of those documents that are required for customs clearance. These reforms have helped to inhibit scope for corruption at the border, though problems still persist on the ground. OECD business wants to see further improvements to Russian customs systems, including establishing a single-window, fees levied at a reasonable level that are proportionate to the services undertaken, and the formal adoption of an effective and transparent customs dispute settlement mechanism.

Standardisation and certification

OECD companies operating in Russia are often faced with non-transparent standards and compliance processes as well as with unreasonably high demands and excessive costs concerning certification testing. By some estimates more than 60% of all products to be sold and/or used in the country require mandatory certification/licensing. Companies often have to deal with a

²⁴ World Bank (2008) Doing Business in Russia

²⁵ Ibid.

high number of complex tests, compilation of internal documentation needed for verification, translation of documents and some other procedures and paperwork that makes the certification process costly, time consuming, and inscrutable. In addition, standardisation constitutes a significant barrier to trade as the Russian government does not recognise many of the international standards but requires that the imported products market must have a Certificate of Conformity issued by the Russian State Standards Committee. OECD companies have reported a lack of consistency and transparency in the application of the certification requirements, which are unclear, redundant and constantly changing. The certification process increases the cost and time required for clearing customs, especially for telecommunications equipment (which must comply with two sets of standards to satisfy two different government agencies), pharmaceuticals (importers must provide a Declaration of Conformity for every batch of medicines, while Russian manufacturers are allowed to provide a Declaration for the full series), construction material, and equipment for the energy sector. Despite the long processing time (12-18 months), certificates expire every three years²⁶. Requirements for certificates are altered arbitrarily with no clearly stated guidelines. Companies have reported about trade-limiting railroad packaging regulations and obligatory certification for already registered medicines.

Pharmaceutical products are required to get marketing approval, yet the process is lengthy, unpredictable, and lacking in transparency. The approval process and the corresponding fee collection are the responsibility of the Federal Government Establishment or FGU, a non-commercial subsidiary to the Federal Health Service (Roszdravnadzor). Although Roszdravnadzor officially collects a fee (set by the Russian Tax Code) per product application, the FGU reportedly charges a far greater fee per product application. The reasons for this major differential between these agencies are not clear.

Similar issues exist regarding Crop Protection Product registration, which are unacceptable in today's environment in the Russian Federation. Consequently not all institutions involved in the registration process of Crop Protection Products have accepted the new legal situation initiated by the Ministry of Agriculture of the Russian Federation. Although there are new legislation procedures, the deadlock in the registration process continues to this day.

The end result is a standstill in the registration process particularly for R&D-based companies. At the same time, fast registration continues for generics and products of dubious quality and origin, which might pose unacceptable risks to human health and the environment. In developing new technical standards, the Russian government should ensure that they are harmonised with international norms to the greatest extent possible. Russia should apply the WTO disciplines on Technical Barriers to Trade to ensure that its certification, standardization and labelling requirements are not unnecessary barriers to trade and do not discriminate against foreign suppliers. It is therefore very welcome that a law on technical regulation, which entered into force in 2003, foresees greater harmonisation of regulatory standards with international norms. The law also provides for greater consultation in the future development of standards. This law should be implemented expeditiously and complemented by work towards harmonising existing standards wherever possible. The complexity and costs of conformity assessment procedures should be reduced and there should be greater recognition of certificates from OECD countries.

²⁶ SGS Group (2008) Frequently Asked Questions about Russian/CIS Certification and Licensing

Other non-tariff barriers

In addition to standards protection systems (SPS) restrictions and certification requirements detailed in the preceding paragraphs, exports to Russia face a range of other non-tariff barriers (NTBs).

Excise taxes on certain alcoholic goods are exceptionally high. When combined with standing tariffs, excise taxes can represent a duty level so high that exports become prohibitively expensive. We look forward to Russia binding its overall duty levels at low levels upon WTO accession. A serious and growing problem is Russia's imposition of export taxes on certain raw materials, including timber and various scrap metals, as well as certain agricultural products. These export taxes can constitute a significant threat to the competitiveness of some OECD industries sourcing in Russia. Also export duties on scrap metals cause market distortions and again threaten the competitiveness of industrial users in the OECD area. Taxes on exports of scrap metals give Russian producers an unfair cost advantage over their overseas competitors, as restrictions on exports increase supply in the domestic market and therefore lower prices. Russia should be encouraged to substantially reduce or eliminate all forms of export restrictions.

BIAC is concerned that Russia's export taxation policies may be based on political rather than economic motivations. The Russian government appears to be attempting to nurture the development of 'national champion' industries in order to attract foreign direct investment into these sectors. This is a form of protectionism that runs contrary to the principles of the WTO as well as the OECD. BIAC would like to see the elimination of all forms of export taxes and any quota-type restrictions in the near future.

Rules of origin

Rules of origin should facilitate trade and not act to restrict it. Upon entry to the WTO and in order to ensure that trade is as efficient as possible, Russia should ensure its rules of origin are transparent, simple and harmonised with relevant WTO rules to the greatest extent possible.

Public procurement

Russia's public procurement regime has witnessed significant improvements in the last few years, not least due to changes brought in by a law that came into force at the start of 2006. This law abolished legal restrictions on foreign providers of goods and services from tendering for Russian government contracts (subject to reciprocity in market access for Russian bidders in the supplier's home country). Regulation has been harmonised and streamlined throughout all levels of government, while all contracts are now advertised on a dedicated website. However, we have some concerns that the new law may not be implemented and enforced effectively and consistently throughout the Russian Federation. OECD business wants to see uniform application of these laws throughout all Russian states.

Russia should also be encouraged to apply open, competitive bidding as standard practice for procurement contracts. Currently, reverse auctions are frequently used and initial prices set for large contracts, which run contrary to market principles. Open and fair competition will ensure that goods and services are provided at the best possible value. Moreover, procurement requirements should not be too highly prescriptive, as this generates inefficiencies and encourages

circumvention of the law by unscrupulous operators. Furthermore, there is evidence that excessively complex requirements can lead to corruption among government officials.

BIAC hopes that Russia will begin negotiations towards accession to the WTO Government Procurement Agreement once it has acceded to the WTO itself. OECD business also hopes that Russia will establish a procurement regime that is based on sound market principles and promotes fair and open competition among national and foreign bidders.

F. EMPLOYMENT, LABOUR AND SOCIAL AFFAIRS

Russia made many advances in launching social reforms in the 1990s and early 2000s. It must build upon many of these reforms if they are to provide real value in Russia's rapidly changing economy.

Need for reliable and recent statistics

The Russian economy has changed dramatically since 2001, and it is not clear how this may have impacted on Russia's labour market. Acquiring new up-to-date and reliable statistics on Russia's labour market situation and employment practices is therefore essential in order to compare Russia's performance with the pillars of the Restated OECD Jobs Strategy. This will be particularly important for the proposed OECD ELSAC review, which will provide input towards OECD-Russia negotiations.

Labour market participation and skills shortages

Russia has a low child dependency ratio and a high old-age dependency ratio. As a result, it is likely that the size of the labour force could begin to contract within 15 years²⁷. Moreover, unemployment levels have been declining every year since 1998, with the average rate close to the OECD average of 6.1% in 2005²⁸. In Moscow and many other large cities, unemployment levels are reportedly close to zero²⁹. The labour market therefore appears to be nearing its capacity. Moreover, there are serious concerns about skills shortages, particularly in two sectors essential to Russia's economic growth: energy and construction.

Russia needs to therefore encourage labour market participation of skilled workers. Increased government spending for education should be particularly directed towards management and engineering in order to boost skills in key growth sectors. In addition, actions should be taken to increase labour productivity, which stood at around half of the OECD average in 2005³⁰. This will require more flexible labour laws, and more efficient infrastructure investment will be needed to encourage labour mobility. According to the World Bank, improving the quality of infrastructure in Russia to the level of the median industrial country would raise productivity growth by 1.4%³¹. Moreover, Russia should encourage employment of young and old people, as employment levels

²⁷ OECD (2007) Employment Outlook

²⁸ OECD (2008) Factbook

²⁹ Financial Times (April 17, 2008) Skills shortage hits Russian revival

³⁰ OECD (2006) Economic Survey of the Russian Federation

³¹ World Bank (2007) Russian Economic Report No.15

of 15-24 year olds and 55-64 year olds are significantly lower in Russia than the OECD average³². Lastly, the government's 2007 quotas for new immigrants should be re-examined if the Russian labour market is to generate the sustained economic growth that Russia requires.

Labour law

Russia's 2002 Labour Code poses certain problems, both for Russian and foreign employers, particularly regarding the difficulty in terminating an employee's contract. According to the World Bank Doing Business 2008 report, it is considerably more difficult to hire and fire in Russia, and hours are less flexible, than in OECD countries. It is becoming increasingly common for fired employees to take their employers to court on grounds that they have been unjustly fired according to the Labour Code. The bureaucratic judicial system often then leads to costly delays.

In addition, the Code contains wording that in theory allows a court to close down a company for up to 90 days if an infringement of the Labour Code is discovered³³. Moreover, the employer must prove that all efforts were made to correct the employee before termination of the contract. There is clearly a need for greater clarity in the legislation in order to ensure the worth and effectiveness of the Labour Code.

Informal employment

Russia appears to have a considerable degree of informal employment. According to the official 2001 estimates of the Russian Federation, informal employment stood at 13%³⁴. This figure is high in itself when compared to OECD countries, and it is likely that the real figure was even higher. The proposed OECD ELSAC review should aim to provide more recent and reliable data on Russia's informal employment.

G. COMPETITION AND THE ROLE OF THE STATE

Following the collapse of the Soviet Union, Russia's economy experienced a rapid wave of privatisation that handed control of key sectors to a relatively small number of companies. A new competition authority – the Federal Antimonopoly Service (FAS) – was recently established, with a remit more focused on enhancing the competitive environment than its predecessor. While these reforms are to be welcomed, there remain concerns that serious anti-competitive practices persist in Russia. It is unclear whether the FAS has the requisite authority and ability to issue sufficient penalties to maintain competitive conditions in Russia. Natural monopolies, particularly in the energy sector, remain under insufficient control by the competition authorities. Generally, competition law is very underdeveloped in Russia.

Of concern to OECD business is the strong role of the State in the economy, which has maintained, and in some sectors even further increased, a significant role. The OECD lists over 20 companies from a wide range of sectors that the Russian government identified as 'strategic' corporations in which the State intends to maintain its control including over inward and outward

³² OECD (2007) Employment Outlook

³³ St Petersburg Times (Oct 30, 2007) Navigating Russian Labour Law

³⁴ OECD (2007) Employment Outlook

foreign investment. The sectors include gas, oil, energy transport, electricity, aircraft, shipbuilding, cars, banking, telecoms (fixed lines), TV broadcasting, nanotechnologies, forestry and wood, and fishing. Often the State-controlled companies hold dominant market positions.

In BIAC's view, the strong, and in some sectors growing, role of the State risks can in many cases create negative impacts on the Russian economy. These impacts may be particularly acute where the State holds a dominant market position, as competition from private domestic as well as foreign firms is often limited or even eliminated, and thus economic efficiency may be significantly reduced.

The energy sector is an example for an industry where the State influence and control are particularly salient and has increased. In 2004, the State took over control of Yukos and in 2005, it acquired a controlling stake in Gazprom which has a monopoly on gas exports and is empowered to exclude foreign participation in the development of the Shtokman gas field. The increased and dominant role of the State in important parts of the energy sector negatively affects investment and competition environment in the sector and through this reduces efficiency. For example, as the growth of oil production has declined significantly, the Presidents of Russian private oil companies are quoted to have warned that further State intervention could seriously hamper future investments³⁵.

There are also concerns that the Russian State through its control over Gazprom may be exploiting its status as the dominant regional energy exporter in order to exercise political leverage in the region. Disputes between state-owned Gazprom, and neighbouring countries Belarus, Georgia, and the Ukraine have in the past led to cuts in gas supply to gas-transit states, in some cases leading to disruptions in supply to other countries.

In BIAC's view Russia should be well advised by the OECD to learn from the rather disappointing experience of OECD countries concerning the promotion of State-controlled national champions. The government should be encouraged to take a credible approach towards a more market-driven economy by reducing State influence in sectors/companies and by encouraging strong domestic and foreign competition by private enterprises. In sectors where State-owned and private companies compete, the Russian government should provide a level playing field in order to avoid market distortions.

It is therefore essential to ensure: that the roles of the government as owner and as regulator of SOEs be kept separate; that SOEs are not exempted from the application of any general laws and regulations; that stakeholders and competitors of SOEs have access to efficient redress and an even-handed ruling when they consider that their rights have been violated; and that SOEs face competitive conditions regarding access to finance. Moreover, the legal form of SOEs should allow creditors to press their claims and to initiate insolvency procedures. Reduced State influence in the Russian economy, notably the energy sector, would provide for more competition and economic efficiency, yielding significant benefits for Russia, and in the case of the energy sector it may also contribute to international energy security.

³⁵ Financial Times (April 2008) Russia starts to pay price for its energy strategy.

H. TAXATION

Over the past few years, significant efforts were undertaken in Russia to improve the tax environment, particularly in the areas of tax policy, tax collection and tax administration as well as reduction of number of taxes and the tax rates. It is unanimously concurred that Russian tax system has become more transparent and less anti-business as it used to be. We appreciate the steps that have been already been taken to curb the burden of the tax audits.

Nevertheless, like most other emerging economies, much remains to be done to make the Russian tax laws, and especially their application, closer to international standards and OECD principles. In particular, there remain a number of essential concerns with respect to the Russian tax system including: A form over substance environment; non-transparent application of tax legislation by the tax authorities; difficulties with tax dispute resolution; interpretation of concepts such as arm's length principle and permanent establishment are not yet in line with international norms; tax rulings are not available or are not binding; difficulties with VAT recovery and refund; international tax concepts such as tax consolidation and cost sharing are not recognized, and moreover the legal framework effectively discourages exports from Russia by imposing very high export duties.

BIAC is developing a detailed paper on these challenges for separate submission to the OECD as a contribution to the accession reviews as they relate to international taxation. This paper will be finalised in early June.

I. CORRUPTION

Corrupt practices lead to substantial economic and social costs for companies, their employees, consumers, and governments. They distort trade and can violate the terms of the landmark OECD Anti-Bribery Convention and national laws. BIAC is therefore concerned about the high level of corruption in Russia.

World Bank information suggests that the growth of the volume of bribery and corruption in Russia between 2001 and 2005 was estimated to be 50%³⁶. Meanwhile, World Bank survey information shows that, between 2002 and 2005, there was an increase of 25% of firms who considered corruption to be a major investment climate constraint in Russia³⁷. Such trends are supported by reports from Russian and international civil society organisations.

BIAC believes that the apparent rise in corruption is partly symptomatic of an unsatisfactory Russian legal and bureaucratic system. As already mentioned in Section B, it takes on average 704 days in order to acquire a business license for the construction of a warehouse in Russia, compared to an OECD average of 153, and the relative cost is on average sixty times as much³⁸. It is reportedly often the case that civil servants therefore solicit bribes in order to speed up transactions or to refrain from enforcing outdated and poorly defined laws. Low wages in many parts of the government also serve to increase civil servants' propensity towards bribe solicitation. For example, customs officers are paid only about USD 300 per month yet constantly deal with goods worth millions of dollars, creating incentives for the use of corrupt practices by which to

³⁶ Business Anti-corruption Portal (2008) Linked to our BIAC Guide to Anti-Bribery Convention

³⁷ World Bank (April 2007) "Enhancing Russia's Competitiveness and Innovative Capacity"

³⁸ Business Anti-corruption Portal (2008) Linked to our BIAC Guide to Anti-Bribery Convention

support their incomes. Moreover, the judicial system appears to face problems of corruption, and political interference in the selection of judges for certain cases is apparently common practice. Similarly, the police service is perceived to be one of the most corrupt institutions in Russia. It is reported that the police regularly oblige firms to pay protection money, as well as inspect cargo trucks in order to solicit bribes. Such practices act to further undermine the rule of law in the country.

Tackling corruption

Corruption is a major obstacle for domestic and OECD business operating in Russia, and there is significant room for improvement. The government needs to take a much more credible approach towards fighting corruption which is necessary to make the business environment safer and more attractive. It is imperative that Russia ratifies and adheres to the OECD Anti-Bribery Convention, as written in Appendix A.II of the Roadmap. The OECD could moreover encourage Russia to impose tougher measures on *all* forms of corruption in both public and private sectors. This will require legal and bureaucratic reforms designed to improve the ease of acquiring business licenses and registering property, while also reducing the time taken to prepare, file and pay taxes. Government-led corruption initiatives should adequately involve the participation of the private sector and the civil society. Raises in civil servants' wages may also discourage bribe solicitation and through this contribute to reducing corruption.

J. ENVIRONMENT

Russia could do more to address its considerable and growing environmental problems. BIAC calls on the OECD to carry out further work focusing specifically on environmental issues in Russia. There is a pressing need for further research during OECD-Russia negotiations in order to ensure that the principles and instruments as outlined in Appendix A.V of the Roadmap are effectively enforced and monitored. This would be particularly useful given the absence of Russian government long-term environmental policy strategies.

Climate Change

It should be borne in mind that the Kyoto Protocol sets its country targets based on countries' respective 1990 GHG levels. National economic collapse following the end of the Cold War has meant that Russia is now producing very low GHG levels with respect to the level that it produced in 1990, and is therefore well within its Kyoto target. However, in absolute terms, Russia is projected to remain within the world's top five countries of the highest energy-related carbon dioxide emissions until 2030³⁹. Moreover, its GHG level is forecasted to increase by a quarter between 2005 and 2030, to 2.0Gt⁴⁰.

BIAC therefore encourages Russia to take further steps towards reducing its growing GHG emissions, despite being within its Kyoto target. Much-needed investment in refitting pollutive power stations should be encouraged as well as greater implementation of energy efficiency practices in industry. It has been suggested by the IEA, for example, that the level of energy

³⁹ IEA WEO 2007 Reference Scenario, p200

⁴⁰ Ibid.

efficiency in Russia is still some 2.5 times lower than the OECD average⁴¹. Such reforms are therefore essential for the sustainable growth of Russia's economy.

Pollution

Land, water and air pollution are growing problems in several parts of Russia, particularly in urban areas. This poses health and safety consequences for society and economic growth. The concentrations of PM10 in 98 Russian cities, for example, are estimated to be several times above the World Health Organisation Air Quality Guidelines level⁴². Similarly, most of Russia's major rivers are classified as polluted or highly-polluted. Meanwhile, average growth of collected municipal waste is growing at approximately 7% per annum, reflecting Russia's strong economic growth and rising levels of consumption⁴³. According to the World Bank, accumulation of hazardous waste is rapidly increasing and there are concerns regarding the security of its storage. This is of particular concern regarding Russia's nuclear energy sector, with some 31 operating reactors and another 20-25 planned or proposed, as decisions will need to be made imminently as to how to safely store nuclear waste⁴⁴.

Russia should agree to undertake the environmental reforms as required or recommended in Appendix A.V of the Roadmap. There is moreover urgent need for further development of the national legal and regulatory framework for environmental matters. This should include the development of a framework for meaningful stakeholder participation, enabling national and international business to contribute to environmental decision-making processes. Furthermore, medium and long-term national and regional policy strategies should be created in order to address issues of air, soil and water quality, and waste and forest management. In addition, pollution monitoring systems should be enhanced and expanded, and an effective compliance and enforcement system should be implemented. Meanwhile, reforms to environmental standards should be made in order to ensure against overly-strict (and thus often unenforced) standards on the one hand, and overly-weak standards that create little added value on the other.

K. CORPORATE GOVERNANCE

The OECD Principles of Corporate Governance note that an effective corporate governance system acts to provide the necessary level of confidence required for the proper functioning of a market economy. In the case of OECD-Russia accession negotiations, BIAC is therefore pleased that the Steering Group on Corporate Governance will review Russia's willingness and capacity to implement the recommendations in the OECD Principles of Corporate Governance and the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

While the corporate governance system in Russia may be gradually improving since the introduction of the 2002 Corporate Governance Code, the system still appears very weak. In the case of ownership disclosure (an integral part of the OECD guidelines and Russia's own national code), only 28% of the total private ownership of Russia's 54 largest public companies was

⁴¹ Russian Federation (2007) Regular Review of Energy Efficiency Policies 2007.

⁴² OECD (2007) Policies for a Better Environment: Progress in Eastern Europe, Caucasus and Central Asia

⁴³ Ibid.

⁴⁴ World Nuclear Association (2008) Russia country profile

disclosed as of September 2005⁴⁵. There are furthermore concerns that perceived weaknesses in government impartiality and integrity unfortunately undermine the general willingness to promote transparency in business and civil society. A transparent ownership structure, for example, is widely believed to have aided the government in gathering evidence in its prosecution of Yukos. Improvements in corporate disclosure and transparency will thus significantly hinge upon the success of the State in fostering predictability and confidence for business.

The weak corporate governance system in Russia largely stems from inherent problems in the national legal framework. While legal instruments have often been put into place, such as the Corporate Governance Code (much of which has now become binding), they tend not to be effectively enforced. This is often due to a lack of essential powers and resources allocated to monitoring and enforcement bodies, such as the Federal Service for Financial Markets. Moreover, the legal and regulatory framework for State-owned enterprises (SOEs) does not always ensure a level playing field between SOEs and private companies in Russia, as evidenced by growing SOE monopolies such as Gazprom. In addition, ownership aspects are not clearly defined, leading to potential conflicts of interest that can create market distortions. This is particularly problematic in cases where high-level policy-makers make personal investments in SOEs or hold governing positions on the boards. Similarly, BIAAC is concerned by the current Russian system whereby State representatives on SOE boards are provided detailed guidance on how to vote on agenda items, undermining the credibility and value of the board. As a result, rule of law is undermined to the extent that Russian legislation and the judiciary often become ineffective.

BIAAC welcomes the work of the OECD Russian Corporate Governance Roundtable and the 2006 meetings co-organised with the Russian Ministry for Economic Development and Trade on the corporate governance of State-owned enterprises (SOEs). It is essential that corporate governance of Russian SOEs is benchmarked against the OECD Guidelines on Corporate Governance of State-Owned Enterprises. BIAAC encourages moves towards greater SOE board independence from government, and the role of the government in SOEs must be clearly defined. This will require building an effective legal framework to ensure consistency and to limit market distortions. Sufficient resources should be awarded to monitoring and enforcement bodies in order to ensure that they may carry out their work effectively. Such reforms will serve to build confidence both inside and outside of Russia, facilitating trade and investment with Russian private and State-owned enterprises.

⁴⁵ Standard & Poor (2006) "Corporate governance practices in Russia and in the implementation of the Corporate Governance Code"

CONCLUSION

Russia's OECD accession could present major opportunities for OECD business, not only as a large market, but also as a useful partner in investment, trade, and human capital. Similarly, OECD membership will provide significant rewards for Russia in terms of benefits derived from shared knowledge and guidance, lessons learnt, and broad international co-operation with the world's most developed economies.

However, as is clear from this paper, there are several matters that need to be urgently addressed while membership negotiations continue, particularly regarding the overarching problems resulting from inadequacies in the rule of law in Russia. These matters must be sufficiently improved upon in order to enable Russia's convergence with OECD policy standards, thus permitting eventual OECD accession.

BIAC expects the OECD to consider the perspectives expressed in this paper, and to use them as a basis for a structured BIAC-OECD dialogue on issues pertaining to Russia's accession. OECD business stands ready and willing to provide detailed and constructive input and support as membership negotiations continue.