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**Product Market Regulation  
in Russia**

**Paul Conway,  
Tatiana Lysenko,  
Geoff Barnard**

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**ABSTRACT/RESUMÉ****Product Market Regulation in Russia**

This paper uses the OECD's indicators of product market regulation (PMR) to assess the extent to which the regulatory environment in Russia supports competition and to draw attention to the areas where further reform efforts would pay dividends. The indicators show that, despite improvements in some areas, many aspects of Russia's regulatory framework are still restrictive, which provides considerable scope for reaping gains from bringing regulation into line with international best practice. In particular, the scores suggest that Russia's economic performance would greatly benefit from a reduction in the role of the state enterprise sector in markets that are inherently competitive and reinvigorated efforts to liberalise foreign trade and direct investment regimes. In some network sectors, recent regulatory changes have significantly improved the scope for competition. However, ongoing work needs to focus on separating competitive and monopoly market segments and eliminating barriers to entry. In addition, the authorities need to develop the capacity and strengthen the hands of the sectoral regulators. Introducing an overarching competition policy would also help bring the issue of competition to centre stage and spread a competition ethos through different levels of government.

*JEL Classification:* L1; L32; L33; L4; L5; H1; H82; H83; K20; K21; P2; P3; F13

*Keywords:* Russia; economy; transition; growth; competition; product market regulation; trade; foreign direct investment; state ownership; corruption

\* \* \* \* \*

**La réglementation des marchés de produits en Russie**

Cette étude utilise les indicateurs de réglementation des marchés de produits (RMP) afin d'évaluer le degré auquel l'environnement réglementaire en Russie est favorable à la concurrence et d'identifier les domaines où des réformes supplémentaires seraient bénéfiques pour l'économie Russe. Les indicateurs révèlent que, malgré des améliorations dans certains domaines, plusieurs aspects de l'approche réglementaire restent restrictifs, ce qui laisse beaucoup de marge pour récolter des bénéfices économiques d'un alignement de la réglementation avec les meilleures pratiques internationales. En particulier, les valeurs des indicateurs suggèrent que la performance économique de la Russie bénéficierait de façon importante d'une réduction du rôle du secteur des entreprises publiques dans les marchés qui sont par nature concurrentiels et d'un renforcement des efforts pour libéraliser les régimes du commerce extérieur et de l'investissement direct étranger. Dans certaines industries de réseau, des changements réglementaires récents ont favorisé la concurrence. Cependant, un travail soutenu sera nécessaire afin de séparer les segments du marché qui sont par nature concurrentiels de ceux qui sont monopolistiques et d'éliminer les obstacles à la concurrence. Les autorités devraient aussi développer les capacités et renforcer les pouvoirs des régulateurs sectoriels. La création d'une politique globale de concurrence aiderait à mettre la question de concurrence au devant de la scène et de transmettre un esprit de la concurrence à travers les différents niveaux du gouvernement.

*Classification JEL :* L1; L32; L33; L4; L5; H1; H82; H83; K20; K21; P2; P3; F13

*Mots clés :* Russie ; économie ; transition ; croissance ; concurrence ; réglementation des marchés de produits ; échange ; investissement direct de l'étranger ; propriété de l'État ; corruption

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## PRODUCT MARKET REGULATION IN RUSSIA<sup>1</sup>

by Paul Conway, Tatiana Lysenko and Geoff Barnard

### 1. Introduction

1. The promotion and protection of competitive markets is enshrined in the Constitution of the Russian Federation and, according to surveys of Russian entrepreneurs, is seen as one of the key tasks of government. And with good reason – the extent to which regulation promotes or hinders competition in markets for goods and services has been found to be an important determinant of economic growth in both developed and developing countries. Reflecting the importance of competition, the Russian government has made considerable progress over recent years in improving the regulatory environment to enhance the role of competitive market forces. For example, in October 2006 a new competition law came into force, with the Federal Antimonopoly Service acting as the principal enforcement institution. Beginning in 2003, the regulation of electricity markets was also comprehensively reformed. However, in spite of these and other significant improvements in the regulatory framework, a range of business surveys continue to highlight regulatory uncertainty and a business climate that is less supportive of private sector competition than in OECD countries and some other emerging markets.<sup>2</sup>

2. This paper uses the OECD's indicators of product market regulation (PMR) to assess the degree to which the regulatory environment in Russia is conducive of competition in goods and services markets and to highlight areas where further reform would pay dividends. These indicators are based on a standardised procedure that has been used extensively on OECD members and a number of other countries to evaluate the stance of product market regulation in key areas. The paper begins by briefly outlining the PMR indicator methodology and presenting the overall indicator results for Russia. It then assesses the extent of competition in Russian product markets before reviewing some of the recent literature on linkages between the regulatory environment, competition and economic performance. The paper then presents the detailed PMR indicator results for Russia along with a number of policy recommendations that would increase product market competition and improve economic performance.

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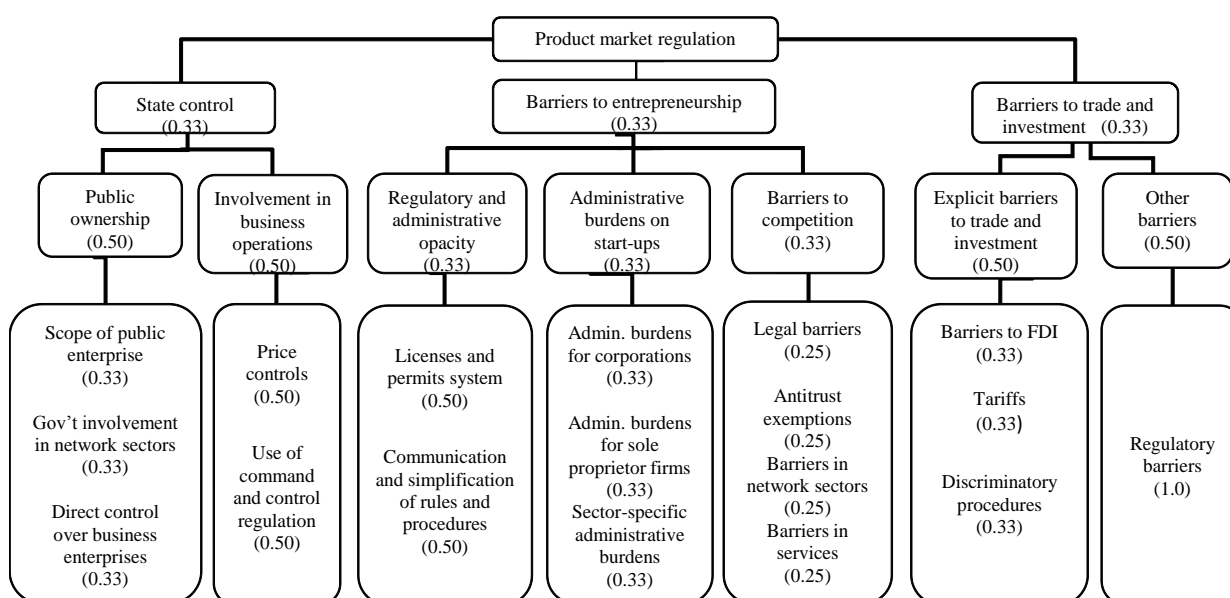
2. A summary of recent surveys of Russia's business climate is given in OECD (2008b).

## 2. The OECD's PMR indicators<sup>3</sup>

3. The OECD's PMR indicators assess the extent to which the regulatory environment promotes or inhibits competition in markets where technology and market conditions make competition viable. These indicators have been used extensively over the last decade to benchmark regulatory frameworks in OECD and a number of other countries and have proven useful in encouraging countries to implement structural reforms that enhance economic performance.

4. The PMR indicator system summarises a large number of formal rules and regulations that have a bearing on competition. These regulatory data cover most of the important aspects of general regulatory practice as well as a range of features of industry-specific regulatory policy, particularly in the network sectors. This regulatory information feeds into 18 low-level indicators that form the base of the PMR indicator system (Figure 1). These low-level indicators are progressively aggregated into three broad regulatory areas: *i) state control*; *ii) barriers to entrepreneurship*; and *iii) barriers to international trade and investment*. In turn, at the top of the structure, the overall PMR indicator serves as a summary statistic of the general stance of product market regulation.

**Figure 1. The structure of the PMR indicator system**



Source: Wölfl *et al.* (2009).

5. The OECD's PMR indicators have a number of characteristics that differentiate them from other indicators of the business environment. First, in principle, the low-level indicators only record "objective" information about rules and regulations, as opposed to "subjective" assessments of market participants, as in indicators based on opinion surveys. This isolates the indicators from context-specific assessments and makes them comparable across time and countries. Second, the PMR

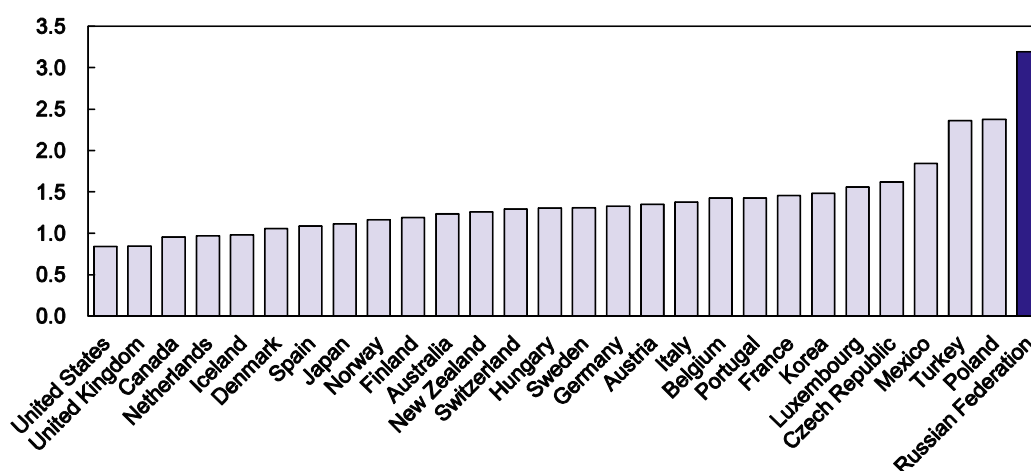
3. For a detailed description of the PMR indicators and the latest results for OECD countries see Wölfl *et al.* (2009). Results for selected non-OECD countries, including countries currently negotiating accession to the OECD and countries with which the OECD is in a process of Enhanced Engagement, are discussed in Wölfl *et al.* (2010).

indicators follow a bottom-up approach, in which indicator values can be related to specific underlying policies. One of the advantages of this system is that the values of higher-level indicators can be traced with an increasing degree of detail to the values of the more disaggregated indicators and, eventually, to specific data points in the regulation database. This is not possible with indicator systems based on opinion surveys, which can identify perceived areas of policy weakness, but are less able to relate these to specific policy settings.

### *The overall intensity of product market regulation in Russia: an international comparison*

6. Estimating the PMR indicators for Russia reveals that, despite liberalisation in some areas, product market regulations are, on average, highly restrictive. The *overall level of regulation* is significantly higher and restricts competition to a greater extent than in any of the OECD countries, including the emerging market economies within the OECD area (Figure 2).<sup>4</sup> All three of the high-level sub-components of the overall PMR index are high in Russia relative to comparator countries, particularly *state control* and *barriers to international trade and investment* (Figure 3). As will be expanded on below, this implies much scope for improving the regulatory environment and reaping benefits in terms of improved economic performance.

**Figure 2. The overall indicator of product market regulation**

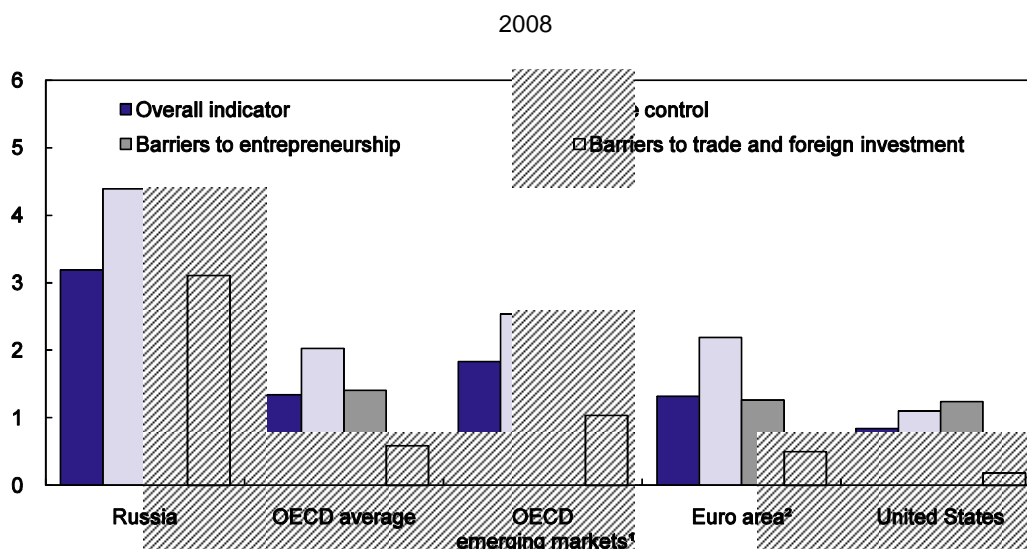


Note: Index scale of 0-6 from least to most restrictive.

4. By design, all the indicators in the PMR system range from 0 to 6 from least to most restrictive of competition.



Figure 3. The overall PMR indicator and main sub-indicators



1. Czech Republic, Hungary, Korea, Mexico, Poland, Turkey.

2. Austria, Belgium, Finland, France, Germany, Italy, Luxembourg, Netherlands, Portugal, Spain.

Note: Index scale of 0-6 from least to most restrictive.

### 3. The extent of product market competition in Russia is generally weak

7. Between 2001 and 2007 the share of market sectors assessed to be highly concentrated in Russia increased from 43 to 47%.<sup>5</sup> Although differences in methodology and sectoral coverage make comparison difficult, this appears to be an extremely high incidence of concentrated sectors compared to OECD countries, and these results are indicative of an economy dominated by a relatively small number of large companies.

8. Substantial falls in the number of firms producing a given percentage of Russian GDP also signals an alarming decrease in competition among Russia's largest firms (Table 1). As well as reflecting the strong growth of these firms, this also indicates ongoing industry consolidation and vertical integration of supply chains. With political support, the dominance of large conglomerates has also been spreading across market segments as they acquire non-core assets and diversify product lines. More positively, the trend of increasing dominance may have reversed slightly since 2005, perhaps reflecting the beneficial impact of recent policy changes to stimulate competition. However, whether measured by the share in GDP or employment, the significance of large firms in the Russian economy is much greater than in many OECD and other countries. Small and medium-sized enterprises (SMEs) in Russia account for about 20% of total employment and generate an even smaller share of output, while for most OECD economies both figures exceed 50% (OECD, 2008a).

5. This is calculated on the basis of 119 markets, for which data from Rosstat are available for both 2001 and 2007. Concentration ratios are calculated using the HHI and CR3 methodologies. A highly concentrated industry is defined as one in which the Herfindahl-Hirschmann Index (HHI) is greater than 2000.

**Table 1. Number of largest firms producing a given share of GDP**

Share of GDP	2003	2004	2005	2006
10%	52	19	10	11
20%	710	207	69	90
30%	7128	2248	474	620
40%	97 937	36 601	4 320	5 364
50%	-	94 621	87 906	102 443

Source: Federal Antimonopoly Service (2008).

9. In addition to highly concentrated industries, the formation of cartels also adversely impacts on competition in Russian product markets. With markets typically characterised by a small number of large firms, the temptation is to increase profits by reducing effective competition between market participants. Indeed, the Federal Antimonopoly Service considers cartel formation to be one of the major threats to competition in the Russian economy and estimates that as many as one in five industries may be prone to cartel activity. In part, cartel formation reflects past policy settings that encouraged market division – for example, in the 1990s different regions were assigned to individual oil companies (Federal Antimonopoly Service, 2008).<sup>6</sup>

10. More encouragingly, some indicators suggest that product market competition may be improving along several dimensions. Surveys of entrepreneurs indicate that the level of competition in markets is, in many cases, perceived to be fierce and growing in intensity (Federal Antimonopoly Service, 2008). Although no significant measures have been taken to liberalise trade since the early 2000s, the ratio of imports to GDP has trended upward in recent years, suggesting that competition from imports has increased. Openness to imports remains low compared to most OECD countries, including the emerging market economies within the OECD, as well as most emerging markets outside the OECD (Figure 4). On the other hand, among similarly large countries, Russia's openness is not markedly out of line. Continued gradual increases in imports-to-GDP are probably to be expected, which would help strengthen competitive pressures in domestic markets.

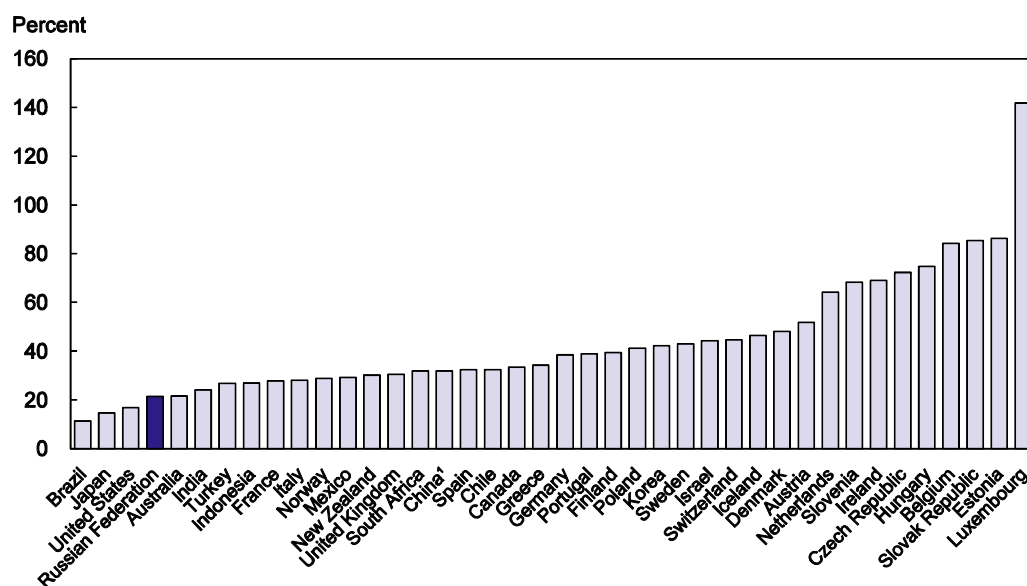
11. Another feature of Russian product markets that dilutes the benefits of competition is a business preference for dealing with well-known counterparts and a reluctance to change suppliers. According to the Institute for the Economy in Transition surveys, enterprises regularly cite established relations between producers and consumers as the main obstacle to competition<sup>7</sup>. A lack of trust also encourages firms to seek control over suppliers, leading to a significant degree of vertical integration, even in markets where this is not typical in other economies (Bessonova, 2009). This reduces competition further and erodes its benefits.

6. The Federal Antimonopoly Service reports that cartel formation is most problematic in the following sectors: wholesale and retail trade in oil products, agriculture and retail trade, banking (consumer credit), the pharmaceutical industry, building materials, metallurgy and the chemical industry.

7. High transport costs are another major impediment cited by enterprises in this survey.

**Figure 4. Openness to imports: an international comparison**

Imports of goods and services as a share of GDP, 2005-07



1. 2005-06.

Source: OECD Economic Outlook 84 database and World Bank, WDI database.

12. In summary, empirical work on Russian product markets typically depicts a limited degree of competition that may have even decreased until recently for large firms at the national level. At the regional level, given internal barriers to trade, the degree of product market competition is even weaker across all industries (OECD, 2006; Bessonova, 2009). In many regional markets it is still typical to have a few incumbent firms operating in cooperation with regional or local officials. As well as reflecting corruption and rent-seeking behaviour, these arrangements often also arise as a result of limited fiscal autonomy at lower levels of government. Many of the regional governments and municipalities pursue their social objectives through shadow budgets that employ the quasi-fiscal services of large incumbent enterprises operating in their territory. These arrangements typically translate into effective barriers to entry from outside competition. In part, this is a legacy of the Soviet era, when product markets were characterised by massive distortions resulting from policies that granted monopoly concessions, protected incumbents from foreign competition and provided extensive state support to key sectors. More fiscal autonomy would help break the dependence of regional governments on a limited number of local firms for revenue raising.

#### 4. Product market competition improves economic performance

13. An appropriate regulatory framework is essential for the efficient functioning of market economies. At the same time, however, regulation is one of the most pervasive forms of state intervention in economic activity. Over recent decades, concerns have been raised about the potential for regulation to be too intrusive and stifle market mechanisms with negative implications for resource allocation and productive efficiency. This can occur when aspects of the regulatory regime fail to meet their original public interest aims and instead end up protecting special interest groups. The cost of regulations may also sometimes exceed the expected benefits, creating so-called “government failure”. Technical progress, fundamental shifts in demand and improvements in regulatory techniques may also make the design of the existing regulatory regime obsolete.

14. To address these apparent weaknesses in product market regulation, governments in OECD and a number of developing countries have been reviewing and upgrading the regulatory environment over recent decades. The reform process has been closely intertwined with enhancing competition in product markets. In general, pro-competitive reforms have been found to have important beneficial effects on GDP *per capita* through a number of different channels, including increased productivity.<sup>8</sup> In particular, lower entry costs tend to improve resource allocation by facilitating the movement of capital from low to high productivity firms and sectors (Arnold *et al.* 2008).<sup>9</sup> Of potential importance to Russia, increased competition can also substitute for effective corporate governance by acting as an “incentive scheme” for managers, motivating them to improve efficiency (Aghion *et al.*, 1999, 2002).

15. Also of particular relevance to Russia, improvements in PMR have been found to speed the international diffusion of new technologies and production techniques, particularly in ICT-intensive sectors (Conway *et al.*, 2006; Aghion and Griffith, 2005). The role of technological diffusion as a driver of productivity growth in relatively less productive economies has been emphasised in recent theoretical and empirical work (*e.g.* Acemoglu *et al.*, 2005), raising the possibility that PMR and competition might influence the extent to which new technologies flow from more to less productive economies. At the firm level, the impact of competition may differ depending on the level of productivity relative to global technological leaders. Recent evidence suggests that an increased threat of new entry from foreign competitors will spur domestic firms that are relatively close to the world technological frontier to increase innovation so as to escape competition. On the other hand, domestic firms with very low productivity may be unable to “catch up” to the leading global firms and appropriate the benefits of innovation. As a result, these firms may face a “discouragement effect” and *reduce* innovation given an increased entry threat from more productive firms. At the sectoral and economy levels, however, the impact of increased competition on innovation and aggregate productivity is positive as weaker incumbents shrink or close and more productive incumbents and new firms innovate (Aghion and Bessonova, 2006).<sup>10</sup> This highlights the key role of product market liberalisation in improving the efficiency with which resources are channelled from low to high productivity firms.

16. Empirical work on transition economies has generally confirmed that product market liberalisation can have large beneficial effects on economic performance. In particular, in countries where the industrial structure was characterised by a high degree of concentration - typically transition economies – the positive impact of competition on productivity growth is found to be relatively strong (OECD, 2006; OECD, 2007). Greater foreign competition, through increased FDI and import

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8. See Nicoletti and Scarpetta (2003) and Conway *et al.* (2006). Enhanced product market competition can also contribute to GDP *per capita* growth by increasing employment (Blanchard and Giavazzi, 2003; Nicoletti and Scarpetta, 2005). As restrictions are eased and competition increases, firms earn lower product market rents, activity is expanded and employment rates tend to rise. However, employment in some of the large firms, particularly in the network sectors, where previous regulations were conducive to over-manning, may be adversely affected by deregulation.

9. Arnold *et al.* (2008) find that the negative effect of anti-competitive regulation on the efficiency of resource reallocation is particularly pronounced in ICT-intensive sectors that have a high potential for exploiting new general-purpose technologies.

10. Accordingly, increased threat of entry increases cross-firm differences in performance and turnover. A number of empirical studies find evidence that more competition increases the heterogeneity of firm performance. Aghion *et al.* (2005) find that entry liberalisation (de-licensing) in Indian states led to an increase in within-industry inequality in output, labour and total factor productivity. Sabirianova *et al.* (2005) also find support for heterogeneous effects of firm entry on firm performance in Russian and Czech industrial firms. In OECD countries, Arnold *et al.* (2008) find that the result of liberalisation increasing heterogeneity in firm performance also holds in OECD countries.

penetration, has also been found to increase the likelihood of a firm in a transition economy innovating whereas state ownership has the inverse affect (Carlin *et al.*, 2001; Gorodnichenko *et al.*, 2008). More generally, soft budget constraints and state ownership have been found to mitigate the positive effects of improvements in the business environment on firm restructuring and performance (Carlin *et al.*, 2001; Aghion *et al.*, 2002). This implies that unconditional state support for firm survival needs to be removed if transition economies are to reap the full benefits of product market liberalisation.

17. In the Russian context, empirical studies imply that increased domestic and foreign competition would help improve firm performance and lead to significant economic benefits. In a sample of almost 15 000 firms covering 75% of employment in the industrial sector, Brown and Earle (2000) find that the “big bang” liberalisation in 1992, which improved product and labour market regulation as well as transport infrastructure, generated large positive effects on total factor productivity (TFP). In addition, private sector firms were found to perform better than state-owned enterprises (SOEs) even after correcting for selection bias.

18. Bessonova *et al.* (2003) use firm-level data from 1995-2001 to assess the impact of trade and FDI liberalisation on the efficiency of Russian firms in the industrial sector. They find that competition with foreign imports and goods produced by foreign-owned firms in Russia increased the speed with which domestic firms are restructured and improved productivity. These authors also find that the effects of liberalising trade and investment depend on other policies, including financial sector reform, measures to increase labour mobility and reductions in regional bureaucracy. These results mirror those of a number of OECD studies that find FDI is an important link between product market regulation and productivity catch up (Nicoletti *et al.*, 2003; Conway *et al.*, 2006). Bessonova (2009) updates the dataset to 2005 and finds that increased penetration of foreign companies has a positive effect on the productivity performance of the most efficient firms but a negative effect on Russia’s relatively inefficient firms. This highlights the importance of effective policies to lower barriers to exit so that inefficient firms can close down, allowing resources to flow to more productive areas of economic activity.

19. These results highlight the potential contribution that regulatory reforms aimed at enhancing competition would make to Russia’s long-term economic prospects. Given that competition among Russia’s largest firms is relatively weak, greater product market competition would lead to substantial improvements in productivity and other aspects of economic performance. As discussed above, the overall PMR indicators suggest that the regulatory environment currently hinders competition and can be improved in a number of ways. The following section uses the detailed PMR indicator results to outline a number of policy recommendations that would increase competition in Russian product markets and thereby improve economic performance.

## **5. The detailed PMR indicator results and policy recommendations<sup>11</sup>**

### ***State control over economic activity is pervasive***

20. Reflecting the communist history of the Soviet era, the extent of *state control* in the Russian economy remains extensive as a result of a high degree of state ownership and control over economic activity. According to the PMR indicators, the extent of state control in Russia is higher than in any OECD country (Table 2, Figures A2.1-A2.5). Over recent years, the policy of the Russian government with respect to SOEs has been aimed at increasing its stake in strategic enterprises to a controlling level and privatising minority stakes of firms in non-strategic sectors. Reflecting this, the the number

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11. Results for all of the low-level indicators for Russia *vis-à-vis* OECD countries are given in the Annex.

of majority stakes of the federal government increased from 25% of total holdings in 2005 to 61% in 2008 (Sprenger, 2008). A related development is the emergence of large state-controlled conglomerates which have in some cases been established through the consolidation of existing SOEs.<sup>12</sup>

**Table 2. The extent of state control**

	2008				
	Russia	OECD average	OECD emerging markets <sup>1</sup>	Euro area <sup>2</sup>	United States
State control	4.39	2.03	2.54	2.19	1.10
Public ownership	4.28	2.91	3.46	3.08	1.30
Scope of public enterprise sector	4.64	3.10	3.54	3.23	2.25
Direct control over business enterprises	4.19	2.86	3.67	2.93	0.68
Government control in infrastructure sectors	4.02	2.76	3.18	3.08	0.99
Involvement in business operations	4.50	1.15	1.61	1.30	0.90
Use of command and control regulation	4.00	1.52	1.94	1.88	1.30
Price controls	5.00	0.78	1.29	0.71	0.50

1. Czech Republic, Hungary, Korea, Mexico, Poland, Turkey.

2. Austria, Belgium, Finland, France, Germany, Italy, Luxemburg, Netherlands, Portugal, Spain.

Note: Index scale of 0-6 from least to most restrictive.

21. The government has also established a number of state corporations that have the special legal status of a non-commercial organisation and are not subject to the Bankruptcy Law nor controlled by the Audit Chamber of the Russian Federation.<sup>13</sup> Disclosure rules for these entities are also less stringent than for joint-stock companies. Despite their non-commercial status, several state corporations pursue commercial activities. The Federal Antimonopoly Service considers the state corporations to be one of the major threats to competition, together with cartels, network industries and anticompetitive behaviour of the authorities.

12. Examples include the United Aircraft Construction Corporation and the United Shipbuilding Corporation.

13. The six new state corporations founded in 2007 are: Development Bank (Vneshekonombank), Rosnanotekh, Rostekhnologii, Rosatom, Olimpstroii, and the Fund for Assistance in the Reform of Housing and Public Utilities. The deposit insurance agency was also established as a state corporation, in 2004, and a previous entity set up to manage the assets of failed banks following the 1998 crisis was subsequently wound up. No new corporations have been founded since 2007. See Sprenger (2008) for a more detailed description.

*The state enterprise sector is large*

22. According to data from the Federal Service for State Statistics, 9% of all registered firms were fully state-owned in 2007 while 2% had mixed ownership.<sup>14</sup> However, SOEs tend to be bigger than private-sector companies so these figures understate the extent of government control over economic activity. In a survey of 822 Russian enterprises conducted by the Higher School of Economics Moscow and the Institute of Economic Research of Hitotsubashi University Tokyo in 2005, the median number of employees of SOEs was 880 compared to 414 for private firms. The corresponding figures for sales volume was 350 million roubles and 195 million roubles respectively. So according to both statistics, SOEs are, on average, roughly twice as large as private sector firms.<sup>15</sup> A more recent statistic also shows that SOEs tend to be relatively large; in regular enterprise surveys conducted by the Institute for the Economy in Transition, Moscow, 58% of SOEs surveyed in 2006-08 employed more than 1 000 people, compared with 30% in enterprises with a different form of ownership.

23. In terms of the employment share, around 10% of all employees worked for fully state-owned companies in 2007 with another 7% employed by companies with mixed state and private-sector ownership (Figure 5A). Although methodological differences make exact comparison difficult, this is high relative to OECD countries (OECD, 2005a). In terms of fixed asset investment, 32% is carried out by the public sector (both general government and SOEs) (Figure 5b). Both measures have been in decline over recent years, although the bulk of privatisations were carried out in the 1990s. At the same time, the government has been increasing its level of ownership among the largest Russian companies listed on the stock exchange. According to Troika Dialog (2008), the share of market capitalisation of the Russian equity market controlled by the state has increased from 24% in 2004 to 40% in 2007.<sup>16</sup> A related development is the emergence of large state-controlled conglomerates which have in some cases been established through the consolidation of existing SOEs. These companies usually occupy dominant market positions in their areas of activity with the scope for private sector participation, including by foreign investors, tightly controlled. This, in conjunction with guaranteed government support, leads to a lack of incentives to increase efficiency, reduce costs and innovate. In combination with the results outlined above of increasing market concentration among Russia's largest companies, this highlights the negative impact of increasing government ownership on competition in key sectors of the Russian economy.

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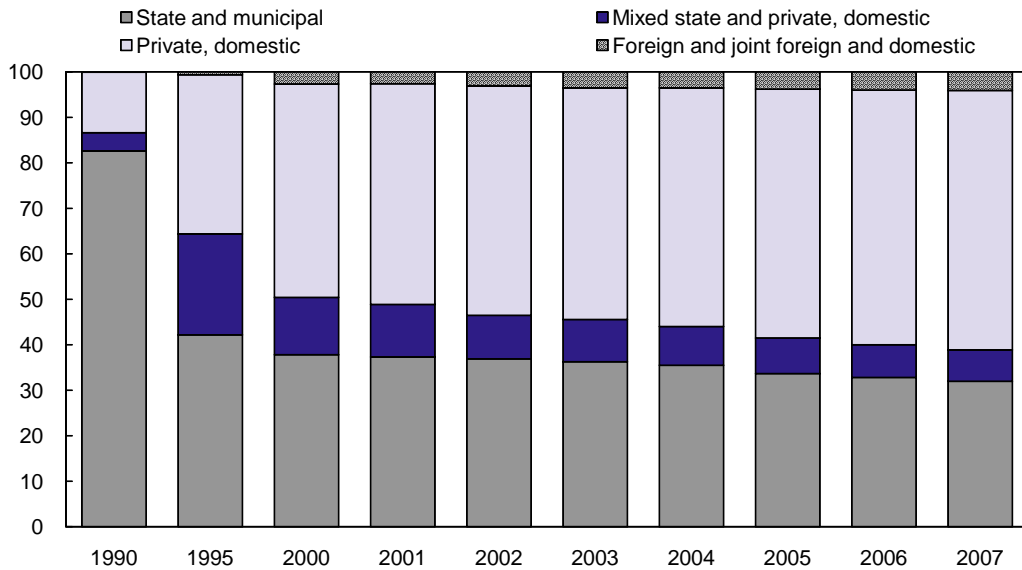
14. The Federal Service for State Statistics uses the following classification of ownership forms: fully state-owned; mixed state and private, domestic; private domestic; foreign and joint foreign and domestic. Fully state-owned include general government and SOEs: where possible, distinction between the two was made in the data presented in the survey. Mixed state and private does not differentiate between majority and minority state holdings. Joint foreign and domestic may include enterprises that have both state and foreign ownership. Enterprises owned by SOEs are classified as private. Based on this classification, some large state-controlled companies are not included in either the fully state-owned or mixed state and private categories. Examples include Gazprom, the largest Russian company; Gazprom Neft, a subsidiary of the Gazprom group; Rosneft, one of the largest companies in the Russian oil industry.

15. Cited in Sprenger (2008)

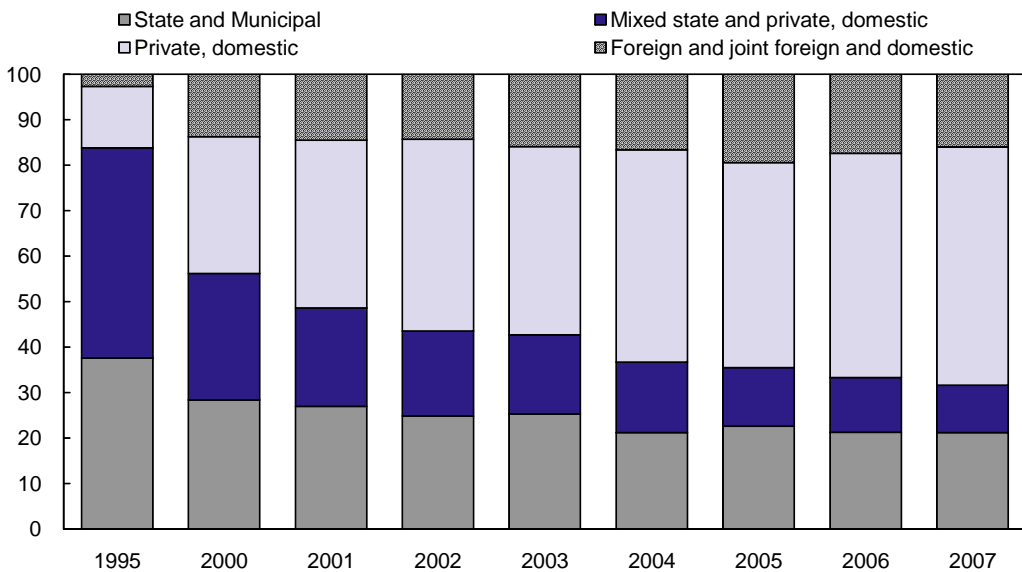
16. This increase reflected: increases in government minority holdings to controlling interests (e.g. Gazprom), previously private enterprises being bought by SOEs, and large SOEs undertaking initial public offerings.

**Figure 5. The size of the public enterprise sector**

**A. Employment share by firm ownership type**



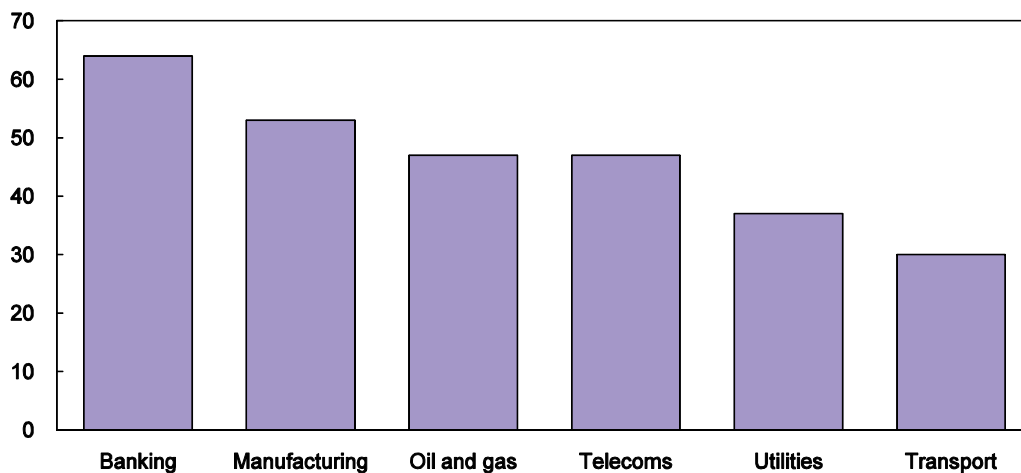
**B. Capital investment share by firm ownership type**



Source: ILO, Federal Service for State Statistics and OECD estimates.

24. As well as being relatively large in size, SOEs operate across a diverse range of sectors, many of which are inherently competitive (Figure 6). Indeed, according to the PMR indicators, Russian SOEs are more ubiquitous across different sectors of the economy than in all OECD countries with the exception of Poland (Table 2, Figure A2.1).



**Figure 6. The state-owned share of listed companies by sector**

Note: As of 21 November 2007.

Source: Troika Dialog (2008).

#### *Improving the corporate governance of the SOEs*

25. The results of the PMR indicator exercise imply that the Russian government exercises considerable control over the SOEs that goes beyond normal ownership oversight. This can have a negative impact on competition in the sectors in which SOEs operate. First and foremost, because government is a major market player, policymaker and regulator in network industries, there is often no clear separation between the ownership function and other functions that influence market conditions. For example, the government uses its ownership role to pursue its industrial policy objectives and has recently announced that it will use the SOEs to create vertically integrated industrial structures that are robust to international competition.

26. As well as having to fulfil non-commercial obligations, the governance of many SOEs is also adversely affected by political interference and the use of civil servants as board members. In many cases, government representatives on SOE boards are instructed by the associated ministry on how to vote on strategic issues and there are widespread reports of Russian government officials using their influence on SOEs to promote political or individual goals that diverge from commercial motives and investor interests. In general, these instructions are not made public. In some sectors the government holds a 'golden share' granting it veto power over the strategic choices of the incumbent state-owned firm. Because they dominate some markets, political interference in the operation of the SOEs not only threatens their profitability but also adversely influences overall market conditions. In 2008, the government announced that it would promote the appointment of independent directors not bound to vote according to government instructions, to SOE boards. In July 2008, independent directors were appointed to 11 SOE boards. This positive development needs to be expanded across a larger number of SOEs.

27. There are a number of other ways in which corporate governance in the state enterprise sector could be improved to ensure a level playing field and government neutrality in its dealings with the private sector (Box 1). First, the commercial and non-commercial roles of the SOEs need to be transparently unbundled with the latter transferred back to the relevant line ministry. Any remaining legitimate non-commercial obligations and responsibilities that SOEs are required to undertake in terms of public services should be clearly mandated by laws or regulations. These obligations should

be disclosed to the general public and the related costs should be covered by government in a transparent way. This would make the SOEs more attractive to potential buyers and thus is an important prerequisite for economically effective privatisation. In the interests of a level playing field with the private sector, soft budget constraints for the SOEs, which arise as a result of access to subsidies from budget and off-budget state funds, need to first be hardened before being reduced and eliminated. As discussed above, soft budget constraints have been found to mitigate the benefits of improved product market regulation. SOEs should also be exposed to competitive conditions in access to finance and government procurement policies, which currently tend to favour the SOEs. Insulating SOEs from competitive conditions will only serve to prolong existing inefficiencies.

#### **Box 1. Corporate governance of state-owned enterprises in OECD countries**

The characteristics of state-owned enterprises (SOEs) raise specific challenges for their governance. Firstly, SOEs are often protected from two major threats that are essential in policing management behaviour: the threat of takeover and bankruptcy. Secondly, accounting and disclosure may be oriented towards public expenditure control and not up to private sector standards. Without appropriate governance arrangements to counter these characteristics the management of SOEs may have more discretion than in the case of private firms and demands on the government's budget for investment and expansion programmes may become excessive.

Governments of OECD countries have faced complex issues and trade-offs in reforming the corporate governance of SOEs. Achieving a sound organisation and effective exercise of the ownership function within the state administration requires an ownership policy that is active while at the same time avoiding undue interference in day-to-day management. In addition, the chain of accountability needs to ensure that the boards and management of SOEs make responsible decisions with appropriate information disclosure to the public. It is also necessary to clearly separate state ownership from the regulatory and policy-making roles and ensure that efficient decision making processes are in place.

The report *Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries* (OECD, 2005a) provides a comprehensive inventory of current practices and recent experiences in reforming governance arrangements for SOEs in OECD countries. Reform has focused on a number of areas including the way in which the boards of SOEs are nominated, their composition, functions, and the way they perform their main tasks. Disclosure rules, for the SOEs themselves and the ownership entity within government, have also been reformed in a number of countries as have provisions to protect minority shareholders, where they exist, and the way in which SOEs relate to stakeholders.

Incentive structures and the ways in which senior executives in SOEs are nominated and remunerated has also been the target of reform. Provided they are soundly structured and effectively implemented, governance reform can improve SOE efficiency and access to capital, while contributing to fair competition by ensuring a level-playing field between companies in the private and public sectors. Better corporate governance of SOEs can also strengthen overall public governance through better transparency and improve fiscal discipline. OECD experience has also shown that good corporate governance of SOEs is an important prerequisite for effective privatisation, since it makes the enterprises more attractive to prospective buyers and enhances their commercial value.

To help governments meet the challenges of public sector governance the OECD has published guidelines on the corporate governance of SOEs (*OECD Guidelines on Corporate Governance of State-Owned Enterprises*, OECD, 2005b). In broad terms, these guidelines cover the following areas: *i)* Ensuring an Effective Legal and Regulatory Framework for SOEs; *ii)* The State Acting as an Owner; *iii)* Equitable Treatment of Shareholders; *iv)* Relations with Stakeholders; *v)* Transparency and Disclosure; *vi)* The Responsibilities of Boards of State-Owned Enterprises. These guidelines complement the OECD's Corporate Governance Principles (Revised 2004) and have been widely endorsed and welcomed by OECD and non-OECD governments.

28. Once the rule of law has improved in Russia, consideration should be given to moving towards a more centralised model of SOE management where SOEs are put under the responsibility of an investment agency. This would facilitate a more unified and consistent ownership policy, distance SOEs from excessive political control, simplify the often elaborate and non-transparent structures currently in place to supervise and control SOEs and ensure equitable treatment of non-state shareholders by preventing politicians and government bureaucrats from pursuing objectives outside the SOE's commercial interests. A centralised management model would also improve standards of transparency and disclosure as well as corporate responsibility more generally, which have been relatively low in Russia, not only compared to OECD countries but also other emerging markets (OECD, 2008b).<sup>17</sup> However, centralising the ownership function of the SOEs requires full accountability to parliament and a high level of transparency so as to avoid the political capture of the investment agency.

*Privatisation needs to be restarted*

29. Since the late 1980s, the privatisation experiences of many developed and developing countries have shown that private ownership typically leads to improvements in firm profitability, output and efficiency (*e.g.* Megginson and Netter, 2001; Kikeri and Nellis, 2004). In the Russian context, despite serious deficiencies in the privatisation process, the evidence suggests that privatisation has still resulted in improvements in firm performance. Although studies of former SOEs vary widely in their assessment of the size of the benefits of privatisation, virtually all report improvements in firms' sales and productivity performance. In addition, compared to SOEs, privatised firms in Russia are more flexible in response to shifts in demand, more innovative and more likely to adopt modern management techniques quickly (OECD, 2005c; Tompson, 2002). Stock market listing for SOEs has also been found to improve their transparency, although having publicly traded debt can also enhance transparency (Kochetygova *et al.*, 2005). Despite the benefits, however, privatisation in Russia has slowed over recent years. Although the privatisation of small and medium-sized SOEs has continued, there have been only a few major privatisation transactions over the last three years, mostly auctions of generation companies as part of the reform of the electricity sector.

30. A significant obstacle to further major reductions in the government's portfolio of SOEs is restrictions on privatisation and foreign ownership in a range of sectors and firms that are deemed to be strategic. In 2004, a presidential decree was issued with a list of more than 1 000 strategic enterprises that require the approval of the president for privatisation and new share issues. The list includes enterprises operating across a wide range of sectors, such as the energy sector, the aircraft industry, shipbuilding, car manufacturing, banking and forestry. This list is extensive and leaves only a relatively limited number of sectors completely outside of state control. As such, it constrains the prospects for future significant privatisation and needs to be cut back. In addition, the law on strategic industries that came into force in May 2008 requires government approval for acquisitions that would result in foreign control over a company operating in one of 42 sectors deemed to be strategic (Box 3). On the other hand, the transformation of unitary enterprises, which do not have ownership shares but

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17. Kochetygova *et al.* (2005) find that the transparency of Russian SOEs is worse than the 10 largest listed Russian companies and much worse than state-owned firms in Western Europe and North America. They also report that disclosure by Russian SOEs is prone to one-off lapses at critical junctures, which have a major bearing on companies' strategies and performance. These lapses usually occur when significant stakeholder interests are at risk and undermine Russia's ability to attract capital at competitive rates, to build efficient and trusted institutions, and maximize its economic growth.

are fully controlled by federal, state, or municipal governments, into joint-stock companies is making them more transparent, and may be a first step towards a later privatisation.<sup>18</sup>

31. Once the corporate governance of the SOEs has been improved, the privatisation programme needs to be stepped up, especially in the competitive sectors of the economy. Offering more opportunities for a positive contribution from the private sector and for beneficial competition would be more in line with the government's declared strategy of modernising and enhancing the competitiveness of the Russian economy. Although the method of privatisation will need to be assessed on a case-by-case basis, mixed sales, which combine strategic sales with public share offerings, have the potential advantages of developing strong corporate governance structures and introducing new management and technology into the company. For SOEs operating in network sectors in which there are monopoly elements, the regulatory environment needs to be consistent with private ownership and competition prior to privatisation (see below).

*The line between the public and private sectors is blurred*

32. The PMR indicators also signal a high level of government involvement in the private business sector. In part, this reflects a prevalence of command and control type regulation that can give rise to seemingly arbitrary policy decisions. For example, the Russian government owns an exceptionally large number of 'golden shares' in private-sector companies that allow it to have seats on boards even when it does not own any conventional shares. These golden shares, which allow the government to veto the firm's commercial decisions, were often created as part of the privatisation of firms operating in sectors deemed to be of strategic importance. Data presented in Sprenger (2008) indicate that on 1 January 2007, the Russian government owned golden shares in 181 companies in which it had no conventional equity stake. There are also cases where regional and municipal governments appoint board members for privately owned firms despite not holding any conventional or golden shares.

33. Allowing the state to exercise a level of control beyond the level of risk implied by its ownership stake carries with it the potential for abuse. Government should, therefore, eliminate the use of golden shares and disclose shareholder agreements and capital structures that allow it to exercise control over a firm that is disproportionate to its equity stake.

34. Other aspects of Russia's regulatory regime also indicate a high prevalence of "command and control" type regulation. For example, universal service obligations are used more extensively in Russia than in OECD countries. In addition, alternative approaches to command and control regulation that are designed to influence incentives are not routinely assessed as part of the policymaking process. If the Russian government wishes to encourage a vibrant private sector it will have to rely less on direct intervention in the economy and instead work towards creating a quality regulatory environment.

***Barriers to entrepreneurship restrict private sector development***

35. Low *barriers to entrepreneurship* are an important condition for creating competitive markets. Russia performs well in some of the regulatory areas covered by this indicator (Table 3), reflecting the implementation of major reform of business regulation early this decade and ongoing

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18. Unitary enterprises are regulated under the Law on State and Municipal Enterprises. They generally do not disclose financial information but are audited by the Audit Chamber of the Russian Federation. They have only limited rights over their property and many types of transactions that they undertake have to be approved by the corresponding government agency.

**Table 3. Barriers to entrepreneurship**

2008

	Russia	OECD average	OECD emerging markets <sup>1</sup>	Euro area <sup>2</sup>	United States
Barriers to entrepreneurship	1.78	1.41	1.91	1.26	1.24
Regulatory and administrative opacity	1.00	1.00	1.18	0.64	0.19
Licenses and permit system	2.00	1.78	2.00	1.20	0.00
Communication and simplification of rules and procedures	0.00	0.22	0.35	0.09	0.38
Administrative burdens on start ups	2.32	1.53	2.70	1.61	0.99
Administrative burdens for corporations	2.33	1.62	2.79	1.60	0.75
Administrative burdens for sole proprietor firms	3.00	1.61	2.75	1.78	1.25
Sector-specific administrative burdens	1.64	1.35	2.55	1.46	0.97
Barriers to competition	2.01	1.69	1.87	1.53	2.53
Legal barriers	2.00	1.07	1.14	0.81	1.14
Antitrust exemptions	1.16	0.50	0.61	0.00	2.25
Barriers in network sectors	2.22	1.94	2.29	1.69	3.07
Barrier to entry in services	2.67	3.25	3.43	3.61	3.64

1. Czech Republic, Hungary, Korea, Mexico, Poland, Turkey.

2. Austria, Belgium, Finland, France, Germany, Italy, Luxemburg, Netherlands, Portugal, Spain.

efforts to improve the efficiency of the public bureaucracy.<sup>19</sup> In particular, the indicator of regulatory and administrative opacity is comparable to the average for OECD countries. This reflects improvements in the communication and simplification of rules and procedures including the introduction of plain language drafting and systematic procedures for publicising new regulations. The indicator of the licence and permits system is also around the average for OECD emerging markets, following the introduction of one-stop shops (OSSs) that deal with applications for notifications and licenses. However, despite these efforts, the administrative burden that the government places on entrepreneurs starting a new business, whether they are corporations or sole traders, is still very high and acts as an obstacle to new entry. These high indicator values could also be indicative of more widespread inefficiencies in government administration and reflect ongoing difficulties in reforming the public administration, creating new regulatory institutions and implementing market-orientated forms of regulation.

#### *Regulatory and administrative opacity has improved...*

36. The indicators of *regulatory and administrative opacity* in Russia compare favourably internationally, reflecting continuing efforts to improve the effectiveness of public administration. A programme to reduce administrative burdens imposed by the state on enterprises and citizens has been launched by the Ministry of Economic Development. This programme includes explicit quantitative targets for burden reduction and uses a range of different strategies, including extensive use of ICT. Another initiative designed to reduce red tape is the introduction of OSSs for providing

19. A series of federal laws adopted over this period simplified rules and procedures related to the entry of new businesses and reduced the administrative burden on existing companies. See OECD (2002a), OECD (2006), Yakovlev and Zhuravskaya (2008).

information on notifications and licenses. In some cases, OSSs are also used to issue or accept notifications and licenses. The essential idea of the OSSs is that potential investors only need to be in contact with a single entity to complete all the necessary paperwork and applications in a streamlined and coordinated process, rather than having to go through a labyrinth of different government bodies. In practice, given the impracticalities of assuming full control of the approval process, OSSs tend to act as a coordination mechanism between relevant government authorities.

37. To be effective in reducing administrative burdens, OSSs need to be implemented along with other reforms geared towards cutting red tape. In the absence of such measures, OSSs run the risk of simply adding another layer of bureaucracy to the approval process. Indeed, because OSSs provide a focal point for investment clearance, they can act as important catalysts for improving administrative processes and cooperation across government departments.

38. Closely related to the OSS concept is the idea of “deemed clearance”, under which licenses are issued automatically if the licensing office does not act by the end of the statutory response period. Deemed clearance regimes, which are not currently used in Russia, can be an effective method of enhancing the single window concept if they are set and implemented judiciously. However, the administrative system must be reformed to the point where it is capable of meeting these statutory response periods. The objective is not to circumvent regulation but to implement and enforce it as efficiently as possible.

*... but administrative burdens on start-ups remain excessive and act as a barrier to entry*

39. The PMR indicators demonstrate that despite continuing efforts to improve the functioning of the public bureaucracy, *administrative burdens on start-ups* remain high compared with other countries (Figures A2.7-A2.8). The number of mandatory procedures involved in the creation of new companies, as well as the number of agencies involved and the total cost of start-up procedures are higher in Russia than in most OECD economies. By way of confirmation, the World Bank’s *Doing Business* indicators, which also assess administrative burdens on start-ups, rank Russia 106th out of 183 countries in 2010 in terms of the ease of setting up a new business. This is a deterioration of 18 places compared to the results for 2009.

*Administrative reform needs to support the regulatory environment*

40. As noted before, various enterprise surveys point out that despite a considerable progress with deregulation, the administrative burden remains high. This suggests that barriers to entrepreneurship in Russia stem not from formal regulations but in large part from informal and often corrupt practices on the part of government officials. This increases compliance costs, especially for small firms, and discourages firm expansion into the formal sector, thus restraining competition and productivity.

41. With an interventionist tradition and administrative structures that have in many cases not kept pace with economic liberalisation, a significant reengineering of administrative processes is needed to improve the functioning of the Russian government bureaucracy. Reforming formal laws and regulations will have only a minimal impact on economic performance in the absence of major improvements in the functioning of state institutions. The public bureaucracy needs to become much more accountable and efficient so as to simplify the interaction between government and firms and citizens.

42. Establishing a coordinated programme of administrative reform to improve the functioning of the public bureaucracy requires institutional change and is complex and time-consuming. In addition, a long-term strategy for regulatory reform needs to be explicit, coherent and supported by the

highest levels of government. Recognising the scope of this challenge, many OECD governments have established regulatory oversight bodies with “whole-of-government” responsibility for regulatory policy. One advantage of this approach is that it promotes a consistent and systematic method of reform across the entire administration. In addition, OECD experience has been that regulatory reform will often fail if left entirely to ministries, implying that a degree of centralisation can improve the chances of successful reform.

43. The Russian government is well aware of the importance of improving the quality of public administration and, as discussed above, has moved some way towards becoming a more service-oriented facilitator of private-sector entrepreneurship. At present, however, although ministries are obliged to consult with other government departments before drafting new laws, there is no centralised oversight body charged with reviewing regulatory proposals to ensure they do not impose unnecessary or unreasonable administrative burdens on firms and citizens. This important task would involve the use of regulatory impact analysis (RIA) to assess the benefits and costs of significant proposed new regulation. A regulatory oversight body could also develop guidelines on the standards of good regulation and the use of alternatives to traditional command-and-control regulation. Once developed, individual ministries would need to adhere to these principles of regulatory quality in their area of competence. New ways of measuring the impact of administrative regulation would also need to be developed to identify areas of high administrative burden (OECD, 2006). An oversight body could also help to better integrate the administrative functions of the federal and regional governments, thereby ensuring that progress in regulatory reform is more uniform across the Federation.

44. A centralised and fully-functional regulatory oversight body would go against a tradition of ministerial independence in regulatory matters and could therefore meet with strong resistance. This implies the need for a careful balancing act between cooperation and confrontational relationships with ministries. The need for political support means that the relevance of regulatory reform to larger social and economic goals must be clarified and clearly communicated to all concerned. Ideally, the objectives of the regulatory oversight body should be outlined as part of an explicit regulatory policy that sets out reform priorities and the tools and institutions used by government to shape their regulatory power. The OECD experience has been that countries consistently make greater progress when they have an explicit regulatory policy. As noted in OECD (2002b), “the more complete the principles, and the more concrete and accountable the action programme, the wider and more effective the reform”.

*Underdevelopment of SMEs is one sign of the presence of formal and informal barriers to entrepreneurship*

45. Smaller businesses are particularly vulnerable to bureaucratic interference because, compared to larger enterprises, they are less able to bear the costs of administrative burdens. The underdevelopment of SMEs in Russia compared to OECD economies indicates that despite substantial efforts to improve the operating environment for small businesses, barriers to entrepreneurship remain high. The Russian government recognises the importance of SMEs in fostering competition and addressing social problems and has devoted significant efforts to promote SME development over recent years. Important legislative initiatives have been implemented and more are in the pipeline (Box 2).

### Box 2. Government policy on SMEs

The share of GDP produced by SMEs in Russia is estimated to be around 13-17%, significantly below the level in most OECD countries. SMEs, including individual entrepreneurs, account for only about a fifth of total employment in the Russian economy, again substantially below most OECD economies. The government views SME development as a major priority for economic policy. The programme on long-term socio-economic development of the Russian Federation targets an increase in the share of SMEs in GDP and employment to 30% by 2020. Over this period, the government envisages a steep rise in the number of SMEs accompanied by structural changes, with more SMEs present in healthcare, science, information services and utilities, and relatively fewer in retail trade, a sector where a significant proportion of SMEs currently operate.

The framework for government SME policy was outlined in the new law on SME development adopted in 2007. The law defines an SME as a business entity meeting the following criteria: 1) state and foreign ownership together does not exceed 25%; 2) ownership by non-SME entities together does not exceed 25%; 3) headcount does not exceed 250 employees for medium-sized enterprises, 100 for small enterprises and 15 for microenterprises; 4) annual turnover does not surpass the threshold set by the government once every five years. The following turnover thresholds were set in 2008: 60 million roubles a year (*i.e.* USD 2.6 million at that time, but less than USD 2 million a year later) for micro enterprises, 400 million roubles for small and 1 billion roubles for medium enterprises. The breakdown by three types of SMEs, which was previously absent from legislation, is identical to the norms adopted in the European Union (EU). The thresholds for employment are similar to those applied in the EU, and the turnover thresholds are also in line with the EU practices, although fixing such a threshold for 5 years may prove restrictive in Russia's high-inflation environment. The implementation of this norm is, however, postponed until 1 January 2010, so until this date the government may revise the current threshold.

Beyond definitions, the law stipulates a number of measures that should be implemented to advance SME development, including simplified accounting and taxation, special treatment as suppliers for government procurement, protection against excessive inspections, aid with property, and financial and advisory support. The law itself does not provide any specifics beyond the definition of SMEs and therefore additional legislative acts outlining specific measures were needed. Little happened in the months following adoption of the law on SME development, but shortly after his inauguration in May 2008 President Medvedev signed a decree on urgent measures to eliminate administrative barriers to entrepreneurship that required a speedy development of such legislation. Several legislative initiatives have been implemented since. In July 2008, a law was adopted giving SMEs pre-emptive rights to purchase state property they have leased for at least three years. A new law came into force on 1 May 2009, which limits scheduled inspections of SMEs to one every three years, while any unscheduled inspection now requires an authorisation of the Prosecutor General. The same law introduces a notification mechanism for 13 types of business activities including retail trade, hotel and restaurants and publishing. Other implemented measures include reduced tariffs for access to electrical grids and the extension of the obligatory state contract quota of 10-2% reserved for small businesses to purchases by municipalities.

Since the onset of the global financial and economic crisis, the government has intensified its efforts to support small business, with an aim of casting immediate measures to alleviate the consequences of the crisis into the medium-term framework of SME development. The government pledges an increase in budget expenditures to 10.5 billion roubles in 2009 directed at SME support, such as grants to new entrepreneurs, development of microfinancing and interest rate subsidies. 30 billion roubles will be injected into the capital of *Vneshekonombank* which should be used to finance commercial banks and a variety of non-bank financial entities working with SMEs. More measures are in the pipeline, including reducing the list of products requiring certification, support for SMEs involved in innovation, non-discriminatory access to gas infrastructure, etc. The government will also work on improving already adopted legislation, for example, on the pre-emptive rights of SMEs to buy out state property they occupy.

46. The government efforts to develop the SME sector are welcome. As usual, implementation of the adopted measures will remain a key issue. The limit on foreign ownership for SME support, a novelty of the 2007 law, is, however, a surprising development. While such a restriction exists in a



few OECD member countries, it may nevertheless be worthwhile to reconsider this move, not least because of an unintended side effect: possibly burdening the large number of resident former Soviet Union citizens running small businesses in Russia.

*Corruption is endemic and stifles entrepreneurship*

47. Overly complex administrative procedures also increase discretion within the government bureaucracy, thereby facilitating corruption opportunities. Consistent with heavy administrative burdens, Russia is ranked 146th out of 180 countries in the Transparency International 2009 Corruption Perceptions Index. This puts Russia's on a par with Kenya, Zimbabwe and Sierra Leone, and indicates that corruption and bribery are so widespread that they are perceived to be a normal part of business activity.<sup>20</sup>

48. Combating corruption remains a major reform challenge. Reflecting this challenge, an Anti-corruption Council headed by President Medvedev was established, and the National Plan on Counteracting Corruption approved in July 2008. A series of anti-corruption bills has been adopted since, including the Federal Law "On Counteracting Corruption" and various amendments to the existing laws. The implemented legislative initiatives aimed at strengthening public control over politicians and senior bureaucrats, such as a requirement to publicise incomes and financial assets of their family members, as well as measures to prevent and manage conflict of interest, are welcome. Increasing the transparency and accountability of state institutions is an important part of the solution to the problem of rampant corruption. Administrative reform needs to mitigate the potential for corruption by minimising uncertainty and subjective decision making within the government administration. Further reductions in licensing and other formal regulatory burdens would reduce bureaucrats' opportunities to extract bribes from private-sector firms. Judicial and civil service reforms would improve the fairness, transparency and efficiency with which remaining regulations are administered.

49. An important consideration with efforts to reduce corruption is that they filter down department hierarchies and are effectively implemented at the lower levels. Training seminars, performance based pay scales, and promotions based on merit would all help in this regard.

*Government disregard threatens the effectiveness of competition policy*

50. The disregard for competition law by the authorities is apparent from the fact that 53% of the total number of violations of antitrust law in 2007 was committed by various levels of the Russian government. These violations cover a range of actions including combining functions of executive authorities and economic entities, making anticompetitive agreements, restricting the free movement of goods and transferring assets to the private sector without a competitive tender. 80% of the violations were committed by the regional and municipal authorities. Those actions distort markets and can have a catastrophic effect on competition. Breaches of the law by regional authorities seeking to protect local markets from outside competition constitute an administrative barrier to entry that can result in monopolised markets at the regional level.

51. Several legislative initiatives implemented over the last few years have sought to reduce the opportunities for anticompetitive behaviour by the authorities. The 2005 law on government procurement has fostered transparency of government purchases of goods and services by, in particular, requiring that information about prospective tenders be published on the internet. To strengthen the effectiveness of government grants and to prevent discriminatory practices, the

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20. See OECD (2006) for a review of other available indicators on corruption.

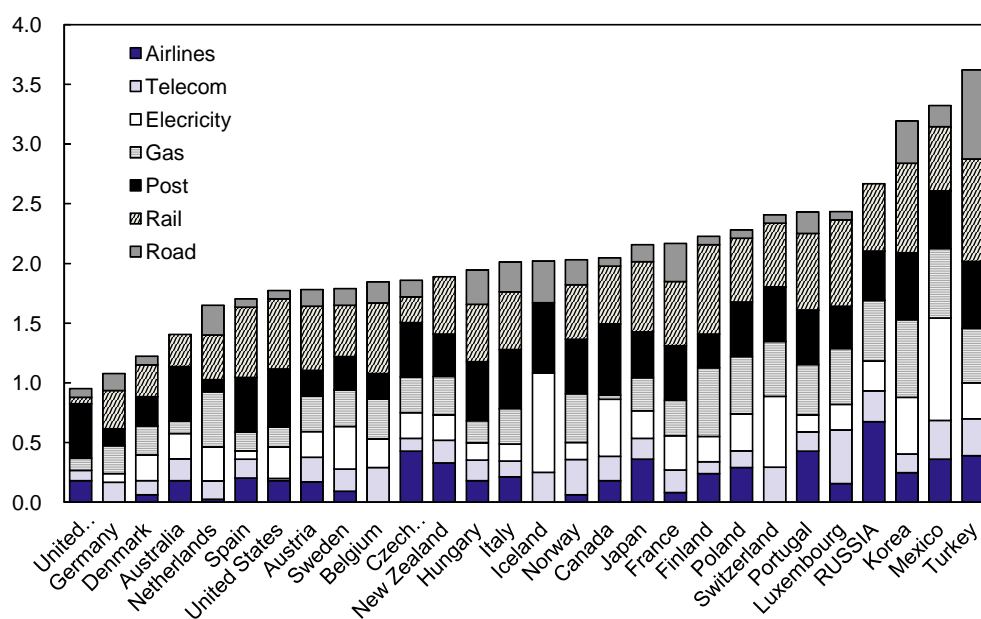
2006 competition law introduced antimonopoly control of state and municipal aid. The law outlines an exhaustive list of the types of the state aid considered to be legal and requires the competition authority’s approval of granting such aid. The amendments to the competition law adopted in 2008 make obligatory a competitive tender for most transactions involving state property. Although these are positive developments, the fact that many violations of competition law by the authorities were committed by repeat offenders in 2007 suggests that the sanctions for infringements are currently inadequate. The recently adopted amendments to the Administrative Code that impose sanctions against the government officials for breaking competition law, including a ban on occupying a government position for up to three years, are welcome.

*The regulatory regime is highly variable across network sectors*

52. In some of the network sectors Russia scores comparatively well in the PMR framework with indicator scores below the OECD average in 2007. In other sectors, however, the regulatory regime is assessed to be highly restrictive (Figure 7).

**Figure 7. Level and heterogeneity of regulation in network sectors**

Contributions of each sector to aggregate indicator



Source: OECD indicators of regulation in energy, transport and communications (ETCR).

53. In the electricity sector, since 2003 the government has pursued a liberalisation strategy that includes unbundling and partially privatising the incumbent, a joint stock company “Unified Energy System of Russia” (RAO UES). Prior to reform, the electricity sector was highly vertically integrated with RAO UES controlling all large-capacity non-nuclear generation assets, 72 regional utilities with local monopolies on distribution and supply, and the transmission system (OECD, 2004; OECD, 2008b). Under the reform agenda, the transmission grid and system operation have been hived off into two separate companies, both state-owned. Electricity generation assets have been dispersed into a number of separate companies, all of which were initially owned by RAO UES. By end-2007, nearly all newly created generation companies had been listed on the stock exchange and the state and

RAO UES had divested some of their holdings in these companies. By end-June 2008 RAO UES's divestment was complete and the company ceased to exist. However, the state is estimated to have retained between one quarter and one third of national generation capacity in 2008, including 100% ownership of all nuclear plants (OECD, 2008b). Reflecting recent acquisitions, state ownership of generation assets has since increased to more than 50% (Renaissance Capital, 2009).

54. In addition to unbundling and partial privatisation, price formation policies in the electricity sector are also being reformed. In the wholesale electricity market, 50% of contracts between distributors and generation companies are regulated by the Federal Tariff Service while the remaining contracts are traded on a limited spot electricity market.<sup>21</sup> Regulated prices are being increased to bring them more into line with market levels and cross-subsidies eliminated. The government also plans on liberalising retail markets in parallel with the wholesale market with the goal of having all electricity prices set by the market by 2014. Given current investment requirements and expected robust demand growth, private sector participation in the electricity sector is imperative, implying that this reform schedule must be adhered to or, ideally, accelerated.<sup>22</sup>

55. The mobile telecom market is also reasonably well regulated with minimal barriers to entry. As a consequence, this market is predominantly comprised of private sector firms, including some with foreign involvement. In a number of cases, these companies have successfully expanded into the Commonwealth of Independent States region.<sup>23</sup> In contrast to mobile telecoms, the fixed-line market remains under state control. The state-owned and vertically-integrated incumbent, Svyazinvest, has controlling stakes in the seven regional fixed-line telecoms companies and in Rostelcom, which has a monopoly in long-distance and international calls. Privatisation of Svyazinvest has been under discussion for a long while, but so far the government has maintained full ownership. The introduction of competition into the telecoms market has brought large benefits in most OECD countries and should be pursued in Russia.

56. In a number of other network sectors, very little effort has been made to introduce competition. For example, the regulatory environment in the gas sector has become less conducive to competition over recent years. In 2005, the government increased its holdings in Gazprom to a controlling interest. At the same time, Gazprom has pursued an active acquisition policy, which extends well beyond its core activities. Gazprom has a monopoly over the gas transport network as well as Russian gas exports.

57. In a number of transport sectors, competition problems remain rife. In the air transport sector, some international routes are served by only one operator with pre-agreed fares, number of flights and landing slots. The air cargo market is highly concentrated. Urban passenger transport markets are usually dominated by local carriers which enjoy a monopoly courtesy of the municipal authorities, who depend on licence fees for revenues. Despite earlier reforms in rail transport, a number of problems, such as cross-subsidisation from freight to passenger services, continue to impede private entrants. Developing the transport infrastructure would aid in the elimination of barriers to intraregional trade and expand markets.

58. The Federal Antimonopoly Service reports a large number of violations of law across infrastructure sectors. In conjunction with a high level of government ownership in a number of

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21. As of July 2009.

22. A full description of reform in the electricity sector is given in Annex A1.

23. For example, MTS, the largest Russian mobile operator, controls the leading mobile companies in the Ukraine, Belarus and Uzbekistan.

sectors and regional monopolies, this implies a need for strong and independent regulation. Although regulators exist for a number of sectors, they are subordinated to the ministry of the sector they regulate in virtually all cases. Furthermore, in many cases the ministry can give instructions to the regulator and overturn its decisions. As well as separating the ownership function from line ministries, the separation of the regulatory function from the policy making and ownership functions in infrastructure sectors with a monopoly element is an equally important prerequisite for establishing efficient markets, attracting increased private sector participation, and reducing the risk premium required by private investors.

59. Independent regulators need to strike a balance between promoting efficiency gains and attracting investment while protecting consumers from potential monopolist abuses and firms from political interference. This is no easy task, and delegating regulatory powers to independent bodies is not without risks. For example, an independent regulator might slow structural change or become captured by firms in the sector, losing the sense of a broader market vision. To mitigate these risks and generate the expected benefits of a high quality regulatory environment, independent regulators need to be based on proper institutional design within strong governance frameworks. Independence should go hand-in-hand with accountability, stability and expertise. Accountability requires that the decision-making process be transparent and subject to clear and simple procedural requirements and checks and balances, including opportunities for public hearings and appeal provisions. In OECD countries, regulators have been most effective and credible when their independence and roles are made explicit in a distinct statute with well-defined functions and objectives.

#### *Improving the competition policy framework*

60. The competition policy framework has been steadily improved over recent years. In 2007, the Federal Antimonopoly Service was given the power to negotiate fines and grant leniency in combating cartels, powers which have become common practice in a number of OECD countries. In addition, with 43% of competition law abuses committed by repeat offenders in 2007, the penalties for infringing competition law were increased substantially and calculated as a percentage (from 1 to 15%) of the offending company's turnover in the market where the law was breached. Given the generally weak state of competition in Russian product markets, these are all positive developments. However, if the Federal Antimonopoly Service is to effectively fulfil its important role, its operational power needs to be bolstered to allow greater use of inspections and the collection of physical evidence in antitrust cases.

61. Competition policy involves more than dealing with monopolies, mergers and anticompetitive practices in the business sector. In particular, the framework needs to be able to ensure that policy proposals issued by the government are compatible with competitive markets. An additional challenge in the case of Russia is to ensure that different branches of government respect and are bound by competition law. A useful development in this regard would be to introduce a policy to ensure that all levels of government and economic regulatory agencies take the competition dimension into account when formulating policy.

62. The introduction of such a policy would be a key event that would help bring the issue of competition to centre stage and spread a competition ethos through different levels of government and the private sector. A properly designed policy to support free and fair market competition should emphasise the removal of entry barriers, ensure competitive neutrality between public and private sector enterprises, establish access regimes for network facilities, provide for justification and notification when there is a need to deviate from established principles of competition, and require all government bodies to undertake a competition audit of all existing and proposed policies. As discussed above, a competition policy should also set out the overarching framework for the regulation

of infrastructure sectors with monopoly elements. A programme targeted at reducing violations of antitrust laws by federal and local government should also be initiated and compliance activities of the Federal Antimonopoly Service stepped up along with increased advocacy of competition in government. Enacting such a policy would demonstrate the government's commitment to competition and act as a creditable signal that the objectives of regulatory policy are not going to change.

***Despite some improvements, barriers to international trade and investment remain high***

63. To a significant extent, Russia's long-term economic development depends on innovating through adapting production techniques and know-how developed abroad. Both international trade and foreign direct investment encourage domestic firms to incorporate foreign technologies into the production process, thereby facilitating technological diffusion. Equally, foreign affiliates tend to be more capital- and skill-intensive and invest more in research and development than domestic firms in the same industry (Keller, 2004; Keller and Yeaple, 2003). As a result, foreign affiliates tend to grow more quickly and make a larger direct contribution to productivity growth in comparison to domestic firms (Criscuolo, 2005) and more outward-oriented countries consistently grow more quickly than relatively closed countries (Srinivasan and Bhagwati, 1999). However, in spite of the potential benefits of international openness, the indicator of *barriers to international trade and investment* signals a high degree of restrictiveness across the board in Russia compared to OECD countries (Table 4). As well as directly improving the performance of the Russian economy, a deeper integration into the global economy *via* increased trade and FDI would also provide an important catalyst for ongoing domestic reform. For these reasons, Russian membership in the WTO and other international and bilateral agreements needs to be actively pursued.<sup>24</sup>

**Table 4. Barriers to international trade and investment**

2008

	Russia	OECD average	OECD emerging markets	Euro area	United States
Barriers to trade and investment	3.11	0.59	1.04	0.50	0.18
Explicit barriers to trade and investment	2.62	0.99	1.70	0.87	0.37
Foreign ownership barriers	3.50	1.29	1.68	1.38	1.11
Discriminatory procedures	1.38	0.54	1.09	0.24	0.00
Tariffs	3.00	1.13	2.33	1.00	0.00
Other barriers	3.60	0.18	0.38	0.13	0.00
Regulatory barriers	3.60	0.18	0.38	0.13	0.00

1. Czech Republic, Hungary, Korea, Mexico, Poland, Turkey.

2. Austria, Belgium, Finland, France, Germany, Italy, Luxemburg, Netherlands, Portugal, Spain.

Note: Index scale of 0-6 from least to most restrictive

***Tariff barriers need to be reduced and simplified***

64. Since the state monopoly on foreign trade was removed in 1992, tariffs have progressively replaced non-tariff barriers as the principal instrument for regulating foreign trade. This has increased the transparency of trade barriers and eliminated some corruption opportunities. As part of its bid for WTO membership, Russia has also accelerated the harmonisation of its trade regulation with

24. Russia is currently the largest economy outside of the WTO.

international norms. However, the trend towards trade liberalisation engenders staunch resistance from administrators and sectoral interest groups. As in other countries, such resistance is particularly hard to counter in economic downturns, as the sharp increase in Russian tariffs on imported cars in late 2008 attests.

65. Assessing the structure of Russia's tariff system is complicated by the widespread use of a combined tariff system under which customs officials apply the maximum of the *ad valorem* or specific tariff on imported goods. Shepotylo and Tarr (2007) estimate that Russia has over 11 000 tariff lines, of which about 1 700 use the "combined" tariff system. Taking this tariff structure into account, the authors find that average tariff rates in Russia increased from 2001 to 2003 but were then broadly stable between 13 and 14.5% to 2005. This average tariff rate is higher than in all OECD countries and most non-OECD middle-income countries. Further, despite the implementation of a programme to simplify the tariff structure in 2000-01, the dispersion in tariff rates is also found to have increased significantly since the beginning of the 2000s, indicating a less uniform tariff structure.

66. Widespread exemptions and variability in the tariff structure result in an inefficient allocation of resources. In addition, increased diversity in the tariff structure encourages lobbying and rent-seeking behaviour and, in the Russian context, presents an opportunity for corruption. In addition to the gains from lower average tariffs, substantial efficiency gains would result from having fewer tariff rates.<sup>25</sup>

*Reductions in FDI barriers would increase productivity*

67. Given its abundant natural resources and large domestic market, Russia has significant potential for attracting FDI inflows. Since 2003, FDI inflows have been growing strongly, more than doubling in 2006, and Russia is now one of the world's leading FDI recipients. Almost half of FDI inflows are in the mining and quarrying sector. As well as attracting large inflows of FDI, many foreign investors consider that Russia offers opportunities for competitive returns on investment. For example, in a UNCTAD survey for 2007-08, the Russian Federation is ranked as the fourth most attractive destination for FDI after China, India and the United States (UNCTAD, 2007).

68. Although inflows of FDI have, until recently, been robust, barriers to foreign ownership are estimated to be high in Russia compared to OECD countries. In part, this reflects the enactment of the law on strategic sectors which came into force in May 2008. This law defines 42 sectors in which control by foreign investors requires prior authorisation from a government commission (Box 3). Although this law increases transparency and is less *ad hoc* than the previous regime, its sectoral coverage is broader and notification delays longer than OECD recommended practice (OECD, 2008b).

69. The emergence of large state-controlled conglomerates with dominant market positions also acts as a barrier to FDI inflows. The scope for foreign investors to acquire equity in these conglomerates or participate in government procurement contracts in the sectors they occupy is strictly limited. There is also evidence of differential treatment of foreign businesses with respect to government procurement and eligibility for government subsidies. Finally, the PMR indicators also signal a lack of provisions encouraging regulators to use internationally harmonised standards and certification procedures or avoid unnecessary trade restrictiveness.

70. Notwithstanding explicit barriers to FDI, the overall regulatory environment in Russia is perhaps the most significant impediment to greater inflows of FDI. A growing body of recent research

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25. See Tarr (2002) for a discussion on the benefits of a uniform tariff structure.

has found that the regulatory environment is a key determinant of FDI. As shown in Nicoletti *et al.* (2003), regulatory policies that restrict market access in one way or another negatively influence the share of foreign direct investment in OECD countries. Conway *et al.* (2006) also find that the employment share of foreign affiliates in manufacturing sectors is higher in countries with relatively more liberal product market environments. Accordingly, reducing state interference in economic activity and carrying out necessary administrative and regulatory reforms would not only increase domestic investment and productivity, but also increase foreign investor interest in the Russian Federation.

### Box 3. The 2008 Law on Strategic Industries

The long-awaited federal law on "Procedures of Making Foreign Investments in Business Entities of Strategic Importance to National Defence and Security of the State" entered into force in May 2008. The law imposes prior governmental approval for foreign acquisitions which would result in 50% and more foreign ownership in a company operating in one of 42 designated strategic sectors. The threshold for foreign acquisitions is reduced to 25% if the foreign investor is a state-owned company, to 10% in the case of foreign investment in mineral exploration and extraction companies and to 5% in such companies if the foreign investor is a foreign state-owned company. The 42 strategic sectors include: defence-related activities, high-technology and dual-purpose sectors (space-related technologies, aviation and activities involving nuclear and radioactive materials) and public communication services (radio and TV broadcasting and printing). In addition, the law concerns natural monopolies as defined by the Russian legislation, except electrical power, municipal heating and postal services.

The 16-member Commission which carries out approval procedures is chaired by the Prime Minister and includes several ministers and heads of public agencies, in particular the Federal Security Service and the Federal Antimonopoly Service, also responsible for implementation of the Commission's rulings. After the registration of the request and its consideration by the Federal Security Service, the Commission has three months to the applicants of its decision with a possible extension of an additional three months.

In introducing the law on strategic sectors, the Russian government has sought to address concerns shared by many other countries to protect essential security interests. It also responded to foreign investors' expectations who wished to see former case-by-case authorisations replaced by clear rules. By defining the sectors and the size of foreign transactions concerned and codifying the conditions of approval procedures, Russia's legislation is in line with the transparency and predictability requirement, one of the three sound policy principles identified in the ongoing discussions within the OECD on policy measures addressing the essential security objectives.

However, Russia's legislation differs from OECD recommended best practices in several important aspects. The sectoral coverage of the Russian law is considerably broader than in OECD countries, which limit essential security interests to the safeguard of the national defence, public order and health. Rather than referring to the monetary thresholds of foreign investment transactions used by OECD countries implementing prior screening procedures, Russia's approach takes into account the share of foreign ownership, differentiated according to the category of investors and sectors. In addition to imposing high restrictions on foreign investment in selected sectors, notably in mineral exploration and extraction, such a complex scheme risks to be perceived as particularly constraining and discouraging to potential foreign investors. Furthermore, taking into consideration the possible extension, the delays for notification of the decisions to the applicants are longer in Russia than in OECD countries applying prior evaluations.

In its current form the new law does include any provisions on the public announcement of approval decisions. Some OECD countries, notably Australia and the United States, have an *ex post* reporting mechanism indicating the number of applications received and the proportion of approvals.

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1. For a more detailed description of the law see the 2008 *OECD Investment Policy Review of the Russian Federation: Strengthening the Policy Framework for Investment*, Chapter 2, OECD, Paris, July 2008.
  2. Freedom of Investment, National Security and 'Strategic' Industries: Progress Report by the OECD Committee, available at [www.oecd.org/daf/investment/foi](http://www.oecd.org/daf/investment/foi).

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## ANNEX A1. REGULATION IN THE RUSSIAN ELECTRICITY SECTOR

1. Beginning in 2003, the Russian electricity sector has undergone an extensive period of regulatory reform and restructuring. The overriding objectives of reform have been to improve the operational efficiency of the sector and encourage large-scale private-sector investment to meet demand shortfalls.

2. The key aspects of the power sector reforms to date and current arrangements in the sector are:

- The potentially competitive and monopoly segments of the market have been separated by vertically unbundling the incumbent operator – RAO UES – into generation, transmission and supply companies. RAO UES has since been disbanded and newly created independent generation and retail companies have been privatised to some extent.
- The transmission assets of RAO UES have been transferred to the Federal Grid Company (FGC), which is owned by the government. The FGC is prohibited from trading electricity and is required to enter into contracts with eligible market participants. Access tariffs are adjusted annually and set on a cost-plus methodology. An independent national system operator has been established to manage electricity flows on the transmission grid serving the wholesale market.
- Eleven Interregional Distribution Grid Companies (IDGCs) are being formed to own and manage the regional electricity distribution networks. The government has 52% equity holding in the IDGCs. The configuration of the IDGCs has changed considerably over the course of the reforms and the process of asset restructuring is still ongoing.
- A wholesale power market has been introduced and is expected to be fully liberalised by 2011. Currently, 50% of wholesale electricity is sold at regulated prices. This amount is expected to fall to 35 to 40% by 2010. By 2011, all electricity on the wholesale market is expected to be sold at unregulated prices. The retail market is expected to be fully liberalised by 2014.
- A range of market institutions and regulators have been established. The Federal Tariff Service (FTS) develops pricing principles and imposes regulated tariffs in the wholesale market. The Regional Tariff Services (RTS) perform analogous roles in the regional distribution networks, subject to thresholds set by the FTS. The Ministry of Energy also plays a key regulatory role in the sector while the Federal Antimonopoly Service (FAS) is responsible for competition supervision and regulating non-discriminatory access to network services. It also regulates the activities of the Administrator of Trade System (ATS), which operates the wholesale market.

3. In principle, the direction of reform in the Russian electricity market is consistent with the establishment of competitive wholesale and retail markets based on transparent prices that accurately reflect costs. Indeed, many of the recent reforms are in line with recommendations made in the

2004 OECD Economic Survey of Russia (OECD, 2004) and the *International Energy Agency's study on electricity reform in Russia* (International Energy Agency, 2005). In practice, however, there are a number of ongoing issues that pose a threat to the establishment of competitive electricity markets

## Market structure

### *Generation*

4. Six Wholesale Generation Companies (WGCs) emerged as part of the unbundling of RAO UES and were assigned generation assets in different energy zones within Russia. In addition, 14 Territorial Generation Companies (TGCs) were formed and acquired generation plants that predominantly supply local businesses and household consumers. Collectively, the WGCs and TGCs each account for around 25% of total installed capacity. A majority state-owned hydro-generating company, RusHydro, was also established and acquired the hydro-electric power plants previously controlled by RAO UES. As well as RAO UES, a number of independent power companies with well-established customers were partially unbundled as part of the reform process, but maintain control of local networks.

5. Despite these reforms, electricity generation in some energy zones remains reasonably concentrated with a few large players that are sometimes highly locally concentrated. In addition, despite a law signed into effect by President Putin in 2003 calling for the state to exit the power generation sector, the Russian government still retains significant ownership of generation assets. According to one estimate, the state currently owns 51% and controls 65% of national generation capacity and is an active force for consolidation in the sector.<sup>26</sup> Diversified ownership is clearly a prerequisite for meaningful competition and ongoing state involvement in electricity generation poses a major threat to an orderly transition to competitive electricity markets. If it is serious about increasing the efficiency of the electricity market and encouraging private sector participation, the state needs to exit the generation sector.

6. Increasing vertical integration into the fuel supply market poses another serious threat to competition in the generation sector. In particular, as a result of recent acquisitions, the natural gas monopoly Gazprom controls a significant proportion of thermal generation capacity in the European zone, while the major coal producer SUEK controls a large part of thermal generation in the Siberian zone.<sup>27</sup> At the same time, both of these companies are the primary fuel supplier to the electricity generation sector. These arrangements could easily result in obstacles in accessing fuel supplies for other generators. This highlights the need for strong and independent regulation in the sector to ensure that fuel is supplied to thermal power generators is on a non-discriminatory basis. In addition, the substantial state holding in Gazprom again calls into question the government's commitment to exit the generation sector.

### *Retail markets*

7. There are currently around 370 retail companies in Russia supplying more than 80 0000 small and medium-sized business and approximately 40 million households. However, despite a large number of market participants, there are currently no clear rules for consumer

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26. Renaissance Capital (2009). The estimates include ownership of nuclear and hydro-electric power plants.

27. As of June 2009, Gazprom group owns 57% of WGC-2, 60% of WGC-6, 46% of TGC-1 and 53% of TGC-3 (Mosenergo).

switching, implying a risk of localised monopoly retail suppliers. In addition, with consumer tariffs regulated until 2014, there is currently limited scope for competition in the sector. This acts as a barrier to entry for independent supply companies and blocks the benefits of reform from flowing through to the end user. Consumer choice is a prerequisite for a competitive retail market and needs to be instigated as soon as is feasible.

8. Cross subsidies in electricity markets also act as a deterrent to market entry and investment. Currently, cross subsidies are estimated to be of the order of RUB 120 billion per year. The government has recognised that these need to be eliminated. Towards the end of 2007, the Ministry of Economic Development entered into an agreement to subsidise electricity directly from the state budget. This practice needs to be extended with all cross-subsidies replaced by direct subsidies from the state budget. In the longer term, subsidies need to be eliminated completely. Transparent price signals that reflect costs create incentives for efficient behaviour and are an essential ingredient for successful market reform.

### **Regulatory arrangements**

9. Good regulation requires good governance. The founding laws on electricity reform provide a good basis for establishing effective governance and regulatory arrangements. However, the specific roles of the various regulatory bodies are not always clear, increasing regulatory uncertainty for private-sector investors. The government must continue improving the regulatory framework to clearly specify the powers of regulators and the sanctions they are able to impose to perform their functions in a predictable and transparent manner consistent with strategic policy objectives.

10. At the same time, the regulatory framework must allow regulators sufficient flexibility to make micro regulatory decisions on technical matters. Where discretion is granted to executive bodies, the legislative framework should clearly prescribe the nature, scope and limits of discretionary powers. Equally important are mechanisms to uphold legal rights and enforce accountability, and procedures for changing the market rules. Moreover, a system of checks and balances needs to be in place to ensure that the decisions of the regulators and market institutions can be appealed.

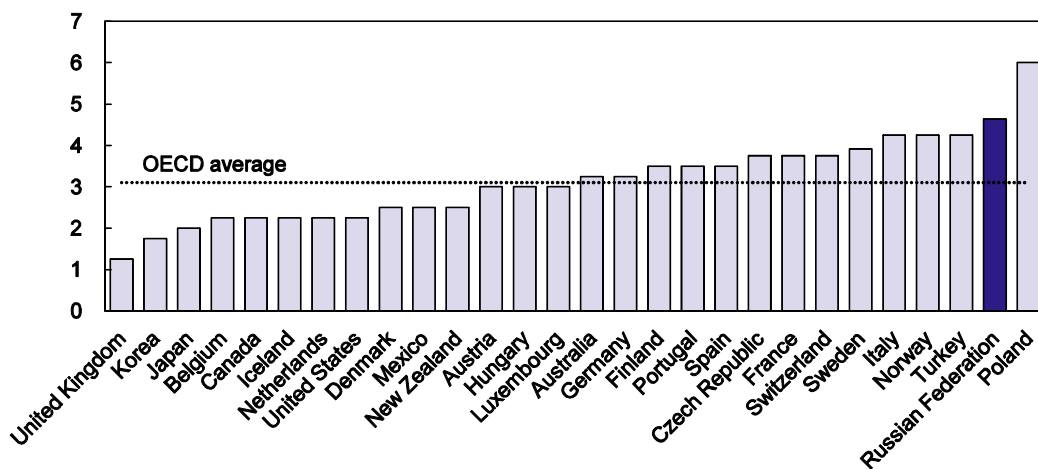
11. A clear separation of regulatory function is also important for ensuring clear rules of the game for market participants. At present, there are several regulators with overlapping powers to regulate different aspects of the electricity market. In particular, the regulatory activities of the Ministry of Energy (MoE) and the Committee of the Market, which is supposed to develop market rules independently from the MoE, need to be coordinated to ensure that complementary regulatory arrangements are established.

12. Given significant market concentration in electricity generation in some regions and the ownership structure in energy markets, effective antimonopoly regulation is likely to be extremely important in the Russian context. Accordingly, the Federal Antimonopoly Service needs to be sufficiently well resourced and have the capacity to effectively monitor the electricity market. The administrative capacities of the other regulatory agencies also need to be enhanced to ensure effectively monitoring and dispute resolution. The Committee of the Market needs to be bolstered so that it can evolve into independent regulatory body for the power sector.

**ANNEX A2. RESULTS OF THE PMR ASSESSMENT OF RUSSIA**

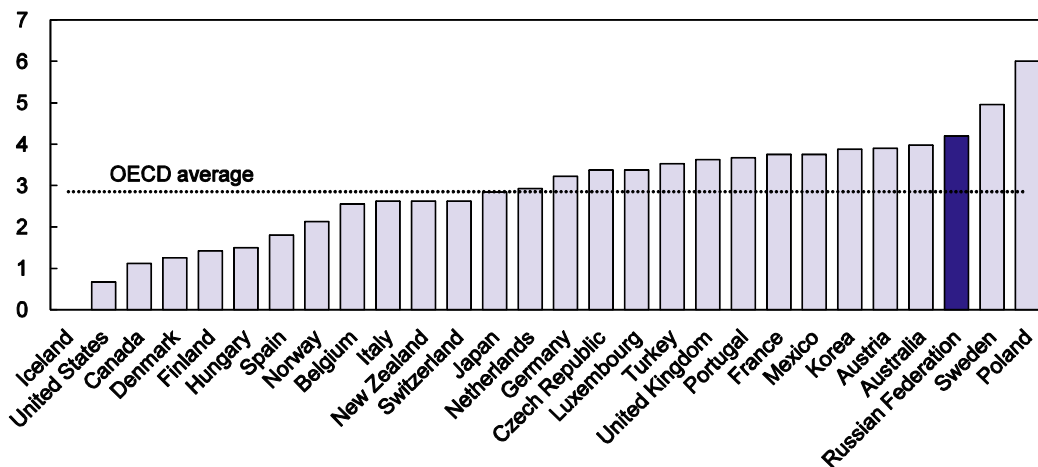
The *scope of the public enterprise sector* indicator measures the pervasiveness of state ownership across business sectors. It reflects the proportion of major sectors in which the state holds an equity stake in at least one firm. With a pervasive state-owned enterprise sector, Russia performs poorly in this area.

**Figure A2.1. Scope of the public enterprise sector**



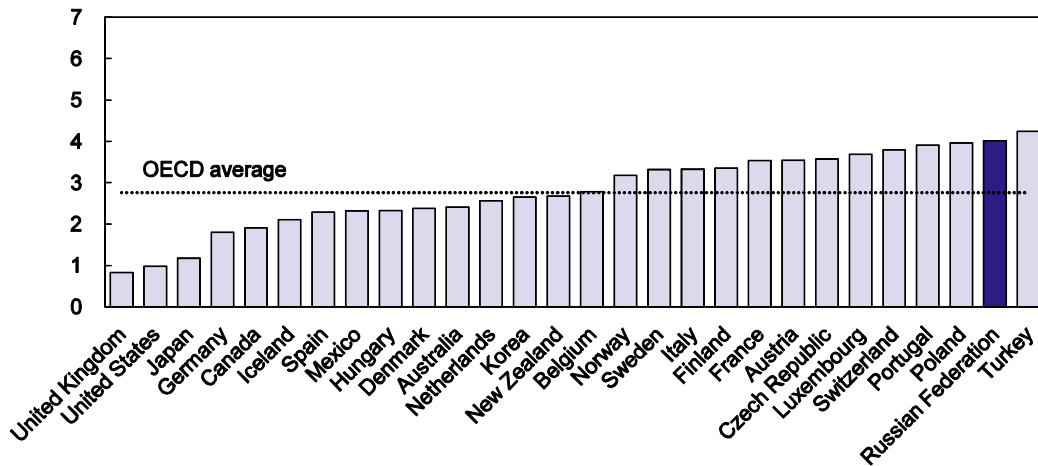
*Direct control over business enterprises* measures across sectors the existence of government special voting rights in privately owned firms, constraints on the sale of state-owned equity stakes, and the extent to which legislative bodies control the strategic choices of public enterprises. Russia performs poorly here reflecting restrictions on share sales for firms in “strategic sectors”, extensive special voting rights, etc.

**Figure A2.2. Direct control over business enterprises**



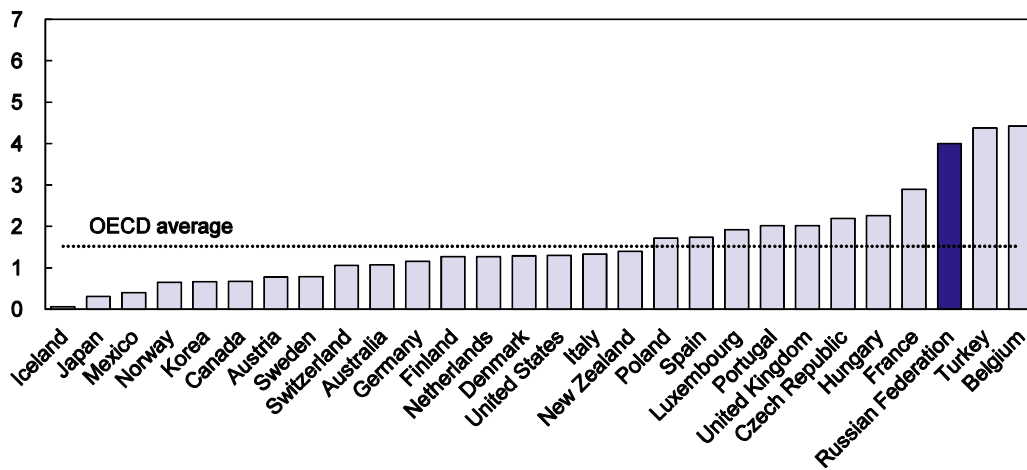
The indicator of *government involvement in network sectors* generally measures the extent of public ownership in the network sectors (gas, electricity, rail, air transport, postal services and telecommunications). Reflecting high levels of government ownership, even in the reformed electricity sector, Russia does not score well here.

**Figure A2.3. Government involvement in network sectors**



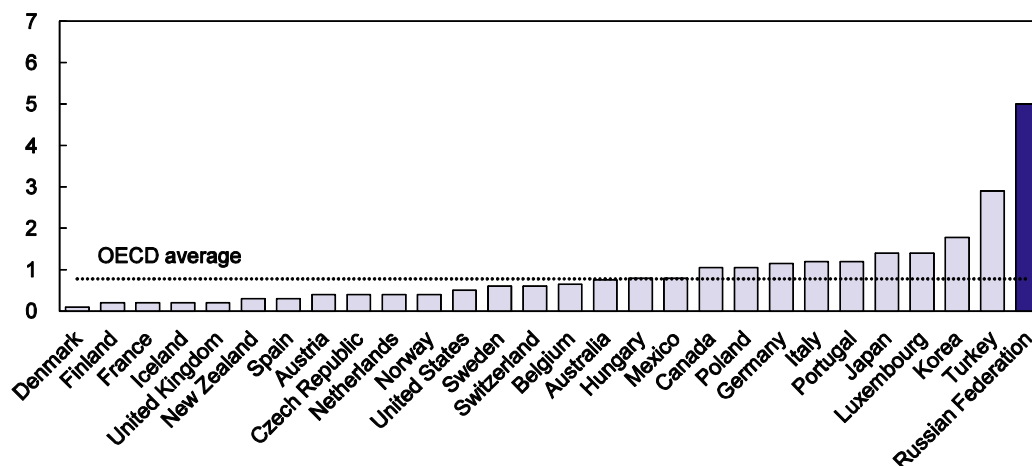
The use of *command and control regulation* indicator measures the extent to which the authorities use coercive (as opposed to incentive-based) regulation, both in general and in specific service sectors.

**Figure A2.4. The use of command and control regulation**



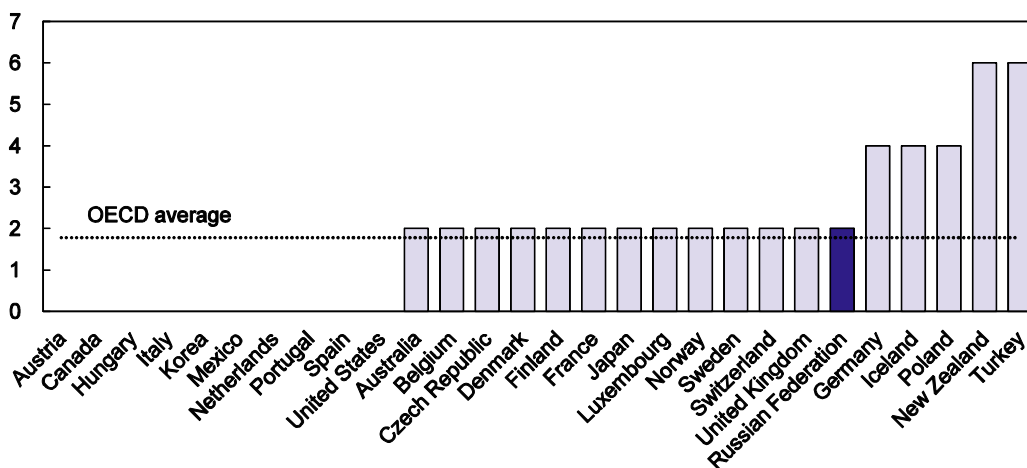
The *price controls* indicator reflects the extent of price controls in specific sectors, such as air travel, pharmaceuticals, alcohol and tobacco and some others. Despite improvements in this area, the Russian government still imposes price controls in several competitive sectors, hence the high indicator value.

Figure A2.5. Price controls



The *licenses and permits* indicator reflects the presence or absence of such devices as “one-stop shops” and “silence is consent” rules for getting information on, and issuing, licenses and permits. Russia does comparatively well here, reflecting the introduction of one-stop shops.

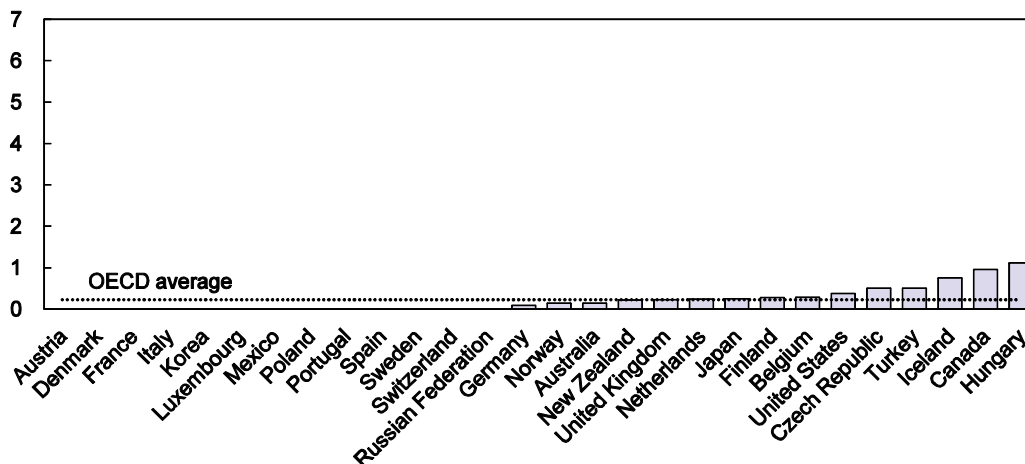
Figure A2.6. The licences and permits system





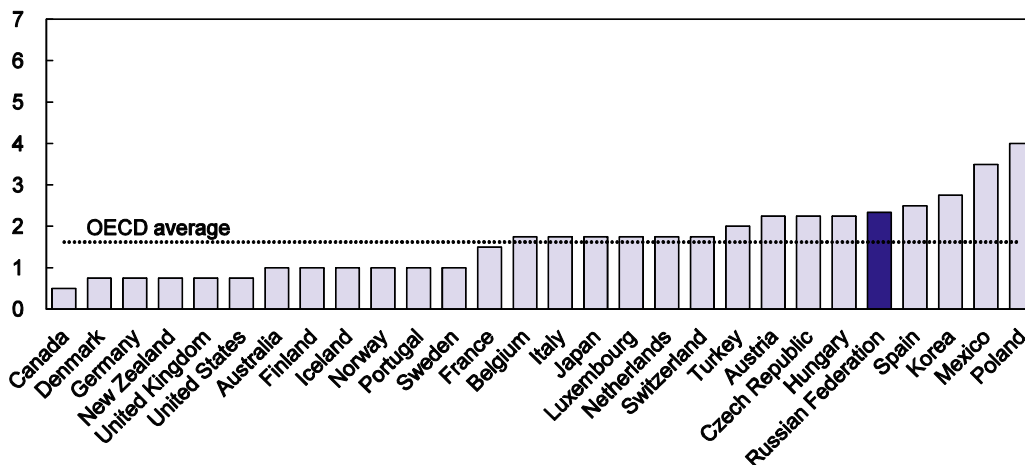
The indicator of *communication and simplification of rules and procedures* refers to aspects of the government’s communication strategy and efforts to reduce/simplify the administrative burden of acting with government. Russia performs well in this regard reflecting the introduction of plain language drafting and systematic procedures for publicising new regulations.

**Figure A2.7. Communication and simplification of rules and procedures**



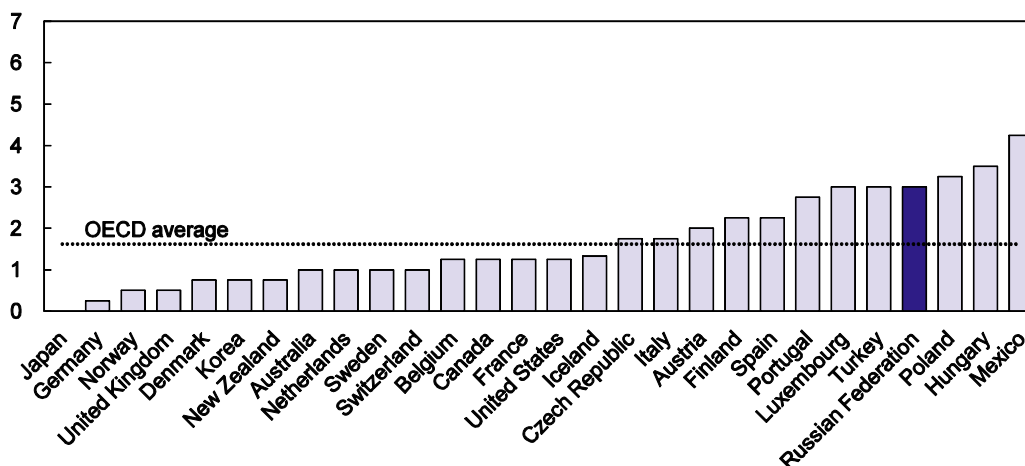
The *administrative burdens for corporations* indicator reflects the number of mandatory procedures involved in the creation of new companies, as well as the number of agencies involved and the total cost of start-up procedures in both time and money. Costs have been converted at PPP exchange rates.

**Figure A2.8. Administrative burdens for corporations**



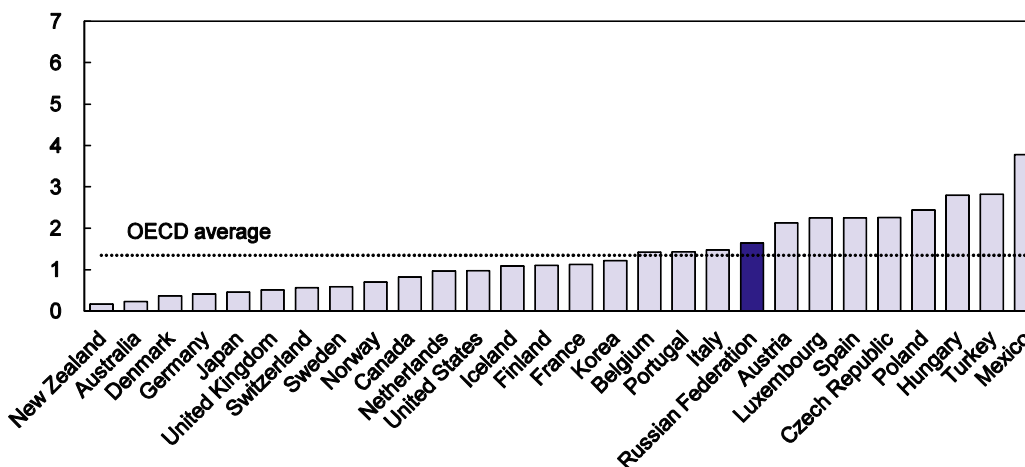
The *administrative burdens for sole proprietors* indicator is constructed in a more or less identical fashion to the indicator for new companies but is concerned with unincorporated small businesses. Again, costs have been converted at PPP exchange rates.

**Figure A2.9. Administrative burdens for sole proprietor firms**



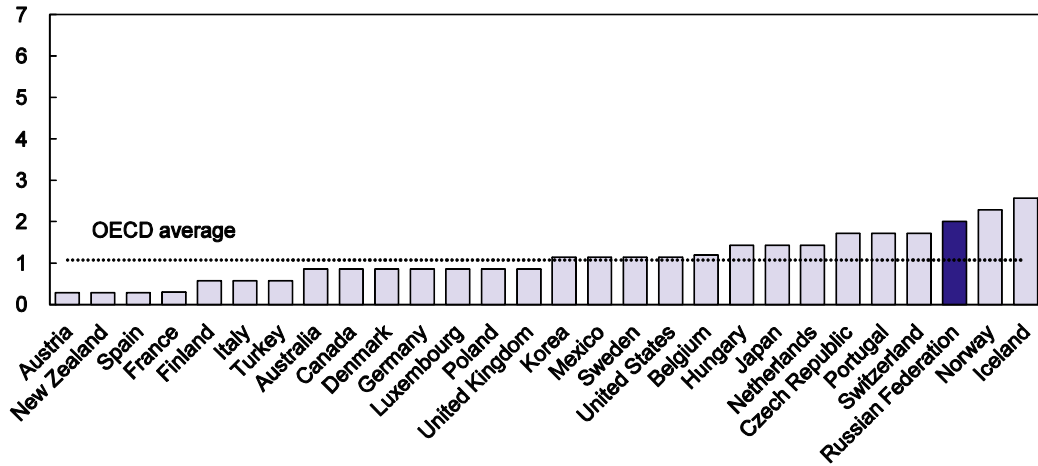
The *sector-specific administrative burdens* indicator reflects administrative burdens in the road transport and retail distribution sectors. For Russia, no information was available about regulation in road freight transport, so that the low-level indicator of the integrated PMR indicator reflects only the retail sector.

**Figure A2.10. Sector specific administrative burdens**



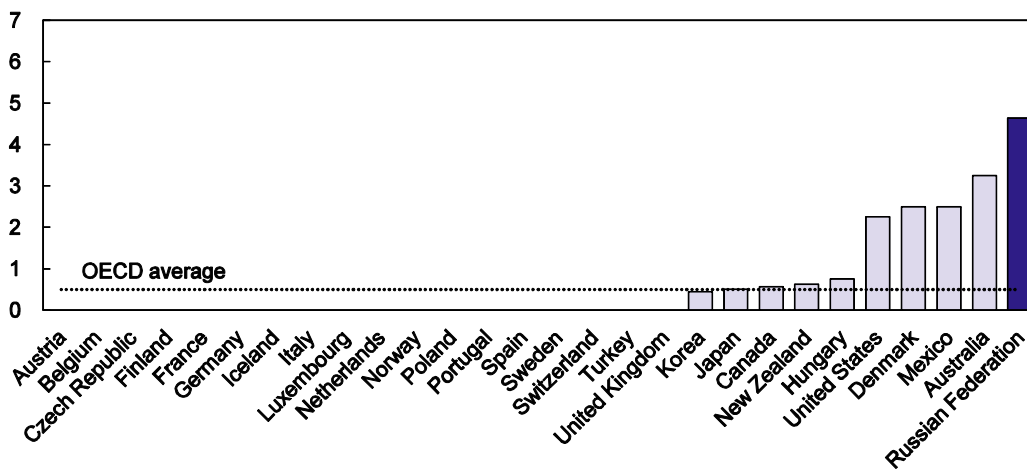
The *legal barriers* indicator refers specifically to the scope of explicit legal limitations on the number of competitors allowed in a wide range of business sectors or subsectors.

**Figure A2.11. Legal barriers**



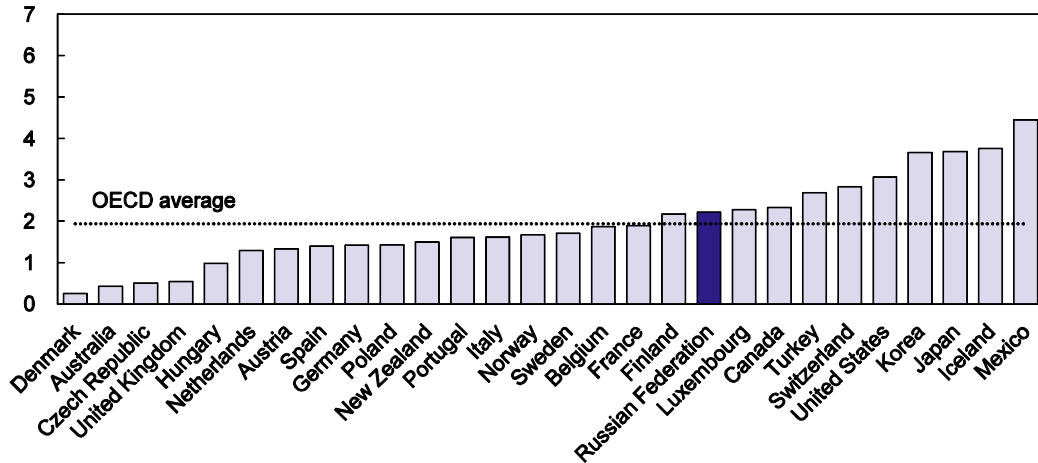
The indicator for *antitrust exemptions* measures the scope of exemptions to competition law that are either extended to public enterprises or authorised by other government and regulatory authorities.

**Figure A2.12. Antitrust exemptions**



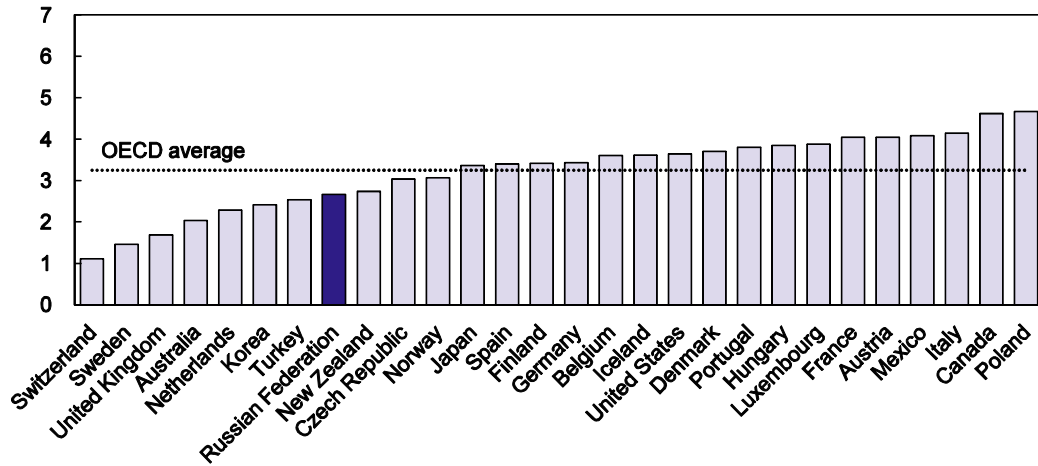
The indicator of *barriers in network sectors* reflects a range of regulations that govern the entry of private-sector firms and vertical integration in the network sectors (gas, electricity, rail, air transport, postal services and telecommunications). Russia performs comparatively well here reflecting recent reforms in the electricity sector.

Figure A2.13. Barrier in network sectors



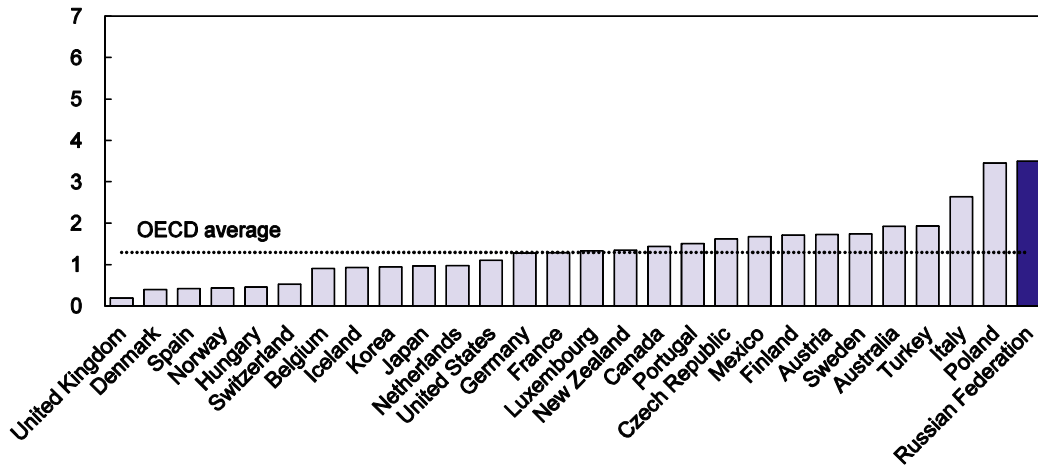
*Barriers to entry in services* covers regulations governing the entry of private-sector firms in the professional services and retail trade. For Russia, no information was available about regulation in professional services, so that the low-level indicator of the integrated PMR indicator reflects only retail trade.

Figure A2.14. Barriers to entry in services



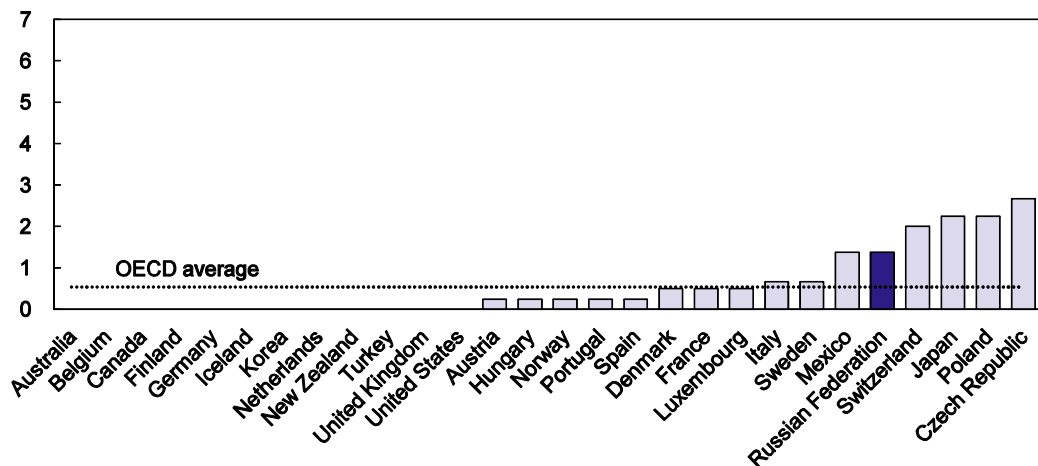
The indicator for *barriers to foreign direct investment* measures the extent to which legal restrictions apply on foreign acquisition of equity in public and private firms in general, and in the telecommunications and airlines sectors in particular.

Figure A2.15. Barriers to FDI (foreign ownership)



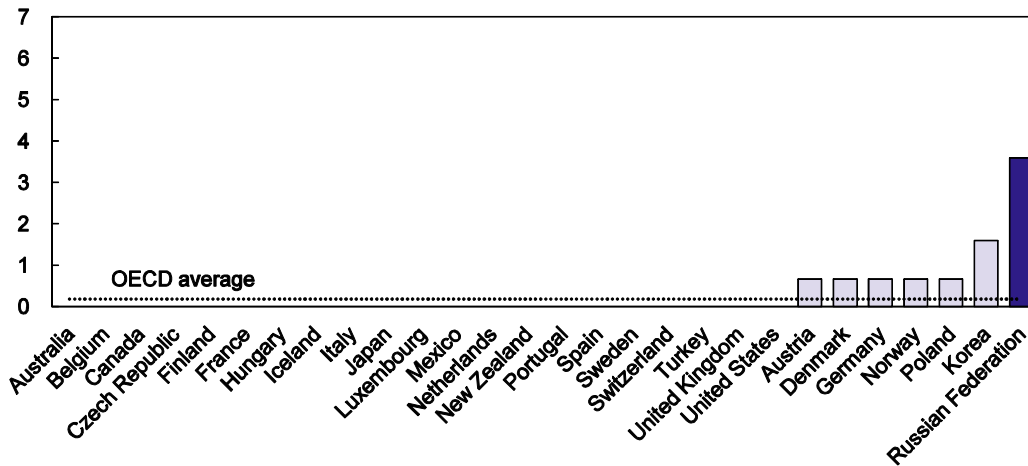
The *discriminatory procedures* indicator reflects the extent of discrimination against foreign firms at the procedural level. It does *not* cover restrictions on foreign ownership, which are captured by *barriers to foreign ownership*.

Figure A2.16. Discriminatory procedures



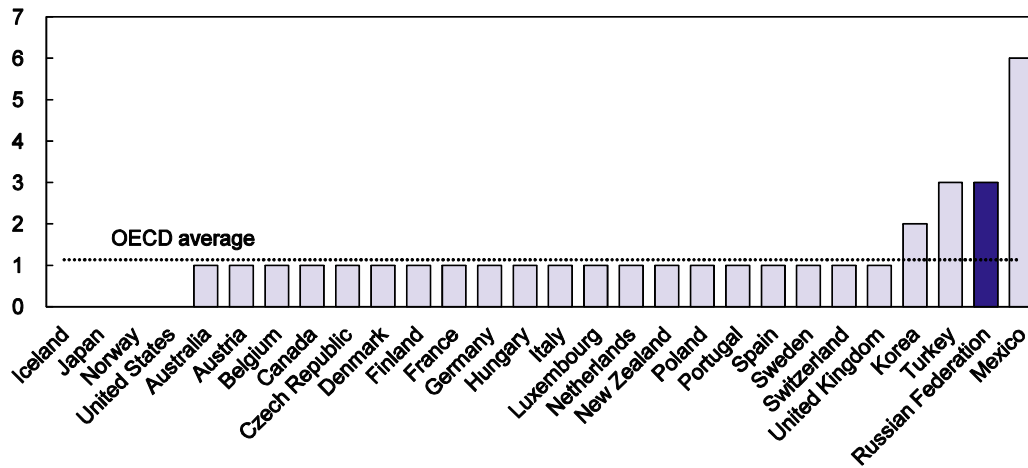
The indicator for *regulatory barriers* reflects other barriers to international trade, such as international harmonisation of standards and regulatory norms or mutual recognition agreements. Russia performs poorly here reflecting a lack of provisions requiring regulators to recognise the equivalence of regulatory measures in other countries, use internationally harmonised standards and certification procedures or avoid unnecessary trade restrictiveness.

Figure A2.17. Regulatory barriers



*Tariffs* reflect the weighted average of a country’s most-favoured-nation tariffs, computed from tariff data of the 6-digit level of the Harmonised System product classification using standard estimation and aggregation techniques.

Figure A2.18. Tariffs



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